OJSC “Central Telegraph”

Consolidated Financial Statements

For the year ended December 31, 2005
with Independent Auditor’s Report

OJSC “Central Telegraph”

Consolidated Financial Statements

For the year ended December 31, 2005

Contents

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Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC "Central Telegraph"

1. We have audited the accompanying consolidated balance sheet of OJSC "Central Telegraph" (hereinafter – "the Company"), as of December 31, 2005, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Except as discussed in paragraphs 3 and 4, we conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. As described in Note 7, there is uncertainty as to the outcome of the litigation in relation to the Company and CJSC "Telegraph". We were not able to satisfy ourselves as to the carrying amount of the long-term financial investments in the accompanying balance sheet. This matter caused us to qualify our audit opinion on the financial statements for the year ended December 31, 2004.

4. As described in Note 5, the Company capitalised employee benefits incurred by its significant subsidiary CJSC "Centel" as part of the carrying value of property, plant and equipment. We were not able to obtain evidence that these expenses were incurred directly in connection with the construction or acquisition of such property, plant and equipment. Accordingly we are not able to satisfy ourselves as to the carrying values of property, plant and equipment.

5. In our opinion, except for the effects on the financial statements of such adjustments, if any, which might have been determined to be necessary had we been able to satisfy ourselves with respect to the matters described in paragraphs 3 and 4, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC "Central Telegraph" as of December 31, 2005, and the consolidated results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

Ernst & Young LLC

31 May 2006

OJSC "Central Telegraph"

Consolidated Balance Sheet

As of December 31, 2005

(in thousands roubles)

	Notes	2005	2004
ASSETS			
Non-current assets			
Property, plant and equipment, net	5	2,725,389	2,309,446
Intangible assets and goodwill, net	6	550,452	420,659
Available for sale investments	7	233,573	231,284
Long-term advances given, long-term accounts receivable and other financial assets	8	84,632	157,617
Total non-current assets		3,594,046	3,119,006
Current assets			
Inventories, net	9	50,272	19,127
Accounts receivable, net	10	254,032	219,911
Current income tax asset		44,474	20,056
Short-term loans	7	1,200	1,029
Other current assets	11	210,373	212,691
Cash and cash equivalents	12	52,607	222,927
Total current assets		612,958	695,741
TOTAL ASSETS		4,207,004	3,814,747
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	13	221,556	221,556
Retained earnings		1,307,450	1,141,361
Total equity attributable to equity holders of the parent		1,529,006	1,362,917
Minority interest	14	-	-
Total equity		1,529,006	1,362,917
Non-current liabilities			
Long-term loans and borrowings	15	796,314	973,251
Long-term finance lease obligations	16	64	63,264
Pension liabilities	20	88,282	61,433
Deferred income from equipment contributions		-	1,974
Deferred income tax liability	25	330,843	271,508
Deferred revenue, non-current portion	18	133,245	227,416
Total non-current liabilities		1,348,748	1,598,846
Current liabilities			
Accounts payable and accrued liabilities	17	386,693	386,336
Payables to Rostelecom	30	8,350	51,030
Taxes and social security withholdings payable	19	75,833	46,569
Dividends payable		1,871	-
Short-term loans and borrowings	15	164,647	165,562
Current portion of long-term loans and borrowings	15	567,037	21,532
Current portion of long-term finance lease obligations	16	581	31,969
Deferred revenue, current portion	18	124,238	149,986
Total current liabilities		1,329,250	852,984
Total liabilities		2,677,998	2,451,830
TOTAL EQUITY AND LIABILITIES		4,207,004	3,814 747

V.A.Martirisyan
General Director

V.E.Kozelsky
Deputy General Director
on economics and finance

I.V.Merkulova
Chief accountant

The accompanying notes form an integral part of these consolidated financial statements.

OJSC "Central Telegraph"
Consolidated Statement of Operations
for the year ended December 31, 2005
(in thousands roubles, except per share amounts)

	Notes	2005	2004
Revenues	21	**2,479,514**	2,039,763
Wages, salaries, other benefits and payroll taxes		**(379,387)**	(341,093)
Depreciation and amortization	5,6	**(277,970)**	(232,226)
Materials, repairs and maintenance, utilities		**(132,761)**	(128,546)
Taxes other than income tax		**(38,310)**	(36,120)
Interconnection charges		**(707,195)**	(597,271)
Doubtful debt expense		**(6,876)**	(5,958)
Loss on disposal of property, plant, and equipment		**(16,425)**	(13,021)
Other operating expenses	22	**(451,022)**	(342,010)
Operating profit		**469,568**	343,518
Interest expense, net	23	**(161,196)**	(147,977)
Income from financial investments	24	**655**	5,258
Income from sale of other assets		**-**	29,127
Foreign exchange gain (loss), net		**(4,689)**	7,520
Profit before income tax		**304,338**	237,447
Income tax expense	25	**(105,873)**	(70,736)
Profit for the year		**198,465**	166,710
Attributable to:			
Equity holders of the parent		**198,465**	168,123
Minority interests	14	**-**	(1,413)
Net income		**198,465**	166,710
Earnings per share			
- basic and diluted earnings per share	26	**0.90**	0.76

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on economics and finance

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OJSC "Central Telegraph"

Consolidated Cash Flow Statement

For the year ended December 31,2005

(in thousands roubles)

	Notes	2005	2004
Cash flows from operating activities:			
Profit before income tax		**304,338**	237,447
Adjustments for:			
Depreciation and amortization	5,6	**277,970**	232,226
Loss on disposal of property, plant and equipment		**16,425**	13,021
Doubtful debt expense		**6,876**	5,958
Financial Investments	24	**(655)**	(5,258)
Interest expense, net	23	**161,196**	147,978
Foreign exchange gain (loss), net		**4,689**	(7,520)
Operating cash flows before working capital changes		**770,839**	623,852
Increase in accounts receivable		**(40,996)**	(63,699)
Decrease in other current assets		**2,317**	60,774
Decrease (increase) in inventories		**(31,145)**	33,403
Increase (decrease) in pension obligations		**26,849**	(10,283)
Increase (decrease) in accounts payable and accrued expenses		**(162,243)**	66,226
Increase in taxes payable other than income tax		**29,264**	1,916
Cash flows generated from operations		**594,885**	712,189
Interest paid		**(140,583)**	(132,619)
Income tax paid		**(70,957)**	(46,250)
Net cash flows from operating activities		**383,345**	533,320
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(537,192)**	(561,706)
Purchase of intangible assets		**(204,364)**	(88,523)
Sale (purchase) of investments and other financial assets		**(2,049)**	23,932
Proceeds from disposal of property, plant and equipment		-	29,127
Interest received		**6,608**	6,899
Dividends received		**182**	285
Net cash flows used in investing activities		**(736,815)**	(589,986)
Cash flows from financing activities:			
Proceeds from borrowings		**1,197,534**	279,257
Repayment of borrowings		**(889,292)**	(178,209)
Proceeds from bond issue		-	197,000
Repayment of finance lease obligations		**(94,588)**	(32,200)
Repayment of vendor financing obligations		-	(60,597)
Dividends paid to equity holders of the parent		**(30,505)**	(22,663)
Dividends paid to minority interests		-	(76)
Net cash flows from financing activities		**183,149**	182,512
Effect of exchange rate changes on cash and cash equivalents		-	(1,324)
Net (decrease) increase in cash and cash equivalents		**(170,320)**	124,519
Cash and cash equivalents at the beginning of the year		**222,927**	98,408
Cash and cash equivalents at the end of the year		**52,607**	222,927
Non-monetary transactions:			
Numbering capacity obtained from OJSC MGTS as a result of mutual settlements		-	157,383
Cross-cancelled debts		**137,096**	51,932
Property, plant and equipment received under lease contracts			1,922

V.A.Martirisyan
General Director

V.E.Kozelsky
Deputy General Director
on economics and finance

I.V.Merkulova
Chief accountant

The accompanying notes form an integral part of these consolidated financial statements.

OJSC "Central Telegraph"

Consolidated Statement of Changes in Equity

For the year ended December 31,2005

(in thousands roubles)

	Attributable to equity holders of the parent						
	Share capital		Retained earnings (as previously reported)	Adjustment (Note 2)	Retained Earnings (as adjusted)	Minority interests	Total equity
	Preference shares	Ordinary shares					
Balance at December 31, 2003	55,389	166,167	1,062,994	(67,232)	995,762	997	1,218,315
Profit for the year	-	-	191,552	(23,429)	168,123	(1,413)	166,710
Decrease in minority interests due to disposal of subsidiaries	-	-	-	-	-	492	492
Dividends			(22,524)		(22,524)	(76)	(22,600)
Balance at December 31, 2004	55,389	166,167	1,232,022	(90,661)	1,141,361	-	1,362,917
Profit for the year	-	-	198,465	-	198,465	-	198,465
Dividends	-	-	(32,376)	-	(32,376)	-	(32,376)
Balance at December 31, 2005	**55,389**	**166,167**	**1,398,111**	**(90,661)**	**1,307,450**	**-**	**1,529,006**

V.A.Martirisyan
General Director

V.E.Kozelsky
Deputy General Director
on economics and finance

I.V.Merkulova
Chief accountant

The accompanying notes form an integral part of these consolidated financial statements

OJSC “Central Telegraph”

Notes to Consolidated Financial Statements

For the year ended December 31, 2005

(in thousands roubles)

1. General Information

Authorization of Accounts

The consolidated financial statements of Open Joint Stock Company Central Telegraph and its subsidiaries – (hereinafter “the Company”) for the year ended December 31,2005 were authorized for issue by the General Director and the Chief Accountant of the Company on May 25, 2006.

The Company

OJSC Central Telegraph is an open joint stock company incorporated in accordance with the laws of the Russian Federation on June 6, 1995. It was formed as a result of the privatization of state-owned company Central Telegraph. The Company’s legal address is 7, Tverskaya St., 125375, Moscow, Russian Federation.

OJSC Svyazinvest, a state-controlled holding company, owned 51% of the Company’s voting shares as of December 31, 2005.

The average number of the Company’s employees as of 31 December 2005 and 2004 was 806 and 824 respectively.

The accompanying consolidated financial statements represent assets, liabilities and operating results of OJSC Central Telegraph and its subsidiaries as listed below:

	31.12.2005		31.12.2004	
Investee	**Accounting method**	**Voting interest**	**Accounting method**	**Voting interest**
CJSC Centel	Consolidation	50.1%	Consolidation	50.1%
CJSC Open Communications	Consolidation	100.0%	Consolidation	100.0%

All of the companies listed above are Russian legal entities incorporated under Russian Federation law.

CJSC Open Communications

CJSC Open Communications, a closed joint stock company, was registered on August 7, 2000. Its legal address is 7, Tverskaya St., 103375, Moscow, Russian Federation.

The average number of CJSC Open Communications employees in 2005 and 2004 was 43 and 40 respectively.

The principal business of the company includes:

- Electric communication services related to transmission and retrieval of newspaper master print to regional clients across the Russian Federation;
- Information services – design and support of Internet solutions, provision of access to Internet, website design and maintenance;
- Wholesale trade in technical photofilm.

1. General Information (continued)

CJSC Centel

CJSC Centel, a closed joint stock company, was registered in Russia on March 31, 1998, combining the interests of OJSC Central Telegraph (74%) and OJSC Corporatsia Intersviaz (26%).

On April 28, 2004 OJSC Central Telegraph sold 23.88% shares in CJSC Centel to LLC DomCom, thus reducing its equity participation to 50.12%.

CJSC Centel's legal address is 7, Tverskaya St., 125375, Moscow, Russian Federation.

The average number of employees on CJSC Centel payroll in 2005 and 2004 was 240 and 105, respectively.

The principal business of the company includes:

- Design and construction of fiber-optic communication lines (FOCL);
- Communication channel rent;
- Operation and maintenance of FOCL and optic distributing frames;
- Allocated Internet services.

Presentation of Financial Statements

Consolidated financial statements of OJSC "Central Telegraph" are prepared on the basis of standalone financial statements of the parent and its subsidiaries prepared under unified accounting policy.

The measurement and presentation currency of the Company is the Russian Rouble, which is the national currency of the Russian Federation.

Consolidated financial statements of the Company are presented in thousands of Russian Roubles.

Liquidity and Financial Resources

To date, the Company has significantly relied upon short-term and long-term financing to fund the improvement of its telecommunication network. This financing has historically been provided through bank loans, bonds and finance leases.

If needed, management believes that certain projects may be deferred or curtailed in order to fund the Company's current operating needs.

Through 2006, the Company anticipates funding from a) cash generated from operations; b) bonds placement in the domestic market; c) financing from domestic and international lending institutions. Management expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

As of December 31, 2005, the Company's current liabilities exceeded its current assets by 716,293 (December, 31 2004 – 157, 243). However in 2005 the Company realized profit from operating activities in the amount of 469,568 (2004 – 343,518), and cash flows from operating activities amounted 594,885 (2004 – 712,189).

2. Basis of Presentation of the Financial Statements

Basis of Preparation

These financial statements have been prepared and presented in accordance with International Financial Reporting Standards ("IFRS").

These financial statements are prepared based on the statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation, with adjustments and reclassifications recorded for the purpose of fair presentation of ending balances, results of operations and cash flows in accordance with IFRS.

These financial statements have been presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or any other adjustments that might result if the Company either be unable to continue as a going concern or if the Company was to dispose of assets outside the normal course of its operating plan.

The Russian economy was considered hyperinflationary until prior to January 1, 2003. As such, the Company applied IAS 29 "Financial Reporting in Hyperinflationary Economies". The effect of applying IAS 29 is that non-monetary items, including components of equity (excluding property, plant and equipment fair value of which at January 1, 2003 was used as historical cost), were restated to the measuring units current at January 1, 2003 by applying the relevant inflation indices to the historical cost, and that these restated values were used as a basis for accounting in subsequent periods.

The changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2005.

The changes in accounting policies result from adoption of the following new or revised standards:

- IFRS 2 "Share-Based Payment";
- IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations";
- IAS 1 (revised) "Presentation of Financial Statements";
- IAS 2 (revised) "Inventories";
- IAS 8 (revised) "Accounting Policies, Changes in Accounting Estimates and Errors";
- IAS 10 (revised) "Events after the Balance Sheet Date";
- IAS 16 (revised) "Property, Plant and Equipment";
- IAS 17 (revised) "Leases";
- IAS 24 (revised) "Related Party Disclosures";
- IAS 27 (revised) "Consolidated and Separate Financial Statements";
- IAS 28 (revised) "Investments in Associates";
- IAS 31 (revised) "Interests in Joint Ventures";

2. Basis of Presentation of the Financial Statements

The changes in accounting policies (continued)

- IAS 32 (revised) "Financial Instruments: Presentation and Disclosure";
- IAS 33 (revised) "Earnings per Share";
- IAS 39 (revised) "Financial Instruments: Recognition and Measurement".

The principal effects of these changes in policies are discussed below.

IAS 1 (revised) "Presentation of Financial Statements" and IAS 27 "Consolidated and Separate Financial Statements"

Minority interests in net assets of the Company's subsidiaries are presented within equity, separately from parent shareholders' equity. Previously, minority interests were presented separately from liabilities and equity in the Company's consolidated balance sheet.

IAS 39 "Financial Instruments: Recognition and Measurement" (amended 2004)

The gains and losses on re-measurement of financial assets available-for-sale to fair value are recognized as a separate component of equity. A gain or loss on an available-for-sale financial asset is recognized directly in equity (including reversal of impairment losses for equity instruments), through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company's right to receive payment is established.

IFRSs and IFRIC Interpretations not yet effective

The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IAS 19 (amended 2004) "Employee Benefits";
- IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement";
- IFRS 6 "Exploration for and Evaluation of Mineral Resources";
- IFRS 7 "Financial Instruments: Disclosures";
- IFRIC 4 "Determining whether an Arrangement contains a Lease";
- IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds".

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company's financial statements in the period of initial application.

Management Estimates

The preparation of financial statements requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates with regard to those financial statements relate to the valuation and useful lives of property, plant and equipment, intangible assets, provision for inventory obsolescence, deferred taxation, provision for bad debt reserve pension liabilities and as discussed in Notes 5, 6, 9, 25, 10 and 20.

(in thousands roubles)

2. Basis of Presentation of the Financial Statements (continued)

Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year relate to the outcome of legal proceedings relating to CJSC "Telegraph", as described in Note 7.

Reclassifications and adjustments to corresponding figures

In 2005 the Company determined and presented its obligations existing under defined benefit plans in accordance with IAS 19, "Employee Benefits". The Company engaged an actuary to perform a valuation of the pension obligations and recorded the defined benefit obligation as of December 31, 2005 and made adjustments to the corresponding figures as of December 31, 2003 and 2004.

The following reclassifications to the 2004 financial statements were introduced in order to conform to the 2005 presentation:

Consolidated balance sheet as at December 31, 2004	As previously reported	Effect of reclassifications and adjustments	As restated	Description of reclassifications and adjustments
Pension Liabilities	-	61,433	61,433	Adjustment for pension liabilities as of December, 31 2004
Long-term loans and borrowings	981,074	(7,823)	973,251	Adjustment to cost of Bond issue series 01 and 02
Property, Plant and Equipment (PP&E)	-	(7,073)	-	Reversal of wages paid to administrative and managing personnel of CJSC "Centel" in 2004 from capitalized expenses to operating expenses
	-	(2,111)	-	Additional depreciation charge for PP&E
	-	(939)	-	Effect of reversal of interest expenses overcapitalized in 2004
	-	44,678	-	Reclassification of Inventory used in construction to PPE
	2,274,891	34,555	2,309,446	
Inventory	63,805	(44,678)	19,127	Reclassification of Inventory used in construction to PP&E
Accounts Payable and accrued liabilities	360,372	25,964	386,336	Accrual of liabilities to Pension fund in accordance with final settlement on pension plan to current pensioners
Short-term loans and borrowings	163,564	1,998	165,562	Adjustment to cost of Bond issue series 01 and 02
Deferred income tax liability	272,540	(1,032)	271,508	Total effect of all adjustments on deferred tax
Retained earnings as of December 31, 2004	1,232,022	(90,661)	1,141,361	Total effect of all adjustments on Retained earnings

(in thousands roubles)

2. Basis of Presentation of the Financial Statements

Reclassifications and adjustments to corresponding figures (continued)

Consolidated Income statement for 2004				
Wages, salaries, other benefits and payroll taxes	-	(15,679)	-	Accrual of defined benefit pension plan expenses for 2004
	-	(7,073)	-	Reversal of wages paid to administrative and managing personnel of CJSC "Centel" in 2004 from capitalized expenses to operating expenses
	(318,341)	(22,752)	(341,093)	
Depreciation and amortization	(230,115)	(2,111)	(232,226)	Additional depreciation charge for PP&E
Other operating expenses, net	(345,010)	3,000	(342,010)	Adjustment to cost of Bond issue series 01 and 02 for issue costs
Interest expenses, net	-	(1,658)	-	Adjustment to cost of Bond issue series 01 and 02 for issue costs
	-	(939)	-	Effect of reversal of interest expenses overcapitalized in 2004
	(145,380)	(2,597)	(147,977)	

Consolidated balance sheet as at December 31, 2004	**As previously reported**	**Effect of reclassifications and adjustments**	**As restated**	**Description of reclassifications and adjustments**
Net profit	191,552	(23,429)	168,123	Total effect of adjustments
Dividends	(22,524)	-	(22,524)	
Retained earnings as at December 31, 2004	1,232,022	(90,662)	1,141,360	Total effect of adjustments
Basic and diluted Earnings per share	0.86	(0.1)	0.76	Total effect of adjustments

Because of the changes in presentation format of the financial statements for 2005, the Company made reclassifications of certain items in the financial statements for 2004. The Company has changed presentation of the following figures in the 2004 financial statements:

Consolidated balance sheet as at December 31, 2004	**As previously reported**	**Effect of reclassifications and adjustments**	**As restated**	**Description of reclassifications and adjustments**
Current income tax asset	-	20,056	20,056	Current income tax asset are presented separately from Other current assets
Other current assets	-	(20,056)	-	Current income tax asset is presented separately into Current income tax asset
	-	(8,001)	-	Netting of other taxes prepaid with respective liabilities
	240,748	(28,057)	212,691	
Short-term Other taxes payable	54,570	(8,001)	46,569	Netting of other taxes prepaid with respective liabilities

2. Basis of Presentation of the Financial Statements

Reclassifications and adjustments to corresponding figures (continued)

Consolidated cash flow statement for 2005	As previously reported	Effect of reclassifications and adjustments	As restated	Description of reclassifications and adjustments
Income tax paid	27,914	18,336	46,250	Increase of Current income tax asset and corresponding increase in Income tax paid

3. Summary of significant Accounting policies

3.1 Principles of Consolidation

The consolidated financial statements of the Company represent the financial statements of the Group of companies, i.e. the parent and its subsidiaries, presented as if the Company operated as a single economic entity.

Subsidiaries

Subsidiaries, which are those entities in which the Company has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. The Control is a power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealized gains on transactions between parent and/or subsidiary companies are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In case of necessity, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Company.

3.2 Investments

The Company's investments are classified as either loans and receivables or available-for-sale investments, as appropriate. When investments are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its investments upon initial recognition. All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Company.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. During the period the Company did not hold any investments in this category.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity upon initial recognition designates as available for sale; or

(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other categories. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the statement of operations. Reversals of impairment losses in respect of equity instruments are not recognised in the statement of operations. Impairment losses in respect of debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the statement of operations.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis.

3.3 Accounting Policies, Changes in Accounting Estimates and Errors

Change in accounting policies

The Company changes an accounting policy only if the change is required by a Standard or an Interpretation of IFRS or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the Company's financial position, financial performance or cash flows.

The Company accounts for a change in accounting policy resulting from the initial application of a Standard or an Interpretation in accordance with the specific transitional provisions, if any, in that Standard or Interpretation.

(in thousands roubles)

3.3 Accounting Policies, Changes in Accounting Estimates and Errors (continued)

Changes in accounting estimates

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate. The effect of a change in an accounting estimate is recognized prospectively by including it in profit or loss in the period of the change, if the change affects that period only or the period of the change and future periods, if the change affects both.

Prior Period Errors

An Company corrects material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by restating the comparative amounts for the prior period presented in which the error occurred or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Prior period error is corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

3.4 Foreign Currency Transactions

The measurement and presentation currency of the Company is the Russian Rouble, which is the national currency of the Russian Federation. Transactions in foreign currencies are initially recorded in the measurement currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the measurement currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations as foreign exchange gains (losses). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

Assets and liabilities settled in Roubles but denominated in foreign currencies are recorded in the Company's consolidated financial statements using the same principles as for assets and liabilities denominated in foreign currencies.

The exchange rates as of December 31, 2005 and 2004 were as follows:

Rate as of 31 December	2005	2004
Russian Roubles for 1 US dollar	**28.78**	27.75
Russian Roubles for 1 Euro	**34.19**	37.81

3.5. Property, Plant and Equipment

3.5.1 Property, Plant and Equipment

Property, plant and equipment are recorded at purchase or construction cost less accumulated depreciation and any impairment in value. The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. Impairment losses are recognized in the statement of operations.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalized, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Expenses for repair and maintenance of Property, Plant and Equipment objects are recognized in the Statement of operations when they occur.

Social assets are not recognised in the financial statements as it is not expected that they bring any future economic benefits to the Company. Expenses incurred in connection to acquisition, reconstruction and upgrade of tangible social assets are charged to the income statement as incurred.

3.5.2 Construction in Progress

Construction in progress is recorded as the total of actual expenditures incurred by the Company from the beginning of construction to the reporting date less any impairment in value.

3.5.3 Depreciation and Useful Life

Depreciation is calculated on property, plant and equipment on a straight-line basis from the time the assets are available for use, over their estimated useful lives as follows:

Buildings and Constructions	25 years
Switching equipment	15 years
Other telecommunication equipment	10 years
Transportation equipment, computers, office and other equipment	5 years

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised.

The depreciation charge for a period is usually recognized in the income statement. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of such other assets and is included in their carrying amount.

3.5.3 Depreciation and Useful Life (continued)

The period of validity of the Company’s operating licenses is significantly shorter than the useful lives used for depreciation of the cost of property, plant and equipment. Based on the Russian licensing legislation and prior experience, management believes that the operating licenses will be renewed without significant cost, which would allow the Company to realize the cost of its property, plant and equipment through normal operations.

3.5.4 Assets received free of charge

Equipment transferred to the Company free of charge by its customers and other entities outside the privatization process is capitalized at market value at the date of transfer. A corresponding income is fully recognized in the statement of operations. In cases transfers of equipment relate to the rendering future services to the transferee the equipment is considered as a deferred revenue and is recognised as income on the same basis that the equipment is depreciated.

Equipment contributions that do not generate any future income for the Company are not recognized.

3.5.5. Borrowing Costs

The borrowing costs are capitalized by the Company as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs are directly attributable to the acquisition, construction or production of a qualifying asset including construction in progress.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset is determined as the actual borrowing costs incurred on that borrowing during the period.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

3.6. Leases

Leases where all the risks and rewards of ownership of the asset are transferred from lessor to leasee are classified as finance leases.

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases.

3.6.1 Finance Leases

At the commencement of the lease term, or the date from which the lessee is entitled to exercise its right to use the leased asset, the Company recognizes finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. At the commencement of the lease term, the asset and the liability for the future lease payments are recognized in the balance sheet at the same amounts except for any initial direct costs of the lessee that are added to the amount recognized as an asset.

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned, and the depreciation recognized is calculated in accordance with accounting policy of the Company applicable for depreciable and amortized assets. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term and its useful life.

3.6.2 Operating Leases

Operating lease payments are recognised as an expense in the statement of operations on a straight-line basis over the lease term.

3.7 Intangible Assets

3.7.1 Licenses

Cost of licenses paid to Government for permission to provide telecommunication services within identifiable period of time is recognized as intangible assets.

3.7.2 Software and Other Intangible Assets

Software and other intangible assets acquired separately are measured on initial recognition at cost. The cost of other intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

3.7.3 Useful Life and Amortization of Intangible Assets

The Company assesses whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset is regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Intangible assets with finite lives are amortized over the useful economic lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

3.7.3 Useful Life and Amortization of Intangible Assets (continued)

Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates.

The cost of licenses and software is depreciated on a straight-line basis over the estimated useful life equal to the term of the licenses or the right to use the software. Useful life of other intangible assets is approximately 10 years.

3.8 Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average basis. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

3.9 Advances Given

Advances given to acquire non-current assets are classified as non-current and considered as non-monetary assets. Long-term advances given in course of operating activities are also classified as non-current assets.

3.10 Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets comprise cash and cash equivalents; an equity instrument of another entity; a contractual right to receive cash or another financial asset from another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the Company; or a contract that will or may be settled in the Company’s own equity instruments and is a non-derivative for which the Company is or may be obliged to receive a variable number of the Company’s own equity instruments, or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company’s own equity instruments. For this purpose the Company’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the Company’s own equity instruments.

Financial liabilities include contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or a contract that will or may be settled in the Company’s own equity instruments and is a non-derivative for which the Company is or may be obliged to deliver a variable number of the Company’s own equity instruments or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company’s own equity instruments. For this purpose the Company’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments.
The Company recognizes a financial asset or a financial liability on its balance sheet when, and only when, the Company becomes a party to the contractual provisions of the instrument.

3.10 Financial Instruments (continued)

When a financial asset or financial liability is recognized initially, the Company measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The Company classifies its financial assets and financial liabilities as current or non-current based on term of its maturity taking into account other factors that limit the Company’s ability to realize assets within 12 months or existence of call options in financial liabilities valid within 12 months after the balance sheet date.
Financial asset is derecognised when the rights to receive cash flows from the asset expired or the Company transferred its rights to receive cash flows from the asset.

Financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

3.11 Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand and in the Company’s bank accounts, as well as cash deposits and short-term investments with original maturities of three months or less.

3.12 Accounts receivable and provision for bad debt

Trade receivables, are recognized at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Company will not be able to collect the debts.

Provision for bad debt is created based on the historical pattern of collections of accounts receivable and specific analysis of recoverability of significant accounts.

Provision for bad debt is also created for other accounts receivable except advances given based on the assessment of the Company’s ability to collect the debts.

Expenses on bad debt provision are recognized in the statement of operations.

The carrying amount of current Accounts receivable is a reasonable approximation of their fair value.

3.13 Troubled debt restructurings

A troubled debt restructuring occurs when the Company grants a concession to the debtor in the forms of modification of the terms of the debt, including the extension of the maturity date, change of payment schedule or reduction of the face amount of the debt, or in the form of transfer of the assets or an equity interest in the debtor in satisfaction of the debt. The Company recognized a loss in the amount of the difference between the fair value of the assets and/or equity interest received and the recorded amount of the receivable. This loss will be recognized in full in the period the restructuring takes place.

3.14 Loans given

Loans given are recognized at the amortized cost, using the effective interest method less provision for impairment or uncollectibility. Loans given are recorded in the non-current assets unless the repayment is not expected within 12 months after the balance sheet date.

3.15 Loans and Borrowings Received

Loans and Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method; any difference between the fair value of the consideration received (net of transaction costs) and the redemption amount is recognised as an adjustment to interest expense over the period of the borrowings.

3.16 Employee benefits

3.16.1 Current employment benefits

Wages and salaries paid to employees are recognized as expense in current period.

3.16.2 Unified social tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Company by the application of a regressive rate (from 26% to 17%) to the annual gross remuneration of each employee. The Company allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund vary from 20% to 14% depending on the annual gross salary of each employee.

The Company's contributions relating to the UST are expensed in the year to which they relate.

3.16.3 Other pension plans and post-employment benefits

Under collective bargaining agreements and internal regulations on additional pension benefits, the Company also provides additional benefits for its active and retired employees by using post-employment defined benefit plans. The majority of the Company's employees are eligible to participate under such post-employment benefit plans based upon a number of factors, including years of service, age, and compensation.

The Company determines the present value of the defined benefit obligation and the fair value of any plan assets on each reporting date separately for each plan. The obligations are valued by professionally qualified independent actuaries hired by the Company using the projected unit credit method. The assets of the defined benefit plans are valued by professionally qualified actuaries or independent appraisers.

Actuarial gains and losses are recognised as income or expense when the net cumulative unrecognised actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plans.

Upon introduction of a new plan or improvement of an existing plan past service cost is recognized on a straight-line basis over the average period until the amended benefits become vested. To the extent that the benefits are already vested immediately, past service costs is immediately expensed.

Gains or losses on the curtailment or settlement of pension benefit obligations are recognized when the curtailment or settlement occurs.

3.17 Income Taxes

Tax expense is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the entity expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Any such previously recognized reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred tax assets and liabilities are not discounted.

3.18 Shareholders’ Equity

3.18.1 Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity.

3.18.2 Dividends

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared at Shareholders’ meeting before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorized for issue.

3.19 Minority Interest

Minority interest is the interest in subsidiaries not held by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair values of identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in net assets since the date of the combination. Minority interest is presented separately from liabilities and shareholders' equity.

3.20 Revenue recognition

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Company and the revenue can be reliably measured.

Revenue is recognized in the amount of cash or cash equivalents received in the form of cash or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an effective interest rate.

3.20.1 Revenue from customers

The Company categorizes the revenue sources in fourteen major categories:

1. Long distance calls - domestic;
2. Long distance calls - international;
3. Local telephone calls;
4. Installation and connecting fees;
5. Documentary services;
6. Data transfer and telematic services;
7. New services;
8. Rent of telephone channels;
9. Services for national operators;
10. Services for international operators;
11. Other telecommunications services;
12. Other revenues.

Long distance calls (domestic and international)

Revenues from long distance services depend on time of call, duration of call, destination of call, type of service used, subscriber category and the applied rate plan. Customers of the Company use the service via installed fixed telephones as well the service could be accessed by means of pay-phones. The Company charges long distance fees on a per-minute basis. The Company recognizes revenues related to the long distance services in the period when the services are rendered.

Local telephone calls

Revenue from the local telephone services depends on the duration of the telephone connections and subscription fee, while time driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only. Customers of the Company use the service via installed fixed telephone, as well the service could be accessed by means of pay-phone. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

3.20.1 Revenue from customers (continued)

Installation and connection fees

Installation and connection fees for indefinite period contracts are paid by a combination of a fixed cash amount and by the contribution of fixed assets consisting of cable and duct, commonly referred to as the "last mile". Revenue received in the form of cash is recognized when the installation and connection are complete. For installation and connection fees paid in the form of fixed assets, revenue is deferred and recognized into income on the same basis that the fixed assets are depreciated.

Documentary services

Revenues from telegraph services comprise fees for telegram transmissions and other wire line data transmission services. The Company recognizes revenues related to telegraph services in the period when the services are rendered.

Data transfer and telematics services

The Company recognizes revenues related to data transfer and telematics services in the period when the services are rendered.

New services

Major revenues from new services include internet services, ISDN, ADSL, IP-telephony, intelligent network services. The Company recognizes revenues related to new services in the period when the services are rendered.

Rent of telephone channels

Major revenues are recognized from the following services: rent of intercity and international, digital, analogue, and telegraph channels. The Company recognizes revenues from the rent of channels in the period when the services are rendered.

Services for national operators

Revenue from national service providers includes two different groups.
The first group of revenues represents services rendered to the Company's partners for termination of long-distance traffic of its operators-partners in the network of the Company.

The second group of revenues from national operators represents services rendered to interconnected telecom operators that transfer local, intercity and international traffic of their customers via network of the Company.

Major revenues are recognized from the services rendered to operators for transit of local, intercity and international traffic. Further, the Company generates revenue from interconnection to the network (one time fees), rent of channels, rent of equipment, data transfer and Internet services.
The Company recognizes revenues from national operators in the period when the services are rendered.

Services for international operators

The revenues represents services rendered to interconnected international telecom operators that transfer international traffic of their customers via network of the Company.

The Company recognizes revenues from national operators in the period when the services are rendered.

3.20. Revenue from customers (continued)

Other telecommunication services

Other telecommunication services primarily consist of revenues received by public switched telephone network (PSTN) stations from the rent of direct lines and local junctions, as well as subscription fees for wired-radio outlets. The Company recognizes revenues related to other services in the period when the services are rendered.

Other revenues

Other revenues primarily consist of revenues received from manufacturing of the telecommunication equipment and its technical support, transportation services, recreation services and sale of products and services provided by auxiliary units.

3.21 Barter Transactions

When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

3.22 Earnings per Share

The Company calculates basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.

The Company’s preference shares are considered participating equity instruments for the purpose of earnings per share calculations (see Note 26).

3.23 Contractual Commitments

Contractual commitments comprise legally binding trading or purchase agreements with stated amount, price and date or dates in the future.

The Company discloses significant contractual commitments in the Notes to the financial statements.

The asset or liability under contractual commitments are not recognized in the financial statement until any of the parties performs in accordance with the contract and until any of the party became legally liable to pay or entitled to receive the payment under the terms of the contract.

3.24 Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a borrowing cost.

3.25 Contingent Assets and Contingent Liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The Company does not recognize a contingent liability. A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. The Company does not recognize a contingent asset. A contingent asset is disclosed where an inflow of economic benefits is probable.

3.26 Non-current Assets Held for Sale and Discontinued Operations

A discontinued operation is a component of the Company that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, is part of a single co-coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

The Company classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

The Company measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) are be measured in accordance with applicable IFRSs.

The Company presents and discloses information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

3.27 Related Party Transactions

The Company defines the following terms to specify the related party: a party is related to the Company if:

1. directly, or indirectly through one or more intermediaries, the party controls, is controlled by, or is under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries), has an interest in the entity that gives it significant influence over the entity or has joint control over the entity;
2. the party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
3. the party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
4. the party is a member of the key management personnel of the entity or its parent;
5. the party is a close member of the family of any individual referred to in (1) or (4);
6. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in 4 or 5; or
7. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Relationships between the parent and its subsidiaries and between subsidiaries themselves are not disclosed by the Company.

3.28 Events after the Balance Sheet Date

The Company adjusts the amounts recognized in its financial statements to reflect adjusting events after the balance sheet date. Events require an entity to adjust the amounts recognized in its financial statements are caused by favorable and unfavorable outcomes of conditions that existed at the balance sheet date and change in management estimates subject to uncertainties which was used for accounting of a number of business activities.

If non-adjusting events after the balance sheet date are material, nondisclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, the Company discloses the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made the following for each material category of non-adjusting event after the balance sheet date.

4. Segment Information

OJSC Central Telegraph operates in one industry, i.e. provision of electric telecommunication services, on the territory of Moscow and Moscow Region. The Company's structure is based on territorial units, which service the corresponding parts of the Company's network. The Company's management considers that the Company operates in one geographical and operating segment, and evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Company as a whole.

(in thousands roubles)

5. Property, Plant and Equipment

	Land, buildings and constructions	Switches and transmission devices	Vehicles and other Fixed assets	Construction in progress and equipment for installation	Total
Cost					
At December 31, 2003	**801,049**	**1,652,853**	**341,776**	**387,887**	**3,183,565**
Additions	-	-	-	481,022	481,022
Disposals	(647)	(8,959)	(9,324)	(13,862)	(32,792)
Transfers	39,335	429,929	85,076	(554,340)	-
At December 31, 2004	**839,737**	**2,073,823**	**417,528**	**300,707**	**3,631,795**
Additions	-	-	-	630,940	630,940
Disposals	(495,124)	(59,376)	(22,862)	(59,413)	(636,775)
Transfers	235,392	84,569	58,272	(378,233)	-
At December 31, 2005	**580,005**	**2,099,016**	**452,938**	**494,001**	**3,625,960**
Impairment reserve					
At December 31, 2003	-	-	-	**(59,413)**	**(59,413)**
At December 31, 2004	-	-	-	**(59,413)**	**(59,413)**
Reserve recovery on disposed PP&E	-	-	-	**59,413**	**59,413**
At December 31, 2005	-	-	-	-	-
Accumulated Depreciation					
At December 31, 2003	**(530,999)**	**(357,786)**	**(210,470)**	**-**	**(1,099,255)**
Charge for the year	(12,264)	(117,050)	(47,733)	-	(177,047)
Disposals	120	4,033	9,213	-	13,366
At December 31, 2004	**(543,143)**	**(470,803)**	**(248,990)**	**-**	**(1,262,936)**
Charge for the year	(20,790)	(121,211)	(61,399)	-	(203,400)
Disposals	489,006	56,886	19,873	-	565,765
At December 31, 2005	**(74,927)**	**(535,128)**	**(290,516)**	**-**	**(900,571)**
Net book value as of December 31, 2003	270,050	1,295,067	131,306	328,474	2,024,897
Net book value as of December 31, 2004	296,594	1,603,020	168,539	241,294	2,309,446
Net book value as of December 31, 2005	505,078	1,563,888	162,423	494,001	2,725,389

Depreciation charge for 2005 in the amount of 203,400 (2004 – 177,047) was recorded in the “Depreciation and amortization” in the Consolidated Statement of Operations.

As of December 31, 2005 and 2004 property, plant and equipment and construction in progress with total carrying value of 484,365 and 660,014 respectively, were pledged as security under loan financing agreements.

As of December 31, 2005 the carrying value of property, plant and equipment included capitalized employee benefits incurred by ZAO “Centel”. Management believes that benefits of general and administrative personnel capitalized in the amout of 12,278 were incurred directly in connection with the construction or acquisition of such property, plant and equipment.

As of December 31, 2005 and 2004 the above property, plant and equipment figure included fully depreciated assets with the initial value of 521,039 and 964,231 respectively, still remaining in service.

(in thousands roubles)

5. Property, Plant and Equipment (continued)

The net book value of plant and equipment held under finance leases at December 31, 2005 and 2004 amounted to:

	2005	2004
Switches and transmission devices	-	97,834
Construction in progress and equipment for installation	-	14,371
Vehicles and other Fixed assets	**1,359**	35,328
Total net book value of plant and equipment held under finance leases	**1,359**	147,533

Leased assets are pledged as security for the related finance lease obligations (See Note 16).

In 2005 the Company increased construction in progress by the amount of capitalized interest totaling 27,501 (2004 –19,207). Capitalization rate in 2005 was 14.056% (2004 – 14.8 %).

Management estimates that the carrying value of all of the Company's property, plant and equipment as of the date of transition to IFRS was broadly comparable to their fair values.

6. Intangible Assets

	Licenses	Software	MGTS Numbering capacity	Total
Cost				
At December 31, 2003	**8,498**	**68,573**	**267,419**	**344,490**
Additions	4,009	31,238	157,383	192,630
Disposals	(162)	(174)	-	(336)
At December 31, 2004	**12,345**	**99,637**	**424,802**	**536,784**
Additions	14,475	189,599	1,000	205,074
Disposals	-	(739)	-	(739)
At December 31, 2005	**26,820**	**288,497**	**425,802**	**741,119**
Accumulated amortization				
At December 31, 2003	**(4,674)**	**(20,057)**	**(36,414)**	**(61,145)**
Charge for the year	(2,528)	(14,105)	(38,546)	(55,179)
Disposals	160	39	-	199
At December 31, 2004	**(7,042)**	**(34,123)**	**(74,960)**	**(116,125)**
Charge for the year	(3,234)	(28,831)	(42,505)	(74,570)
Disposals	-	28	-	28
At December 31, 2005	**(10,276)**	**(62,926)**	**(117,465)**	**(190,667)**
Net book value at December 31, 2003	3,824	48,516	231,005	283,345
Net book value at December 31, 2004	5,303	65,514	349,842	420,659
Net book value at December 31, 2005	**16,544**	**225,571**	**308,337**	**550,452**

Amortization charge for 2005 in the amount of 74,570 (2004 – 55,179) was recorded in line "Depreciation and Amortization" of the Consolidated Statement of Operations.

(in thousands roubles)

6. Intangible Assets (continued)

In 2005 the Company implemented a complex of operational and business support systems OSS/BSS based on Alcatel solutions. The total costs incurred and capitalized by the Company during the project amount to 180,148.

In 2004 and 2003 the Company entered into several contracts with MGTS for the connection to the latter’s network and the use of MGTS technical resources totaling 8.4 million US Dollars and 4.8 million US Dollars, respectively. The Company’s costs incurred in connection with the MGTS transactions were treated as intangible assets and reported as MGTS Numbering Capacity.

The following schedule illustrates significant intangible assets as of December 31, 2005 and 2004:

	2005		2004	
Description	**Net book value**	**Remaining useful life**	**Net book value**	**Remaining useful life**
MGTS Numbering Capacity	**308,362**	**6-8 years**	349,842	7-9 years
Implementation of Business management subsystems based on the Alcatel solutions	**173,548**	**9 years**	-	-

7. Financial investments

As of December 31, 2005 and 2004, the Company’s investments comprised the following:

	2005	2004
Long-term investments available for sale	**233,573**	231,284
Total Long-term investments	**233,573**	231,284
Short-term investments available for sale	**1,200**	1,029
Total short-term investments	**1,200**	1,029
Total Financial investments	**234,773**	232,313

(in thousands roubles)

7. Financial investments (continued)

As of December 31, 2005 and 2004, the Company's financial investments held for sale comprised the following:

Company	2005 Ownership interest	2005 Carrying value	2004 Ownership interest	2004 Carrying value
Long-term investments				
CJSC "Telegraph"	**49,34%**	**231,284**	49,34%	231,284
OJSC "Sviyazintech"	**2%**	**2,289**	-	-
Short-term investments				
Loan issued to "Brene" LLC		**-**		439
Loan issued to" Information Industrial Company" CJSC		**-**		590
Loan issued to "Orbita" LLC		**1,200**		-
Total financial investments available for sale		**234,773**		232,313

In accordance with the resolution of the Company's Board of Directors meeting held on 14 February 2005 the Company acquired 2% of shares in OJSC "Svyazintech" for 2 289.

Management believes that carrying amount of these investments approximates their fair values.

CJSC "Telegraph"

Closed joint stock company Telegraph (CJSC Telegraph) was registered on May 15, 1998. The shareholders were OJSC Central Telegraph and Zenimo S.A. (Switzerland). As of December 31, 2005 and 2004 the shareholders' structure of CJSC Telegraph was as follows:

	At December 31, 2005	At December 31, 2004
OJSC Central Telegraph	**49.3%**	49.3%
Crossline Holding S.A. (Switzerland)	**25.6%**	25.6%
Zenimo S.A (Switzerland)	**25.1%**	25.1%

The Company contributed part of the building on 7, Tverskaya St., Moscow and a standalone building at 7, Nikitsky Lane., Moscow, to the charter capital of CJSC Telegraph. In 2002 the Company lost its representation in the Board of Directors of CJSC Telegraph and ability to exercise other shareholder's rights. Accordingly, during 2002 the Company ceased to exercise significant influence on CJSC Telegraph and stopped applying equity method of accounting for the investment in CJSC Telegraph. As of December 31, 2005 and 2004 investment in CJSC Telegraph was recognized at fair value, which in management's opinion approximated historical cost adjusted for inflation.

(in thousands roubles)

7. Financial investments (continued)

In April 2003 CJSC Telegraph sold the part of building contributed by OJSC Central Telegraph, to LLC Unika-Invest. OAO Svyazinvest took legal action to nullify the deal. On June 21, 2003 the Moscow Arbitration Court arrested the part of the Company’s building contributed to the charter capital of CJSC Telegraph, as security for the OAO Svyazinvest claim for the CJSC Telegraph property. On June 26 2003, OAO Svyazinvest filed a lawsuit against the Company and LLC Unika-Invest to nullify the sales-and-purchase agreement on the Tverskaya, 7 premises owned by CJSC Telegraph and LLC Unika-Invest and to enforce the implications of such nullification.

Further, OJSC Central Telegraph brought an action to claim the property located at 7, Tverskaya St. that had passed into the LLC Unika-Invest’s ownership under the agreement with CJSC Telegraph.

The lawsuits brought in 2004 and 2005 have resulted in no final ruling on any of the claims. Court rulings on the above claims made subsequent to December 31, 2005 are detailed in Note 32.

Management believes that a high probability exists of that the Moscow Arbitration Court will take a decision on CJSC Telegraph property in favor of the Company. Management is taking every measure to reassume control over CJSC Telegraph.

Impairment reserve for financial investments as of December 31, 2005 and 2004 has been established in the following amounts:

	2005	2004
Impairment loss	**22,181**	22,441
Total Impairment loss	**22,181**	22,441

8. Long-Term Advances given, long-term accounts receivable and other financial assets

As of December 31, 2005 and 2004 long-term advances given, long-term accounts receivable and other financial assets comprised the following:

	2005	2004
Long-term accounts receivable and other financial assets	**84,559**	157,607
Long-term loans given	**73**	10
Total	**84,632**	157,617

As of December 31, 2005 and 2004 long-term advances given comprised advances provided to equipment suppliers.

9. Inventories

Inventories at December 31, 2005 and 2004 comprised the following:

	2005	2004
Cable, materials and spare parts for telecommunications equipment	**24,714**	16,385
Other inventories	**70,564**	67,863
Provision for inventory obsolescence	**(45,006)**	(65,121)
Total	**50,272**	19,127

(in thousands roubles)

In 2003, a provision of 76,049 was created against spare parts (radio assemblers and disassemblers for Radiotel) purchased in 1995 as that inventory could not be sold at the purchase price.

In 2005 and 2004 some radio assemblers were sold. Accordingly, the respective portion of obsolescence provision has been reversed and the gain from the reversal of the provision totaled 20,115 (2004 – 10,928) and was included in the “Other operating expenses” in the Consolidated Statement of Operations.

10. Accounts Receivable

Accounts receivable as of December 31, 2005 and 2004 comprised the following:

	2005	2004
Trade receivables – telecommunication services	**245,778**	207,795
Other accounts receivable	**37,164**	36,370
Provision for accounts receivable impairment	**(28,910)**	(24,254)
Total	**254,032**	219,911

Accounts receivable for telecommunication services by major customer groups are as follows:

	2005	2004
Corporate customers	**214,615**	171,676
Residential customers	**24,387**	31,869
Government customers	**6,776**	4,250
Total	**245,778**	207,795

Accounts receivable as of December 31, 2005 and 2004 were denominated in the following currencies:

	2005	2004
Russian roubles	**241,134**	196,493
US dollars	**4,644**	11,302
Total accounts receivable	**245,778**	207,795

The Company invoices in Roubles and US dollars its governmental and corporate customers on a monthly basis. For residential customers, the Company sends monthly payment requests and substantially relies upon these customers to remit payments based on the received payment requests. All customer payments are based upon tariffs, denominated in roubles, in effect at the time the calls are made.

The following summarizes the changes in the provision for impairment of trade and other receivables:

	2005	2004
Balance at January 1	**24,254**	26,576
Provision for the year	**12,921**	25,013
Reversal	**(6,046)**	(19,055)
Write-off of impaired accounts receivable	**(2,219)**	(8,280)
Balance at December 31	**28,910**	24,254

Impairment expenses for 2005 in the amount of 6,876 (2004 – 5,958) was included in the “Doubtful debt expense” line of Consolidated Statement of Operations.

(in thousands roubles)

11. Other Current Assets

As of December 31, 2005 and 2004 other current assets comprised the following:

	2005	2004
VAT receivable	**151,385**	141,963
Prepayments and advance payments	**28,394**	24,719
Deferred expenses	**17,802**	14,258
Other payments and current assets	**11,559**	26,682
Settlements with personnel	**985**	1,045
Other prepaid taxes	**240**	1,063
Short-term loans given	**8**	2,961
Total	**210,373**	212,691

12. Cash and Cash Equivalents

As of December 31, 2005 and 2004 cash and cash equivalents comprised the following:

	2005	2004
Cash at bank and on hand	**14,607**	12,927
Short-term deposits (less than 3 months)	**38,000**	210,000
Total cash and cash equivalents	**52,607**	222,927

As of December 31, 2005 cash and cash equivalents included a short-term deposit in OJSC KIT Finance Investment bank maturing on 6 February 2006. Interest rate on short term deposits is 8% per annum.

As of December 31, 2004 short term deposits maturing in less than three months were represented by the following contracts:

	Contract	Deposit amount (thousands Rubles)	Deposit rate	Maturity date
OJSC Web Invest Bank	No 04-1/111d of 01.11.2004	70,000	12%	March 22, 2005
OJSC Web Invest Bank	No 04-1/1113d of 01.11.2004	60,000	12%	March 21, 2005
OJSC Web Invest Bank	No 04-14/1217d of 22.12.2004	80,000	12%	January 20, 2005
Total		210,000		

As of December 31, 2005 cash at bank and on hand included amounts denominated in the following currencies:

	2005	2004
Russian Roubles	**13,503**	12,305
US dollars	**1,104**	622
Total cash at bank and on hand	**14,607**	**12,927**

(in thousands roubles)

Significant Non-Cash Transactions

Under agency agreement federal state unitary enterprise UFPS Mospochtamt accepts telegrams for OJSC Central Telegraph. In 2005 agency commission of 137,096 (2004 – 51,932) was settled by offsetting mutual liabilities.

In 2004 the Company made offset of mutual liabilities under agreements No 11480 of 27.05.2003 and No 11479 of 27.05.2003 with OJSC MGTS in the amount of 185,439.

Non-cash transactions have been excluded from consolidated statement of cash flows.

13. Share Capital

The Company’s share capital consists of the following:

	Number of outstanding shares (thousands)		
	Preference shares	**Ordinary shares**	**Share capital**
As of December 31, 2003	55,389	166,167	221,556
As of December 31, 2004	55,389	166,167	221,556
As of December 31, 2005	**55,389**	**166,167**	**221,556**

All shares have a par value of 1 Rouble. 75% of the share capital issued as of December 31, 2004 was attributable to ordinary shares and 25% attributable to preference shares, class A.

All authorized shares have been issued and fully paid up.

Preference shares give the holders the right to participate in general shareholders’ meetings without voting rights except in instances where decisions are made in relation to re-organization and liquidation of the Company, and in relation to changes and amendments to the Company’s charter which restrict the rights of preference shareholders. The preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of the Russian accounting net income for the year. If the Company fails to pay the above mentioned dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders’ meeting. Owners of the preferred shares have the right to participate in and vote on all issues within the competence of general meetings following the annual general meeting at which a decision not to pay (or to pay partially) dividends on preferred shares has been taken. Annual amount of dividends on preference shares may not be less than dividends on ordinary shares. The preference shareholders participate in earnings along with ordinary shareholders. Accordingly, the Company’s preferred shares are considered participating equity instruments for the purpose of earnings per share calculations (refer to Note 26).

In case of liquidation, the property remaining after settlement with creditors, payment of preferred dividends and redemption of the par value of preferred shares is distributed among preferred and ordinary shareholders proportionately to the number of owned shares.

Distributable earnings of the parent company are limited to the amount of its retained earnings determined in accordance with the statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2005 and 2004 amounted to 570,083 and 590,450, respectively.

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income of 152,281 and 148,584 in its statutory financial statements in 2005 and 2004, respectively.

13. Share Capital (continued)

Dividends were declared in 2005 in respect of 2004 to holders of ordinary shares and preference shares of Rouble 0.105425 per ordinary share (2004 – Rouble 0.0703 per ordinary share) and Rouble 0.268256 per preference share (2004 –Rouble 0.1958 per preference share). See also Note 27.

The Company’s shareholding structure as of December 31, 2005 (in thousands of shares) was as follows:

	Ordinary shares		Preference shares		Total
OJSC Svyazinvest	84,745	51%	-	-	84,745
Other legal entities	66,399	40%	15,089	27%	81,488
Individuals	15,023	9%	40,300	73%	55,323
Total	**166,167**	**100%**	**55,389**	**100%**	**221,556**

14. Minority Interest

Movement of minority interest for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
Minority interest as of January 1	-	997
Minority interest in subsidiaries disposed	-	492
Minority interest in net income of subsidiaries	-	(1,413)
Dividends paid to minority shareholders of subsidiaries	-	(76)
Minority interest as of December 31	-	-

15. Loans and Borrowings

As of December 31, 2005 and 2004 loans and borrowings included the following:

	Effective interest rate	Maturity	2005	2004
Short term borrowings				
Bank loans				
Bank loans (Roubles)	10,91%	2006	**150,082**	149,647
Bank loans (USD)			**-**	52
Total bank loans			**150,082**	149 ,699
Accrued interest on Bonds issued (Roubles)		2006	**13,065**	10 ,174
Other loans (Roubles)		2006	**1,500**	5,689
Total short term borrowings			**164,647**	165 562
Long-term borrowings				
Bank loans				
Bank loans (Roubles)	12%	2007	**51,111**	74,080
Bank loans (USD)	11,5%	2007-2010	**230,840**	21,532
Total bank loans			**281,951**	95,612
Bonds issued (Roubles)	16,25%	2006-2007	**692,177**	692,177
Other loans (Roubles)	14,74%	2006-2008	**130,480**	-
Promissory notes issued (Roubles)	25%	2009-2010	**258,743**	206,994
Less: current portion of long-term borrowings			**(567,037)**	(21,532)
Total long-term borrowings			**796,314**	973,251

(in thousands roubles)

15. Loans and Borrowings (continued)

As of December 31, 2005 bank loans are secured by telecommunication equipment with the carrying value of approximately 484 365 (2004 – 660 014).

As of December 31, 2005 loans and borrowings had the following maturity schedules:

Maturity date	Bank loans	Bonds	Other loans	Notes	Total
2006	172,693	508,242	50,749	-	731,684
2007	64,014	197,000	48,898	-	309,912
2008	71,028	-	32,332	-	103,360
2009	71,028	-	-	115,347	186,375
2010	53,270	-	-	143,396	196,666
Total	**432,033**	**705,242**	**131,979**	**258,743**	**1,527,997**

Loans and borrowings outstanding as of December 31, 2005 and 2004 were denominated in the following currencies:

Currency	2005	2004
Russian Roubles	**1,297,157**	1,138,761
US Dollars	**230,840**	21,584
Total	**1,527,998**	1,160,345

The Company did not hedge its currency or interest rate risks.

Short-term borrowings

Bank Loans

Rouble-denominated short term borrowings comprise bank loans obtained for working capital financing purposes.

Short-term bank loans as of December 31, 2005 and 2004 included the following:

	December 31, 2005	December 31, 2004
Bank loans (Roubles)		
OAO Russian Development Bank	**-**	140,727
CJSC AKB Promsvyazbank	**150,082**	8,920
Total bank loans (Roubles)	**150,082**	149, 647

OJSC Russian Development Bank

On December, 2004 an agreement was signed with OJSC Russian Development Bank for a loan of 139,450 maturing on March 23, 2005. The interest rate was 10% p.a. The loan was fully repaid in 2005 as it fell due.

(in thousands roubles)

15. Loans and Borrowings

Bank Loans (continued)

CJSC AKB Promsvyazbank

During 2005 a several additional agreements regarding overdrafts to the bank account agreement with AKB Promsvyazbank were concluded. The interest rate was 10% p.a. Within the frame of these agreements in 2005 the Company received cash in the amount of 362,530. The loan and interest payable were fully repaid in 2005.

On December 2005 an agreement was signed with AKB Promsvyazbank for a loan of 150,000. The interest rate was 9% p.a, maturing on 27 February 2006. No pledge was given for this loan.

RF Sberbank

On July 2004 RF Sberbank (Lefortovskoye branch No 6901, agreement No 71/1-04) granted the Company a non-revolving credit line of 150,000 maturing on January 13, 2006 at 11% p.a. The Company pledged property, plant and equipment with collateral value of 269,138 as security for the debt. As of December 31, 2005 the Company fully repaid this loan and interest payable.

Other short term loans

LLC DomCom

In 2004 a loan agreement was signed with LLC DomCom for 5,689 maturing on January 26, 2005. The interest rate was 16% p.a. As of December 31, 2004 the outstanding debt was 6,459 including total interest of 770 . The loan was repaid in 2005 as it fell due.

CJSC "Nacionalnoe RadioTechniceskoe Buro"

On December 26, 2005 an agreement was signed with CJSC "Nacionalnoe RadioTechniceskoeBuro" for a loan of 1 500. The loan was repaid at January 19, 2006 as it fell due.

Long term borrowings

Bank loans

Long term bank loans as of December 31, 2005 and 2004 included the following:

	December 31, 2005	December 31, 2004
Bank loans (Roubles)		
Lefortovskoye OSB No 6901	**-**	45,580
CJSC AKB Promsvyazbank	**28,500**	28,500
Total bank loans (Roubles)	**28,500**	74,080
Bank loans (USD)		
Lefortovskoye OSB No 6901	**253,451**	-
OJSC Vneshtorgbank	**-**	21,532
Total bank loans (USD)	**253,451**	21,532
Total long term bank loans	**281,951**	95,612
Less: current portion of long term bank loans	**-**	-
Lefortovskoye OSB No 6901	**(22,611)**	-
OJSC Vneshtorgbank	-	(21,532)
Total long term bank loans	**259,340**	74,080

15. Loans and Borrowings

Bank Loans (continued)

RF Sberbank

On June 2003 RF Sberbank (Lefortovskoye branch No 6901, agreement No 54/1-03) granted the Company a non-revolving credit line of 95,000 maturing on June 29, 2006 at 12% p.a. The Company pledged equipment with collateral value of 269,138 as security for the debt. As of December 31, 2005 the Company's outstanding liability under the loan was 22,692 including interest of 82.

On July 2005 RF Sberbank (Lefortovskoye branch No 6901) granted the Company a non-revolving credit line of 12,300 US dollars maturing in 2007-2010 at 11.5% p.a. As of December 31, 2005 the Company's outstanding liability under the loan was 8,020 US dollars (230 840). The Company pledged property, plant and equipment with collateral value of 50,688 as security for the debt.

CJSC AKB Promsvyazbank

On April 30, 2004 a long term loan agreement was signed with AKB Promsvyazbank for a 28,500 loan maturing on March 29, 2007. Initial interest rate was established at 14%, at 2005 – 12.5%, at 2006 – 11.5%. As of December 31, 2005 the outstanding liability under the loan was 28,500.

OJSC Vneshtorgbank

On December 18, 2002 the Company obtained a loan of 2,666 thousand US dollars from OJSC Vneshtorgbank maturing on November 18, 2005 at 8% p.a. The Company pledged property, plant and equipment with collateral value of 89,619 to secure the debt. The loan was repaid in 2005 as it fell due.

Bonds issued

In August 26, 2003, the Company registered the issue of 500,000 interest-bearing bonds, series 01, with par value of 1 thousand Roubles each. The bonds have 12 quarterly coupons. Coupon effective interest rate is set at 17.46% per annum. The bonds mature in 1,096 days from the date of issue in August 2006.

In September 2004, the Company registered the issue of 200,000 interest-bearing bonds, series 02, with par value of 1 thousand Roubles each. The bonds have 12 quarterly coupons. Coupon effective interest rate is set at 13.22% per annum. The bonds mature in 1,096 days from the date of issue in September 2007.
Interest expenses under the bonds issued in 2005 and 2004 totaled 106,605 and 87,927 respectively.

Long term promissory notes issued

In 1999 and 2000 the Company issued two non-interest-bearing promissory notes at no discount. The first note with par value of 281,610 maturing in 2009 was issued in December 1999, and the second note with par value of 377,119 maturing in 2010 was issued in April 2000.

The notes were initially recognized at net present value determined by applying discount rate of 25% (average annual Ruble-denominated loan refinancing rate in 2001) and are carried at amortised cost in these financial statements. Imputed interest of 51,749 and 41,399 is reported in the accompanying Statements of Operations for 2005 and 2004 as Interest Expense, net.
As of December 31, 2005 Company's outstanding liability under the notes was 258,743.

(in thousands roubles)

15. Loans and Borrowings (continued)

Other loans

In August 2005, the Company sold telecommunication equipment for the amount of 146,895 and immediately reacquired the right to use the equipment by entering into a lease with RTC- Leasing.

As the Company reacquired substantially all the risk and rewards of ownership of telecommunication equipment, the Company did not recognize this transaction as a sale/lease back transaction, but rather a borrowing transaction.
Effective interest rate is set at 14.74% per annum.
As of December 31, 2005 the Company’s outstanding liability under the loan was 130,479. Interest expense in 2005 was 10,162.

16. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment and transport vehicles. Future minimum lease payments under finance lease contracts together with the present value of minimum lease payments as of December 31, 2005 and 2004 are as follows:

	2005		**2004**	
	Minimum lease payments	**Present value of minimum lease payments**	**Minimum lease payments**	**Present value of minimum lease payments**
Current portion	**746**	**581**	49,034	31,969
1 to 5 years	**69**	**64**	77,954	63,264
More than 5 years				
Total minimum lease payments	**815**	**645**	126,988	95,233
Less amounts representing finance charges	**(170)**	-	(31,755)	-
Present value of minimum lease payments	**645**	**645**	95,233	95,233
Less: Short-term part of finance lease obligations	**(581)**	**(581)**	(31,969)	(31,969)
Long-term finance lease obligations	**64**	**64**	63,264	63,264

In 2005 and 2004, the Company’s primary lessors were OJSC “RTC--Leasing”, LLC“Spetsautoleasing” and CJSC “Russian-German leasing company”.

Effective interest rate under the above liabilities in 2005 and 2004 totaled 10.08% and 21.98%, respectively.

In August 2005 the Company made an early repayment of its obligations to OJSC “RTC-Leasing”.

Under the contracts concluded with CJSC “Russian-German leasing company”and LLC“Spetsautoleasing”, the lessor is entitled to change the schedule of future lease payments to respond to the change of certain macroeconomic factors, in particular, the Russian Federation Central Bank’s refinancing rate.

(in thousands roubles)

17. Accounts payable and accrued liabilities

As of December 31, 2005 and 2004 accounts payable and other current liabilities comprised the following:

	2005	2004
Trade accounts payable	**184,332**	187,812
Advances received from subscribers	**59,324**	49,416
Accounts payable for capital construction	**72,720**	86,729
Salaries, wages and compensations	**46,772**	33,787
Other accounts payable	**23,545**	28,592
Total	**386,693**	386,336

Trade payables for capital construction denominated in US dollars as at 31 December 2005 totaled 5,294 (5,964 in 2004).

18. Deferred Revenue

Deferred revenue comprises revenue from telephone network access services rendered to CJSC Sonic Duo and unrecorded in the reporting and earlier periods that the Company reflects on a straight-line basis over a 10 years period.

	2005	2004
Opening balance	**377,403**	427,702
Revenue recognized during the year	**(153,710)**	(143,484)
Revenue deferred during the year	**33,790**	93,185
Closing balance	**257,483**	377,403
Less: current portion of deferred revenue	**(124,238)**	(149,986)
Total long term deferred revenue	**133,245**	227,417

19. Taxes and Social Security Withholdings Payable

As of December 31, 2005 and 2004 the Company had the following taxes and social security withholdings payable:

	2005	2004
Value added tax	**65,970**	41,384
Property tax	**4,014**	4,835
Unified social tax	**4,347**	-
Income tax	**1,364**	38
Other taxes	**138**	312
Total	**75,833**	46,569

Value added tax of 65,970 (2004 – 41,384) becomes payable to the tax authorities only against actual receipt of payment from customers or write off of the respective account receivable.

Starting January 1, 2006 amendments to the Tax Code relating to rules of determination of the taxable base were introduced. These are described in Note 32 "Subsequent Events".

(in thousands roubles)

20. Pension liabilities

In addition to statutory pension benefits, which represent defined contribution pension plan, the Company also contributes to post-employment benefit plans, which covers most of its employees and qualifies for accounting as defined benefit pension plan.

The defined benefit pension plan provides old age retirement pension and disability pension. The plans provide for payment of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. The benefits are based on a formula specific to each branch of the Company. According to the formula the benefits depend on a number of parameters, including the relative pay of participants and their length of service in the Company at retirement. The benefits do not vest until and are subject to the employee retiring from the Company on or after the above-mentioned ages.

Non-government pension fund Telecom-Soyuz, which is related to the Company (Note 30), maintains the defined benefit pension plan. The Company makes contributions to the pension fund in the amount set forth in the agreement with the pension fund.

The Company further provides other long-term employee benefits such as a death-in-service payments and lump-sum payment upon retirement of a defined benefit nature.

Additionally the Company provides financial support of a defined benefit nature to its old age and disabled pensioners.

As of December 31, 2005 there were 769 active participants to the defined benefit pension plan of the Company (as of December 31, 2004 – 824).

As of December 31, 2005 and 2004 the net liabilities of defined benefit pension comprised the following:

	2005	2004
Present value of defined benefit obligation	**159,906**	141,445
Fair value of plan assets	**(366)**	(7,590)
Present value of unfunded obligations	**159,540**	133,855
Unrecognized past service cost	**(67,708)**	(79,080)
Unrecognized actuarial (losses)/gains	**(3,550)**	6,658
Net pension liability in the balance sheet	**88,282**	61,433

As of December 31, 2005 management estimated employees’ average remaining working life at 9 years (2004 - 9 years).

The amount of net expense for the defined benefit pension and other post-employment benefit plans recognized in 2005 and 2004 is as follows:

	2005	2004
Service cost	**10,913**	10,033
Interest cost	**13,250**	15,502
Expected return on plan assets	**(349)**	(1,396)
Actuarial gains/(losses)	**-**	(2,408)
Amortization of past service cost	**11,372**	11,372
Net expense for the defined benefit pension plan	**35,186**	33,103

(in thousands roubles)

20. Pension liabilities (continued)

The movements in the net liability for defined benefit pension and other post-employment benefit plans in 2005 and 2004 are as follows:

	2005	2004
Net liability at January 1	**61,433**	71,716
Net expense for the year	**35,186**	33,103
Contributions	**(8,337)**	(43,386)
Net liability at December 31	**88,282**	61,433

As at December 31, 2005 and 2004 actuarial expectations of pension liabilities under defied benefit plans were the following:

	2005	2004
Discount rate	**7.00%**	9.18%
Expected return on plan assets	**9.96%**	9.33%
Future increase of salary	**8.15%**	9.18%
Rate used in calculation of annuity value	**6.00%**	6.00%
Percentage of dismissed employees	**5.00%**	5.00%
Tables of death (source of data)	**USSR 1985-1986**	Russia 1998

During 2005 and 2004 movement of assets on defied benefit plan is explained by the following factors:

	2005	2004
Fair value of plan assets as at 1 January	**7,590**	10,957
Actual return on plan assets	**484**	384
Employer's contribution	**8,337**	17,424
Financing of deficit during settlement	**-**	25,962
Settlement	**-**	(37,945)
Pensions paid	**(16,045)**	(9,192)
Fair value of plan assets as at 31 December	**366**	7,590

Actual return of plan assets was 12.5% for 2005.

21. Revenues

By revenue types	2005	2004
Local telephone calls	**764,550**	616,060
New services (Internet, ISDN, ADSL, IP-telephony)	**661,007**	498,864
Data transfer and telematic services	**395,911**	290,270
Installation and connection fees	**288,605**	326,520
Other communication services	**140,747**	117,025
Long distance telephone services – domestic	**103,739**	71,232
Long distance telephone services – international	**55,468**	50,408
Documentary services	**23,449**	21,144
Other revenues	**46,038**	48,240
Total	**2,479,514**	2,039,763

(in thousands roubles)

21. Revenues (continued)

The Company identifies revenue by the following major customer groups:

Customer groups	2005	2004
Residential customers	**327,577**	256,828
Corporate customers	**2,108,518**	1,740,535
Government customers	**43,419**	42,400
Total	**2,479,514**	2,039,763

22. Other Operating Expenses

Other operating expenses, net comprised the following:

	2005	2004
Lease of premises	**53,780**	32,656
Advertising expenses	**44,857**	37,625
Agency fees	**23,203**	35,044
Non-commercial partnership expenses	**22,176**	14,232
Insurance	**19,523**	18,316
Audit and consulting fees	**18,291**	9,057
Universal service fund payments	**12,464**	-
Fire and other security services	**10,936**	7,216
Membership fees, charitable activity and trade union payments	**3,510**	2,908
Education expenses	**2,485**	1,502
Post services	**1,334**	1,027
Business travel expenses and representation costs	**2,305**	1,601
Transportation services	**1,316**	731
Payments to Gossvyaznadzor	**-**	6,236
Tax fines and penalties	**219**	191
Other expenses	**234,623**	173,668
Total	**451,022**	342,010

Other expenses include:

	2005	2004
Telegram handling expenses	**133,363**	60,877
Photographic readout of blanket sheets	**25,057**	29,000
Expenses related to Rostelegraph	**34,247**	32,005
Legal expenses	**7,517**	5,084
Other expenses	**34,439**	46,702
Total	**234,623**	173,668

23. Interest Expense

	2005	2004
Interest income	**6,608**	6,899
Interest expense on loans	**(161,745)**	(131,512)
Interest expense accrued on finance leases	**(6,059)**	(23,364)
Total	**(161,196)**	(147,977)

(in thousands roubles)

24. Income from financial investments

	2005	2004
Gain from sale of interest in CJSC Centel	-	1,015
Gain from sale of other investments	**473**	2,922
Reversal of impairment provision	**-**	1,036
Dividend income	**182**	285
Total	**655**	5,258

25. Income tax expense

Income tax charge for the years ended December 31, 2005 and 2004 comprised the following:

	2005	2004
Current income tax expense	**(33,789)**	(36,669)
Prior year income tax adjustments	**(12,750)**	-
Deferred tax expense – origination and reversal of temporary differences	**(59,334)**	(34,067)
Total income tax for the year	**(105,873)**	(70,736)

A reconciliation of the theoretical tax charge to the actual income tax charge is as follows:

	2005	2004
Profit before income tax	**304,338**	237,446
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**(73,042)**	(56,987)
Increase (decrease) resulting from the effect of:		
Non-deductible expenses	**(28,982)**	(28,612)
Other permanent differences	**(3,849)**	14,863
Total income tax charge for the year at the effective rate of 35% (2004 - 30%)	**(105,873)**	(70,736)

(in thousands roubles)

25. Income tax expense (continued)

The composition of deferred income tax assets and liabilities as of December 31, 2005 and 2004 was as follows:

	2,005	2,004
Deferred tax assets:		
Inventories	**9,642**	1,169
Deferred income	**61,796**	90,577
Accounts payable	**12,373**	9,041
Loans received	**1,962**	-
Accounts receivable	**3,118**	-
Other	**408**	122
Total deferred tax assets	**89,299**	100,908
Deferred tax liabilities:		
Property, plant and equipment	**(179,124)**	(141,468)
Intangible assets	**(123,496)**	(100,451)
Long-term promissory notes issued	**(95,997)**	(108,416)
Long-term investments	**(21,371)**	(21,342)
Finance lease	**(154)**	(739)
Total deferred tax liabilities	**(420,142)**	(372,416)
Total net deferred tax liabilities	**(330,843)**	(271,508)

The movement in net deferred tax liability for the years ended December 31, 2005 and 2004 was as follows:

	2005	2004
Deferred tax liability, at January 1	**(271,508)**	(237,441)
Deferred tax expense	**(59,335)**	(34,067)
Deferred tax liability, at December 31	**(330,843)**	(271,508)

In the context of the Company's current structure, tax losses and current tax assets of the different consolidated entities may not be set off against current tax liabilities and taxable profits of other entities and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax asset of one consolidated entity is not offset against deferred tax liability of another consolidated entity.

26. Earnings per share

The Company has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

	2005	2004
Profit for the year attributable to equity holders of the parent	**198,465**	168,123
Weighted average number of ordinary shares outstanding	**221,556**	221,556
Basic and diluted earnings per share attributable to equity holders of the parent , Russian Roubles	**0.90**	0.76

(in thousands roubles)

27. Dividends Declared for Distribution

Dividends declared in 2005 based on 2004 results:

The Board of Directors officially approved dividends for the year 2004:

Dividends on ordinary shares, 0.105424 Roubles per share	17,517.99
Dividends on preference shares, 0.268255 Roubles per share	14,858.38
Total	**32,376.37**

Number of shares used in dividends per share calculation is determined as number of shares in circulation at the reporting date.

The Board of directors has recommended to the General Meeting of Shareholders the following dividends for 2005:

Dividends on ordinary shares, 0.112803 Roubles per share	18,744.14
Dividends on preference shares, 0.274930 Roubles per share	15,228.10
Total	**33,972.24**

Dividends paid to shareholders are determined by the Board of Directors and declared and officially approved at the Annual Shareholders' Meeting. Earnings available for dividends are limited to profits determined in accordance with the Russian statutory accounting regulations and earned by the Company. Dividends are accrued in the year they are declared and approved.

28. Contingencies and Operating Risks

Operating Environment of the Company

The Russian economy while deemed to be of market status continues to display certain characteristics consistent with that of a market in transition. These characteristics include, but are not limited to, relatively high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The stability of the Russian economy will be significantly impacted by the government's policies and actions with regards to supervisory, legal, and economic reforms.

Legal Proceeding

The Russian legal system is characterized by (1) inconsistencies between and among laws, Presidential decrees, and Russian governmental, ministerial and local orders, decisions, and resolutions and other acts; (2) conflicting local, regional and federal rules and regulations; (3) the lack of judicial and administrative guidance on interpreting legislation; (4) the relative inexperience in legislation interpretation; and (5) a high degree of discretion on the part of governmental authorities.

Management is unable to estimate what developments may occur in respect if the Russian legal system or the resulting effect of any such developments on the Company's financial condition or future results of operations. In the nearest future the Company's activity could be subject by judicial reform factors. The Company's financial statements include no adjustments resulting from these uncertainties.

28. Contingencies and Operating Risks (continued)

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2005 management believes that its interpretation of the relevant legislation is appropriate and that the Company’s tax, currency and customs positions will be sustained. However, it is possible that in certain instances of interpreting the legislation and assessing the relevant tax liabilities management of the Company may have assumed the position, which could subsequently be challenged by the government fiscal authorities as one lacking sustainable basis. The Company intends to defend its position on those issues. As of December 31, 2005, the financial statements do not contain adjustments which may become necessary due to these uncertainties and positions assumed by the Company.

Insurance Coverage

During 2005, the Company did not maintain insurance coverage on a significant part of its property, plant and equipment, business interruption losses, or third party liability in respect of property or environmental damage arising from accidents relating to the Company’s property or the Company’s operations. Until the Company obtains adequate insurance coverage, there is a risk that losses resulting from destruction of certain assets could have a material adverse effect on the Company’s operations and financial position.

Claims of tax authorities

Management believes that the Company’s tax liabilities for the current and preceding periods were properly calculated and presented in the financial statements in full. However, based on recent tax examinations of other entities of OJSC “Svyazinvest” Group, management believes, that there is a risk of receiving significant tax claims with respect to the matters, assuming varying interpretations of the tax regulations, in particular matters on settlements between operators for interconnection services. Management believes that the Company has appropriate arguments to litigate possible tax claims. Nevertheless, due to the absence of the established legal practices with respect to such claims legal proceedings currently are largely uncertain.

28. Contingencies and Operating Risks (continued)

Licenses

Substantially all of the Company’s revenues are derived from operations conducted pursuant to licenses granted by the Russian Federation Ministry of Communications and Informatization. These licenses expire in various years ranging from 2006 to 2012. Management has no reason to believe that these licenses will not be renewed or that any licenses will be suspended or terminated. Suspension or termination of the Company’s main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

The Government of the Russian Federation is in process of liberalization of telecommunications market for which additional licenses on providing of DLD/ILD has been granted to a number of alternative operators. It is possible that the Company’s future results of operations or cash flows could be materially affected in a particular period but the effect now can not be determined.

The Decision of the Russian Government # 87 “On Endorsement of the list of the names of communication services entered in licenses and the lists of license terms” of February 18, 2005 (amended as at December 29, 2005 # 837) prescribed types of connection services that are to be included into licenses and list of licensing terms. Licensing terms defined in previously issued licenses are effective unless they contradict the current regulations. The Company considered significant effect of new requirements related to the interconnection settlements, traffic transmission and mobile services on current licensing terms for licenses issued prior to January 1, 2004 and in November 2005, the Company submitted to Federal Service for Communications Supervision (Rossvyaznadzor) its request for changes and amendments to the existing License for provision of local, intercity telecommunications services in order to bring the License terms in compliance with the requirements set by Governmental Decree # 87 dated February 18, 2005. All necessary amendments to the licenses were received.

Universal service fund payments

Industry regulations effective as of December 31, 2005 did not provide clear guidance with respect to the method of calculation of the allocation to the fund that may lead to uncertainty in composition of the basis for such payments. Accordingly, there is a risk of incorrect calculation of the payments to this fund.

Guarantees Issued

As at December 31 the Company guaranteed credit line facilities for agreement № 1/5026 from 30 April 2004 and № 4/610 from 7 July 2005 with Sberbank RF Lefortovkoe branch #6901. The total guarantees in 2005 amounted to 259,334 (in 2004- 28,500).

29. Contractual Commitments

Capital Investments

As of December 31, 2005 the Company has commitments for capital investments into modernization and expansion of its network in the amount of 105,303 (2004 – 374).

(in thousands roubles)

30. Balances and Transactions with Related Parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions or had significant balances outstanding at December 31, 2005 are detailed below.

Rendering Services
During the year ended December 31, 2005 and 2004 the Company rendered significant amount of services to the following related parties:

Related party	**Relationship**	**Type of sales**	**Price determination method**	**2005**	**2004**
OJSC “Investicionnaja kompanija Svazi”	Parent company	Telecommunication services	Arms' length terms	**773**	1 139
Russian Federal Property Fund	Parent company	Telecommunication services	Arms' length terms	**419**	-
CJSC “Telegraph”	Associate company	Telecommunication services	Arms' length terms	**104**	425
OJSC “Volga Telecom” Nijnij Novgorod branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**750**	-
OJSC “Rostelecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**5,764**	6,488
OJSC “South Telecom Company” branch of KubanElektroSvaz	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**2,294**	548
OJSC “Far Eastern telecommunication company” Magadan Region	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**413**	415
OJSC “RTKomm.RU”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**1,626**	-
OJSC “Svyaz-bank”	Controlled by OJSC “Svyazinvest	Telecommunication services	Arms' length terms	**2,154**	1,016
OJSC «Svyaz-bank»	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**6,291**	5,324
OJSC “Center Telecom” Moscow branch	Controlled by OJSC	Telecommunication services	Arms' length terms	**151**	-

	“Svyazinvest”				
OJSC “Volga Telecom” Branch in Chuvashi Republic	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**17**	-
OJSC “South Telecom Company” Stavropol region	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**25**	-
OJSC “UralSvyazInform”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**515**	-
OJSC “Sibir Telecom” Irkutsk branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**128**	-
OJSC “GiproSvyaz”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**31**	-

(in thousands roubles)

30. Balances and Transactions with Related Parties (continued)

Purchases

During the year ended December 31 2005 and 2004 the following related parties rendered significant amount of services to the Company:

Related party	Relationship	Type of purchases	Price determination method	2005	2004
OJSC “South Telecommunication Company” Stavropol region	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**1,122**	1,676
OJSC “Rostelecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**79,538**	116,672
OJSC “Sibir Telecom” Irkutsk branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**244**	312
OJSC “Far Eastern telecommunication company” Magadan Region	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**621**	342
OJSC ”Center Telecom” Moscow branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**23,172**	11,704
“Peterburg telephone network”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**101**	138
Centre of New technologies	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms' length terms	**1868**	492
NPF Telecom-Soyuz	Controlled by OJSC “Svyazinvest”	Pension fund services	Arms' length terms	**14,905**	14,777

(in thousands roubles)

30. Balances and Transactions with Related Parties (continued)

Accounts receivable

As of December 31 2005 and 2004 significant balances of accounts receivable from related parties were as follows:

Related party	Relationship	Type of receivables	2005	2004
OJSC “Center Telecom” Moscow branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	**22**	21
OJSC “Volga Telecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	**5**	-
OJSC ”Volga Telecom” Nijnij Novgorod branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	**128**	-
OJSC ”South Telecommunication Company” “Elektrosvaz of Stavropol region” branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	**05**	19
OJSC “South Telecommunication Company” KubanElektroSvaz branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	**787**	38
OJSC «UralSvazInform»	Controlled by OJSC “Svyazinvest”	Telecommunication services	**21**	-
OJSC «Sibir Telecom» Irkutsk branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	**51**	-
OJSC “Far Eastern telecommunication company” Magadan Region	Controlled by OJSC “Svyazinvest”	Telecommunication services	**34**	59
OJSC “RTKomm.RU”	Controlled by OJSC “Svyazinvest”	Telecommunication services	**92**	-
OJSC “SvyazInvest”	Parent company	Telecommunication services	**32**	97
Russian Federal Property Fund	Parent company	Telecommunication services	**38**	-
OJSC “Svyaz-bank”	Controlled by OJSC “Svyazinvest”	Telecommunication services	**300**	111
OJSC “Rostelecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	**545**	1 243

(in thousands roubles)

30. Balances and Transactions with Related Parties (continued)

Accounts payable

As of December 31 2005 and 2004 significant balances of accounts payable to related parties were as follows:

Related party	Relationship	Type of payables	2005	2004
OJSC “South Telecomunication Company” Stavropol region	Controlled by OJSC “Svyazinvest”	Telecommunication services	95	274
OJSC «Rostelecom»	Controlled by OJSC “Svyazinvest”	Telecommunication services	8,350	51,030
OJSC «Sibir Telecom» Irkutsk branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	25	93
OJSC “Far Eastern telecommunication company” Magadan Region	Controlled by OJSC “Svyazinvest”	Telecommunication services	186	143
OJSC “Center Telecom” Moscow branch	Controlled by OJSC “Svyazinvest”	Telecommunication services	3,922	3,694
OJSC “RTKomm.RU”	Controlled by OJSC “Svyazinvest”	Telecommunication services	17	-
OJSC “Svyaz-bank”	Controlled by OJSC “Svyazinvest”	Telecommunication services	191	-
CJSC “Telegraph”	Associate company	Telecommunication services	3	-

OJSC Svyazinvest

The Company’s parent OJSC Svyazinvest was fully owned by the state through July 1997 when the Russian Federation Government sold 25% plus one share in OJSC Svyazinvest to private investors.

An effectively operating telecommunications and data transmission facility is of great importance to Russia for various reasons including economic strategic and national security considerations. Consequently the Government has and may be expected to continue to exercise significant influence over the operations of OJSC Svyazinvest and its subsidiaries.

The Government’s influence is not confined to its share holdings in OJSC Svyazinvest. It has general authority to regulate tariffs and does regulate domestic long distance tariffs to a limited extent. In addition the Ministry of Communications and Informatization of the Russian Federation has control over the licensing of providers of telecommunications services.

30. Balances and Transactions with Related Parties (continued)

OJSC Rostelecom

OJSC Rostelecom whose majority shareholder is OJSC Svyazinvest is the primary provider of domestic long-distance and international telecommunications services in the Russian Federation. The annual expenses due to Rostelecom are related to traffic carried and terminated outside of the Company's network. The expenses are included in national and international traffic costs. In addition OJSC Rostelecom uses the Company's network for incoming national and international traffic of its subscribers and client operators. Changes in settlements with OJSC "Rostelecom" after January 1 2006 are described in Note 32.

Transactions with government organizations

Government organizations are a significant element in the Company's customer base purchasing services both directly through numerous authorities and indirectly through their affiliates. Certain entities financed by the Government budget are users of the Company's network. These entities are generally charged lower tariffs as approved by the Federal Antimonopoly Agency than those charged to other customers. In addition the Government may by law require the Company to provide certain services to the Government in connection with national security and the detection of crime.

As of December 31 2005 and 2004 Government subscribers accounted respectively for approximately 2.46% and 2.28% of total accounts receivable. Amounts outstanding from government subscribers as of December 31 2005 and 2004 totaled 6,460 and 4,232 respectively.

Non-Commercial Partnership Center for Research of Problems in Development of Telecommunications

Non-commercial partnership Center for Research of the Problems in Development of Telecommunications (hereinafter "the Partnership") is an entity that OJSC Svyazinvest controls through its subsidiaries. The Company has an agreement with the Partnership under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiaries and associates of OJSC Svyazinvest. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31 2005 amounted to 22,176 (2004 – 14,232).

NPF Telecom-Soyuz

The Company has a number of pension insurance agreements with NPF Telecom-Soyuz (see Note 20) which is a party related to OJSC Svyazinvest. Payments to this pension fund in 2005 and 2004 amounted to 14, 905.5 and 14,777 respectively.

LLC DomCom

In 2004 the Company's subsidiary OJSC Centel obtained a loan from minority shareholder LLC DomCom. As of December 31 2004 the outstanding loan totaled 6,459 thousand Rubles including accrued interest of 770 thousand Rubles (see Note 15). As of December 31 2005 the loan was fully repaid.

(in thousands roubles)

Compensation to key management personnel

Key management personnel comprise members of Management Board and Board of Directors of the Company totaling 16 persons as of December 31 2005 and 7 persons as of December 31 2004.

The total compensation to key management personnel as reported in the Statement of Operations as Wages Salaries Other Benefits and Social Contributions for the years ended December 31 2005 и 2004 was 9,349 thousand Rubles and 5,025 thousand Rubles respectively.

31. Financial Instruments and risk management objectives and policies.

The Company’s principal financial instruments comprise bank loans finance leases and cash and short-term deposits. The main purpose of these instruments is to raise finance for the Company’s operations. The Company has other financial assets and liabilities such as trade receivables and trade payables which arise directly from its operations.

Foreign Exchange Risk

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company’s statement of operations balance sheet and/or cash flows. Foreign currency denominated liabilities (see Notes 15 and 17) give rise to foreign exchange exposure.

The Company does not have arrangements to mitigate foreign exchange risks of the Company’s operations.

As at December 31 2005 the Company’s liabilities in US dollars were 230,840 (2004 – 21,548).

For the period from January 1 2004 to December 31 2005 exchange rate of the Russian Rouble to US Dollar decreased by approximately 2.3%. Possible decrease in the exchange rate of the Russian Rouble may lead to an increase in the amount of the Company’s borrowings as well as will cause difficulties in attraction of funds including funds required for refinancing of the existing debt.

Interest rate risk

Interest rate risk is the risk that changes in market interest rates may negatively impact the Company’s financial results.
The following table presents as of December 31 2005 and 2004 the carrying amount by maturity of the Company’s financial instruments that are exposed to interest rate risk:

	< 1 year	1–5 years	> 5 years	Total
As of December 312005:				
Fixed rate				
Short-term obligations	164,647	-	-	164,647
Long-term obligations	567,037	796,314		1,363,351
Finance lease obligations	581	64		645

	< 1 year	1–5 years	> 5 years	Total
As of December 312004:				
Fixed rate				
Short-term obligations	165,562	-	-	165,562
Long-term obligations	21,532	766,257	206,994	994,783
Finance lease obligations	31,969	63,264		95,233

31. Financial Instruments and risk management objectives and policies

Interest rate risk (continued)

Interest on financial instruments classified as fixed rate is fixed until maturity of the instrument. Other financial instruments of the Company not specified in the table above are interest-free and as such are not subject to interest rate risk.

The Company has no significant interest-bearing assets other than those shown in the table above.

Credit Risk

Credit risk is the risk that a counter-party will fail to discharge an obligation and cause the Company to incur a financial loss.

Financial assets which are potentially subject to credit risk consist principally of trade receivables. The carrying amount of accounts receivable net of provision for impairment of receivables represents the maximum amount exposed to credit risk.

The Company has no significant concentrations of credit risk due to significance of the client base and regular monitoring procedures over customers' and other debtors' ability to pay debts. A part of accounts receivable is represented by debts of state and other non-commercial organizations. Recovery of these debts is influenced by political and economic factors however management believes that as of December 31 2005 there is no significant risk of loss to the Company beyond the provision already recorded.

The Company places cash on bank accounts in a number of Russian commercial financial institutions. Insurance of bank accounts is not provided by financial institutions operating in Russia. To manage credit risk the Company places cash in different financial institutions and the Company's management analyzes risk of default of these financial institutions on a regular basis.

Fair Value

Fair value of a financial instrument is the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction (except for forced sale or liquidation). Market prices are considered to be the best evidence of fair value.

Book value of monetary assets and liabilities are approximately equal to their Fair value balance sheet lines denominated in foreign currency were translated into Roubles using appropriate exchange rates at the end of reporting period.

Book value of cash and cash equivalents is approximately equal to their fair value because of short-term nature and minimal credit risks.

32. Subsequent Events

New provisions of the Federal Law on Communications

The legislative framework for the reform of the Russian telecommunications industry is the Federal Law on Communications of 2004. To implement the Federal Law on Communications the Russian Government approved new rules and regulations for the interconnection and interaction of telecommunications networks for the provision of local intra-regional DLD and ILD telephone services and other regulations for the provision of long-distance services including licensing requirements for telecommunications operators. The transition to the new system of interaction on January 1 2006 stems from these new requirements under Russian legislation.

New regulations required in pursuance of the Federal Law on Communications come into force starting January 1 2006:

1. Decision of the Government of the Russian Federation No. 161 of March 28 2005 on endorsing the Rules for connecting electric communication networks and for their interaction (with Amendments and Addenda of June 30 December 29 2005)
2. Decision of the Government of the Russian Federation No. 310 of May 18 2005 on the approval of Rules for Rendering Services of Local Intra-Zone Inter-City and International Telephone Communication (approved by Decision of the Government of the Russian Federation No. 310 of May 18 2005 with the Amendments and Additions of June 30 December 29 2005).
3. Decision of the Government of the Russian Federation No. 242 of April 21 2005 on the approval of the Rules for state regulation of tariffs on universal communications services (with the amendments and additions of October 24 2005)
4. Order of the Ministry of Communications No. 97 of August 8 2005 on Approval of the requirements to public switched telephone networks.
5. Order of the Ministry of Communications No. 98 of August 8 2005 on Approval of the requirements to traffic transmission in public switched telephone networks.

Changes in settlements with OJSC “Rostelecom” in 2006

Prior to January 1 2006 the Company in accordance with the terms of its Addendum #1 to license for telecommunication services rendered domestic long-distance (DLD) and international long-distance (ILD) services (“long-distance services”) to its customers. Revenues and receivables from rendering of the services were recognized as the Company’s revenues and receivables.

Under the previous system of interaction with operators OJSC “Rostelecom” provided long-distance traffic transit services to the Company. The Company independently billed for long-distance services provided to its local network subscribers through its own subscriber billing systems. The Company settled with Rostelecom for long-distance call transit and termination services and Rostelecom in turn paid the Company for call termination services. The Company performed settlements for international telecommunications services with subscribers by tariffs set by OJSC “Rostelecom” and settlements for intercity telecommunications services by tariffs set by the Federal Antimonopoly Agency.

Starting from 2006 the settlements between the Company and OJSC “Rostelecom” changed. Domestic long-distance (DLD) and international long-distance (ILD) services will be rendered by OJSC “Rostelecom”. Revenues and receivables from rendering of the services will be recognized as OJSC “Rostelecom” revenues and receivables.

32. Subsequent Events

Changes in settlements with OJSC "Rostelecom" in 2006 (continued)

The Company and OJSC "Rostelecom" signed an agreement for the year 2006 combining elements as of an agency agreement as well as of a service contract according to which the Company undertakes rendering the following services to OJSC "Rostelecom":

- Subscriber orders' processing services for access to intercity and international telecommunications services provided through the direct and delay operations.
- Billing processing services for intercity and international telecommunications services.
- Preparation formation and storage of necessary data and reports;
- Agency services on collection of payments from subscribers and on call center support in the name and on behalf of OJSC "Rostelecom"
- Claims administration documents delivery.

In addition to the above mentioned contract the parties signed the agreement on network interconnections under which the Company provides OJSC "Rostelecom" the services on traffic transmission and OJSC "Rostelecom" provides the Company connection services.

To comply with the new regulatory requirements the Company must fulfill a number of conditions including:

- technical conformity of its network to requirements set for DLD and ILD communication networks including availability of interconnection points to its network in every federal administrative region of the Russian Federation;
- operational readiness to provide long-distance services to any local network subscriber.

Management believes that fulfillment of these requirements would not lead to additional capital expenditure of the Company as major necessary capital expenditure was made in 2005.

Changes in settlements with interconnected operators

New legislative pronouncements effective January 1 2006 significantly changed the scheme of settlements with interconnected operators.

Prior to January 1 2006 settlements for interconnection services with the operators for local telephone services were of unilateral nature and for intra-regional DLD and ILD telephone services interconnected operators received a part of the revenues from such services depending on the degree of their participation in the provision of a service.

Starting from January 1 2006 settlements are of a mutual nature and consist of the following:

- point of connection set up;
- user fee for point of connection;
- fee per minute of traffic submitted through the network.

The changes will result in additional revenues from interconnection and traffic transmission as well as in additional costs related to payments to these operators for connection points set up user fee and traffic transmission in the operators' network.

32. Subsequent Events

Changes in settlements with interconnected operators (continued)

Currently the Company is undertaking the necessary renegotiation procedures with interconnection operators. The Company expects to finalize these procedures in June 2006.

Interconnection services are currently included into services regulated by the Government. As a consequence the interconnection fee including the profitability level is to be prescribed by the regulating body.

Cancellation of charges for incoming calls

In March 2006 an amendment to the Federal Law on Communication was approved by the President. According to this amendment effective July 1st 2006 the subscriber will not pay for a telephone connection established as a result of a call initiated by another subscriber except for the cases specifically mentioned in the Federal Law on Communication.

This change would mainly affect the settlements between the Company and mobile network operators.

Starting from the enforcement of this amendment the Federal Service on Tariffs will set tariffs for intra-regional services between the Company as a significant operator and mobile network operators. Subsequent to that the Company would renegotiate the agreements with these operators.

The Company envisages increase in revenues from intra-regional services in the second half of 2006 and increase in costs related to calls termination on mobile networks.

Impact of new rules for rendering of telecommunication services on financial statements

The Company's management expects that new rules of provision of telecommunication services will influence both revenues and expenses of the Company however the Company cannot reliably measure the effect of such changes on the financial position and financial results of the Company.

Value Added Tax

Federal Law No. 119-FZ dated July 22 2005 introduced amendments to the Tax Code effective January 1 2006. According to these amended provisions VAT taxable base on sales of goods (rendering of services) is determined at the earliest of:

date of goods (services) shipment (rendering);

date of payment (partial payment) for subsequent delivery of goods (services) transfer of rights of ownership.

Bonds issue

On December 29 2005 the Board of Directors approved the issue of 700,000 interest-bearing inconvertible bonds with par value 1 thousand Roubles each repayable to bearer. The bonds have 12 quarterly coupons. Coupon payments are made on each 91 day starting from the date of placement. The interest rate was determined based on tender and amounted to 9.75%. The bonds mature on 1092th day starting from the date of issue.

On April 5 2006 the Company placed the above bond issue in public subscription.

32. Subsequent Events (continued)

Loan agreements

On February 20 2006 OJSC “Central Telegraph” concluded loan agreement with Sberbank RF (Lefortovskoye branch) for the total amount of 150,000. Loan repayment date is 18 August 2006. The interest rate on loan is 68%. The loan is given without pledge of property.

On February 1 2006 the Company concluded additional agreement for credit line with AKB Promsvyazbank OJSC with credit limit of 30,000. Loan repayment date is 31 July 2006. The interest rate on loan is 9%. The loan is given without pledge of property.

Operations with CJSC Telegraph

On April 5 2006 the Court of Appeal rejected the Company’s claim to recover its property (see Note 7). New hearing of the case on recovery of the property which was unlawfully put in the possession of others in the court of higher instance is scheduled on June 20 2006.
There is uncertainty as to legal proceedings in respect of the real estate located at 7 Tverskaya St. in Moscow. In case of an adverse outcome the value of the Company’s financial investments into CJSC Telegraph may become fully or partially impaired.

Claims of tax authorities

In accordance with decree №20-3П as of 1 April 2006 Tax inspection required the Company to pay back taxes in the amount of 3,168. The Company paid the required taxes. OJSC “Central Telegraph” filed a lawsuit seeking relief from the decision. Management believes that it is highly probable that the Company will prevail in court.