Open Joint Stock Company “Dalsvyaz”

Consolidated Financial Statements
as of December 31, 2003

with Report of Independent Auditors

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Consolidated Financial Statements

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Contents

Independent Auditors' Report

To the Shareholders and Board of Directors of OAO "Dalsvyaz"

1. We have audited the accompanying consolidated balance sheet of OAO "Dalsvyaz" (a Russian open joint-stock company - hereinafter "the Company"), as of December 31, 2003, and the related consolidated statements of operations, cash flows and 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 paragraph 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 26 "Pension Plans and Employee Benefits", the Company has not determined and presented its obligations existing under defined benefits plans in accordance with International Accounting Standard ("IAS") 19, "Employee Benefits". We were not able to quantify the adjustments, if any, to the financial statements. This matter caused us to qualify our audit opinion on the financial statements for the year ended December 31, 2002.

4. As described in Note 10 "Property, Plant and Equipment", the Company's accounting records relating to fixed assets are not designed to support their presentation in accordance with IAS 16, "Property, Plant and Equipment", IAS 29, "Financial Reporting in Hyperinflationary Economies" and IAS 36, "Impairment of Assets". As such, certain estimates were made by management to present fixed assets in the accompanying financial statements. Owing to the nature of the Company's records, we were unable to satisfy ourselves as to the adjustments, if any, which might have been determined to be necessary had additional evidence been available to better analyze the assumptions and estimates made by management. This matter caused us to qualify our audit opinion on the financial statements for the year ended December 31, 2002.

5. As a result of the matters described in paragraphs 3 and 4 above, adjustments, if any, could materially affect (i) property, plant and equipment, equipment contributions, assets and liabilities existing under defined benefits plans, deferred income taxes, and retained earnings as of December 31, 2003 and the corresponding amounts of depreciation expense, wages, salaries, other benefits and payroll taxes, income tax expense and net income for the year ended December 31, 2003 and (ii) related disclosures.

6. In our opinion, except for the effects on the financial statements of such adjustments, if any, from the matters referred to in paragraphs 3 and 4, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO “Dalsvyaz” as of December 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

7. Without further qualifying our opinion, we draw attention to Note 1 “General Information” to the consolidated financial statements which discloses that the current liabilities of OAO “Dalsvyaz” exceeded its current assets by 504,005 thousand Rubles as of December 31, 2003. Management’s plans in regard to this matter are also described in Note 1 “General Information”.

8. As described in Note 1 “General Information”, the Company was the subject of a reorganization that was approved by the shareholders on December 21, 2001. The Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, “Business Combinations”. In applying this method, the Company has reflected amounts in the financial statements as if the entities had been combined from January 1, 2002, the earliest period presented.

August 13, 2004

OAO “Dalsvyaz”

Consolidated Balance Sheet

As of December 31, 2003

(in thousand rubles)

	Note	December 31, 2003	December 31, 2002 as restated
ASSETS			
Non-current Assets:			
Property, Plant and Equipment	**10**	**8,259,594**	7,369,264
Intangible Assets	**11**	**256,910**	13,164
Investments in Associates	**13**	**346,765**	129,018
Other Long-term Investments	**14**	**9,557**	10,292
Other Financial Assets	**18**	**13,762**	1,477
Advances to Suppliers of Equipment	**15**	**233,274**	45,464
Total Non-current Assets		**9,119,862**	7,568,679
Current Assets:			
Inventories, net	**16**	**252,391**	240,001
Trade Accounts Receivable, net	**17**	**470,091**	317,770
Short-term Investments	**14**	**3,215**	–
Other Current Assets	**19**	**450,134**	348,176
Cash and Cash Equivalents	**20**	**140,110**	99,585
Total Current Assets		**1,315,941**	1,005,532
TOTAL ASSETS		**10,435,803**	8,574,211
SHAREHOLDERS’ EQUITY AND LIABILITIES			
Shareholders’ Equity:			
Preference Shares	**21**	**311,689**	311,689
Ordinary Shares	**21**	**955,814**	955,814
Inflation Impact on Share Capital		**1,830,700**	1,830,700
Retained Earnings and Other Reserves		**2,949,370**	2,803,450
Total Shareholders’ Equity		**6,047,573**	5,901,653
Commitments and Contingencies	**27**	**–**	–
Minority Interest		**91**	–
Non-current Liabilities:			
Long-term Loans and Borrowings	**22**	**1,119,850**	110,642
Long-term Finance Lease Obligations	**23**	**607,743**	106,631
Equipment Contributions		**99,415**	93,180
Deferred Income Tax Liability	**7**	**705,185**	712,394
Other Non-current Liabilities		**36,000**	41,113
Total Non-current Liabilities		**2,568,193**	1,063,960
Current Liabilities:			
Trade Accounts Payable and Accrued Liabilities	**24**	**842,583**	731,704
Payables to Rostelecom		**143,918**	109,878
Taxes and Payroll Related Obligations	**25**	**295,715**	288,146
Dividends Payable		**33,693**	29,071
Short-term Loans and Borrowings	**22**	**132,313**	150,433
Current Portion of Long-term Loans and Borrowings	**22**	**124,320**	227,649
Current Portion of Finance Lease Obligations	**23**	**247,404**	71,717
Total Current Liabilities		**1,819,946**	1,608,598
Total Shareholders’ Equity and Liabilities		**10,435,803**	8,574,211

OAO "Dalsvyaz"

Consolidated Statement of Cash Flows

For the year ended December 31, 2003

(in thousand rubles)

	2003	2002 as restated
Cash flows from operating activities:		
Income before taxation and minority interest	**336,633**	318,189
Adjustments to reconcile income (loss) to cash generated from operations:		
Foreign currency exchange loss, net	**10,038**	67,767
Net monetary gain	**–**	(70,479)
Depreciation and amortization	**708,475**	651,319
Loss on disposal of property, plant and equipment	**34,614**	24,653
(Income) from investments in associates	**(217,747)**	(46,665)
Interest expense, net	**106,134**	83,275
Bad debt expense	**125,720**	61,540
Inventory obsolescence reserve	**–**	1,073
Loss from other investments	**578**	1,585
Other non-cash items	**(7,770)**	(47,760)
Operating profit before changes in working capital	**1,096,675**	1,044,497
Increase in trade accounts receivable	**(278,041)**	(83,592)
Increase in other current assets	**(66,681)**	(70,014)
(Increase) decrease in inventories	**(12,390)**	4,432
Increase (decrease) in accounts payable and accrued liabilities	**127,242**	(60,230)
Increase in taxes and payroll related obligations	**23,423**	114,182
Cash flows generated from operations	**890,228**	949,275
Interest paid	**(53,059)**	(52,988)
Income tax paid	**(200,206)**	(175,555)
Interest received	**1,077**	417
Net cash flows provided by operating activities	**638,040**	721,149
Cash flows from investing activities:		
Purchase of property, plant and equipment	**(927,523)**	(491,958)
Purchase of intangible assets	**(248,738)**	(10,871)
Proceeds from sales of property, plant and equipment	**3,023**	–
Loans granted	**(9,481)**	–
Dividends received	**645**	1,515
Net cash flows used in investing activities	**(1,182,074)**	(501,314)
Cash flows from financing activities		
Proceeds from borrowings	**1,438,055**	355,265
Repayment of borrowings	**(1,273,864)**	(338,244)
Proceeds from debt securities issued	**1,000,000**	–
Repayment of finance lease obligations	**(232,586)**	(114,893)
Repayment of vendor financing obligations	**(294,324)**	(42,149)
Repayment of other non-current liabilities	**(5,113)**	(3,922)
Dividends paid	**(43,507)**	(46,866)
Net cash flows from (used in) financing activities	**588,661**	(190,809)
Monetary effects on cash and cash equivalents	**–**	(14,192)
Effects of exchange rate changes on cash and cash equivalents	**(4,102)**	–
Increase in cash and cash equivalents	**40,525**	14,834
Cash and cash equivalents at the beginning of the year	**99,585**	84,751
Cash and cash equivalents at the end of the year	**140,110**	99,585
Non-monetary operations:		
Property, plant and equipment acquired through vendor financing	**–**	–
Property, plant and equipment acquired under lease agreements	**835,965**	271,991
Equipment contributions	**16,755**	21,767

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

OAO “Dalsvyaz”

Consolidated Statement of Operations

For the year ended December 31, 2003

(in thousand rubles)

	Note	2003	2002 as restated
Revenues	**4**	**6,887,446**	5,665,594
Operating Expenses			
Wages, Salaries, Other Benefits and Payroll Taxes		**(3,010,095)**	(2,386,497)
Depreciation and Amortization		**(708,475)**	(651,319)
Materials, Repairs and Maintenance, Utilities		**(816,516)**	(702,820)
Taxes Other than Income Tax		**(100,739)**	(167,601)
Interconnection Charges		**(1,166,968)**	(841,121)
Bad Debts Expense		**(125,720)**	(61,540)
Loss on Disposal of Property, Plant and Equipment		**(34,614)**	(24,653)
Other Operating Expenses	**5**	**(651,346)**	(476,458)
Total Operating Expenses		**(6,614,473)**	(5,312,009)
Operating Income		**272,973**	353,585
Income from Associates		**217,747**	46,665
Interest Expenses, net	**6**	**(106,134)**	(83,275)
Other Expenses, net		**(37,915)**	(1,498)
Foreign Exchange Loss, net		**(10,038)**	(67,767)
Net Monetary Gain		**–**	70,479
Income before Taxation and Minority Interest		**336,633**	318,189
Income Tax Expense	**7**	**(140,620)**	(244,457)
Income before Minority Interest		**196,013**	73,732
Minority Interest		**(91)**	–
Net Income		**195,922**	73,732
Dividends on Preference Shares	**9**	**(22,753)**	(18,078)
Net Income Attributable to Ordinary Shareholders		**173,169**	55,654
Basic and Diluted Earnings per Share (Russian Rubles)	**8**	**1.81**	0.58

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

OAO “Dalsvyaz”

Consolidated Statement of Changes in Shareholders’ Equity

As of December 31, 2003

(in thousand rubles)

	Notes	Share Capital		Inflation impact on share capital	Retained earnings and other reserves	Total Shareholders’ equity
		Preference shares	Ordinary shares			
At December 31, 2001 as restated	**2**	311,689	955,814	1,830,700	2,773,268	5,871,471
Net income for the year		–	–	–	73,732	73,732
Dividends		–	–	–	(43,550)	(43,550)
At December 31, 2002 as restated		311,689	955,814	1,830,700	2,803,450	5,901,653
Net income for the year		**–**	**–**	**–**	**195,922**	**195,922**
Dividends	**9**	**–**	**–**	**–**	**(52,383)**	**(52,383)**
Change in the fair value of financial assets available-for-sale		**–**	**–**	**–**	**2,381**	**2,381**
At December 31, 2003		**311,689**	**955,814**	**1,830,700**	**2,949,370**	**6,047,573**

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

(in thousand rubles, unless otherwise stated)

1. General Information

Authorization of Accounts

The consolidated financial statements of OAO “Dalsyaz” and its 60% subsidiary – ZAO “Sotovye Sety Birobidjana” (hereinafter “the Company”) for the year ended December 31, 2003 were authorized for issue by its appointed General Director and Chief Accountant of the Company on August 13, 2004.

The Company

The Company is an open joint stock company incorporated in accordance with the laws of the Russian Federation.

Open joint-stock company “Svyazinvest” (OAO “Svyazinvest”), a federal holding company majority-owned by the Russian Federation, owns 51% of the Company’s ordinary shares as of December 31, 2003.

The Company’s principal activities are providing telephone services (including local, long-distance and international calls), telegraph, data transfer services, rent of channels and wireless communication services on the territory of Far East region of Russian Federation.

The average number of employees in the Company in 2003 was approximately 18,914 persons (in 2002 – 20,073).

The registered office of the Company is in the city of Vladivostok (the Russian Federation), Svetlanskaya st. 47.

2002 Reorganization

In 2001 the Company’s management started the reorganization by obtaining shareholder approval to merge the following regional enterprises of OAO “Svyazinvest” wherein 62,062,396 ordinary and 19,995,626 preferred shares of the Company were exchanged for 100% of the outstanding voting shares of the regional enterprises as follows:

Regional Enterprise	Ordinary shares issued by the Company	Preferred shares issued by the Company	Exchange Ratio
OAO “Electrosvyaz of Khabarovsk region”	18,534,423	6,178,141	6.10
OAO “Sakhalinsvyaz”	14,559,239	4,149,114	195.51
OAO “Kamchatsvyazinform”	12,188,544	4,062,848	75.06
OAO “Amursvyaz”	8,754,631	2,930,364	168.79
OAO “Magadansvyazinform”	5,933,493	1,977,831	1.53
OAO “Telegraphno-telephonnaya Company”	2,092,066	697,328	8.20
Total	**62,062,396**	**19,995,626**	

The merger was completed and effective on September 30, 2002. Transaction costs related to the merger of 18,527 were expensed in 2002.

1. General Information (continued)

2002 Reorganization (continued)

While International Financial Reporting Standards do not specify accounting principles to be applied to transactions among entities under common control, the Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, "Business Combinations". In applying this method, the Company has reflected amounts in the financial statements at their historical carrying amounts as if the entities had been combined from January 1, 2002, the beginning of the earliest period presented. Unless otherwise described, all information presented in these financial statements gives retroactive effective to the reorganization.

Liquidity and Financial Resources

As of December 31, 2003, the Company's current liabilities exceeded its current assets by approximately 504,005 (2002 – 603,066). As a result, significant uncertainties exist as to the Company's liquidity and future capital resources.

Primarily due to ongoing investments in maintenance and construction programs (construction of multi service telecommunication network, satellite network for data transfer activities and expansion of existing fiber-optic networks), the Company requires cash flows from operations, debt and other long-term financing resources, including hard currency borrowings for which no commercially viable hedging instruments are available.

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 and vendor financing.

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

Through 2004, the Company anticipates funding from: a) existing cash reserves, b) cash generated from operations, c) sale of investments (see Note 30 "Subsequent events"), and d) other financing from domestic and international lending institutions. Management also expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

The accompanying 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 should 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 and had problems with regard to timely settlement of its short-term liabilities and short-term portion of long-term liabilities when they became due.

2. Summary of Significant Accounting Policies

Basis of Preparation

The Company maintains its accounting records and prepares its statutory accounting reports in Russian Rubles and in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying consolidated financial statements presented in accordance with International Financial Reporting Standards (IFRS) are based upon the statutory accounting records that are maintained in accordance with the Russian accounting regulations under the historical cost convention. These statutory accounting records have been adjusted and reclassified to present the accompanying consolidated financial statements in accordance with IFRS. IFRS primarily includes standards and interpretations approved by the International Accounting Standards Board (IASB), International Accounting Standards Committee (IASC) and Standing Interpretations Committee (SIC).

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of 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.

Prior Period Adjustments and Reclassifications

Management of the Company chose to restate the financial position for the year ended December 31, 2002 for a previously unrecorded adjustment. This adjustment relates to invoices for interconnection services. These amounts had previously been reflected in the period invoiced. The effect of this adjustment, along with adjustment of dividends on preferred shares, on previously reported amounts is as follows:

	As previously reported	As restated
Shareholder's Equity, January 1, 2002	5,945,948	5,871,471
Net Income	73,732	73,732
Shareholder's Equity, December 31, 2002	5,970,624	5,901,653
Basic and Diluted Earnings per Share	0.50	0.58

Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary drawn up to December 31, 2003 and 2002.

The Company has accounted for the reorganization (see Note 1 "General Information") based on the principles of uniting of interests as described in IAS 22 "Business Combinations".

Subsidiary is consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred from the Company. Minority interests reflect the interests in subsidiary not held by the Company (see Note 12 "Investments in Subsidiary").

2. Summary of Significant Accounting Policies (continued)

Subsidiaries

A subsidiary is an entity that is controlled by the Company, directly or indirectly, generally through ownership of more than 50% of the voting share capital of the entity. These consolidated financial statements include the assets and liabilities, and revenues and expenses of the Company and of subsidiary undertakings, on a line-by-line basis.

Where subsidiaries are not controlled throughout the year, consolidated results include the results of those entities for that part of the year during which control existed, except where the Company has applied the uniting of interests method in accordance with IAS 22 “Business Combination”. Under the uniting of interests method, the financial statement items of the combining entities for the period in which the combination occurs are included in the consolidated financial statements as if they had been combined from the beginning of the first period presented.

Where the purchase method is applied to account for the acquisition of subsidiaries, identifiable assets and liabilities of subsidiaries are stated at their fair value as of the acquisition date. Minority interest at the date of acquisition is determined in proportion to minority shareholders’ share in the fair value of the assets and liabilities of the subsidiary at that date. The share of minority shareholders is estimated on the basis of the common voting shares and preferred shares owned by shareholders that do not exercise control over the subsidiary.

Balances and transactions between the Company and subsidiary, as well as any income from intercompany transactions are eliminated. Income (loss) from intercompany transactions is identified and eliminated only in cases where the assets transferred under relevant transactions have not been sold to third parties (i.e. non-Company entities) and are carried in the balance sheet of a Company entity as of the balance sheet date.

Associates

An associate is an entity in which the Company has significant influence, which is usually demonstrated by the Company owning between 20% and 50% of the voting share capital.

Under the equity method, the investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Company’s share of net assets of the associates, less any impairment in value. The income statement reflects the Company’s share of the results of operations of the associates.

Unrealized gains and losses arising from transactions with associates are eliminated in proportion to the Company’s interest in the associates by adjusting the book value of investments.

Goodwill

For investments in subsidiaries and associates, any excess of the cost of acquisition over the Company’s share in the fair value of net identifiable assets and liabilities of the acquired entity is recognized as goodwill. Goodwill is amortized on a straight-line basis over its useful life, which according to management’s expectations is approximately 5 years. It is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is stated at cost less accumulated amortization and any impairment in value.

2. Summary of Significant Accounting Policies (continued)

Goodwill (continued)

Goodwill on acquisition of associates is included in the carrying amount of investments in associates.

Upon disposal of investments in a subsidiary or an associate the remaining balance of unamortized goodwill is taken to gains or losses from such disposal.

Accounting for the Effects of Inflation

In 2000 – 2002 the Russian Federation met the definition of a hyperinflationary economy, as defined by International Accounting Standard 29 “Financial Reporting in Hyperinflationary Economies” (IAS 29). The inflation rate based on the Russian consumer price index (“CPI”), as calculated by the State Committee on Statistics (Goskomstat), was 15.1% for 2002 (18.6% and 20.2% for 2001 and 2000, respectively). Although the cumulative inflation index for the three-year period ended in 2002 was less than 100%, it was considered that the remaining criteria set forth by IAS 29 indicated that the Russian Federation continued to experience conditions that meet the definition of a hyperinflationary economy during 2002.

IAS 29 requires that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. In applying IAS 29, the Company used conversion factors derived from the Russian CPI.

The indices used to adjust amounts in these consolidated financial statements with respect to 2002 prices (2002 = 1.0) for the years ended December 31, and the respective conversion factors, are:

Year	Index	Conversion factor
1992	7,541	362.4
1993	67,846	40.3
1994	211,612	12.9
1995	487,575	5.6
1996	594,110	4.6
1997	659,403	4.1
1998	1,216,401	2.2
1999	1,663,091	1.6
2000	1,997,843	1.4
2001	2,374,037	1.2
2002	2,733,087	1.0

The main guidelines followed in adjusting the consolidated financial statements as of December 31, 2002 to current purchasing power at December 31, 2002 are:

- all amounts are stated in terms of the measuring unit current at December 31, 2002;
- monetary assets and liabilities are not restated as they are already expressed in terms of the monetary unit current at December 31, 2002;
- non-monetary assets and liabilities which are not carried at amounts current at December 31, 2002 and shareholders’ equity are restated by applying the relevant conversion factors;
- indexation adjustments to property, plant and equipment applicable to prior periods are credited to “Retained earnings and other reserves” in the accompanying balance sheet;

2. Summary of Significant Accounting Policies (continued)

Accounting for the Effects of Inflation (continued)

- all items in the consolidated statements of income and of cash flows are adjusted by applying appropriate conversion factors with the exception of depreciation, amortization and losses from disposal of fixed assets and other assets;
- the effect of inflation on the Company’s net monetary position is included in the consolidated statement of operations as a monetary gain.

Effective from January 1, 2003, international accounting and financial reporting bodies have determined that the Russian Federation no longer meets the criteria of IAS 29 for hyperinflation. Beginning 2003, the Company ceased applying IAS 29 and only recognizes the cumulative impact of inflation indexing through December 31, 2002, on non-monetary elements of the financial statements. Transactions undertaken subsequent to December 31, 2002 are reported at actual, nominal amounts except for those involving non-monetary assets and liabilities acquired prior to January 1, 2003. Results of operations (including gains and losses on disposal) involving such assets and liabilities are recognized based on the “restated cost”, which was calculated by applying through December 31, 2002 the relevant conversion factors to the carrying values of these assets and liabilities.

Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currency are translated into Rubles at official Central Bank of the Russian Federation (CBR) exchange rates at the year-end. Transactions denominated in foreign currencies are reported at the CBR rates of exchange at the date of the transaction. Any gains or losses on assets and liabilities denominated in foreign currencies arising from a change in official exchange rates after the date of transaction are recognized as currency translation gains or losses.

Transactions that are conducted in Rubles when the related assets and liabilities are denominated in foreign currencies (or conventional units) are recorded in the Company’s consolidated financial statements on the same principles as transactions denominated in foreign currencies.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of each group of assets as follows:

Buildings	45 years
Constructions	20 years
Switches	15 years
Transmission devices	10 years
Computers	5 years
Transport	5 years
Other	3 years

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

For the purpose of disclosure, Property, Plan and Equipment are aggregated into the following groups:

- Buildings and constructions;
- Switches and transmission devices;
- Machines and other, in which computers, transport fixed assets and other items are included.

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. 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.

Construction in progress is recorded as the total of actual expenses incurred by the Company from the beginning of construction to the reporting date, adjusted for the effect of inflation (for periods prior to January 1, 2003) from the date when such expenses occur to the reporting date in accordance with IAS 29. Accrual of depreciation begins when fixed assets are put into operation.

Borrowing costs that are attributable to the acquisition or construction of fixed assets are capitalized as part of the cost of the related asset when it is probable that they will result in future economic benefits to the Company and the costs can be measured reliably. Capitalization of borrowing costs commences with the beginning of activities to prepare the asset for intended use and lasts until the assets are ready for their intended use.

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. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of operations.

The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense. Renewals and betterments are capitalized. Upon the sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

Equipment Contributions and Government Grants

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, and a corresponding deferred income is recognized as a liability in the balance sheet and credited to the statement of operations on the same basis as the equipment is depreciated.

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

2. Summary of Significant Accounting Policies (continued)

Equipment Contributions and Government Grants (continued)

Grants received from municipal authorities for the purchase of property, plant and equipment are reflected in the balance sheet as deferred income and recognized as income during the useful life of the respective asset in accordance with IAS 20 "Accounting for Government Grants and Disclosure of Government Aid Information".

When the grants relates to an income item, it is recognized as income over the periods necessary to match the grant on a systematic basis to the cost that it is intended to compensate.

Intangible Assets

Intangible assets acquired separately from the business are capitalized at cost. Intangible assets acquired as part of an acquisition of a business are capitalized separately from goodwill if the fair value can be measured reliably, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, created within the business are not capitalized and expenditure is charged against profits in the year in which it is incurred.

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Research and Development Costs

Research and development costs are expensed as incurred.

Investments

Financial investments include the following three categories: held-to-maturity investments, investments available-for-sale and investments held for trading.

All investments are initially recognized at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

After initial recognition, investments that are classified as held for trading are measured at their fair value. Gains or losses on trading securities are recognized in the income statement and included into income (loss) from financial investments.

Investments that are intended to be held to maturity, that have fixed maturity, being initially recorded at cost, are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. For investments carried at amortized cost, gains and losses are recognized in income when the investments are derecognized or impaired, as well as through the amortization process. Those that do not have a fixed maturity are measured at cost.

After initial recognition, investments that are classified as available-for-sale are measured at their fair value. Gains or losses on available-for-sale investments are recognized as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income.

2. Summary of Significant Accounting Policies (continued)

Other Financial Assets

Other Financial Assets consist of Long-term Accounts Receivable, Long-term Loans Granted to personnel and other financial assets. They are accounted at amortized cost using the effective interest rate.

Inventories

Inventories, which are mainly comprised of cable, materials, spare parts for telecommunications equipment and goods for resale, are priced at the lower of cost or net realizable value. Cost is determined using the average cost method.

Transportation, insurance and other similar expenditures incurred to bring inventories to their existing condition and location are included into the cost of raw materials and goods for resale.

Accounts Receivable

Accounts receivable are stated at face value, less an allowance for doubtful accounts. An estimate of doubtful debts is made when collection of the full amount is no longer probable.

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.

Interest-Bearing Loans and Borrowings

All interest-bearing loans and borrowings are initially recognized at cost of consideration received. After initial recognition, interest-bearing loans and borrowings are subsequently measured at cost plus accrued interest calculated using the effective interest rate method.

Non Interest-Bearing Loans and Borrowings

The initial recognition of non interest-bearing loans and borrowings and equipment received per non-interest-bearing loans and borrowings are made at their fair market value estimated by discounting future payments to their present value. Market interest rates are approximated by using the prevailing rates of return for Company's financial instruments having substantially the same terms and characteristics. The subsequent measurement of interest-bearing loans and borrowings are carried at amortized cost using the effective interest rate method.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, settlement of the obligation will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. If the effect of the 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 an interest expense.

2. Summary of Significant Accounting Policies (continued)

Pensions and Other Post-Employment Benefits

State Plans

Social contributions are made through a unified social tax ("UST") calculated by the Company by the application of a regressive rate (from 35.6% to approximately 18 %) 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 28% 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.

Other pension and post-retirement benefits

Under collective bargaining agreements, the Company also provides post-employment retirement benefits by using defined contribution plans and defined benefit plans. The majority of the Company's employees are eligible to participate under defined benefit plans based upon a number of factors, including years of service, age and compensation.

A defined contribution plan is a post-employment benefit plan under which the Company's liability is limited solely to the amount of a contribution it agrees to pay into a fund. In this case all actuarial and investment risks will be borne by employees. The Company recognizes contributions under a defined contribution plan in the period to which they are attributable.

Under defined benefit plans, the Company's obligation is to provide the agreed benefits to current and former employees whereby actuarial and investment risks fall, in essence, on the Company.

Leases

Finance leases of equipment that transfer substantially all the risks and rewards incidental to ownership of the leased item to the Company are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to interest expense.

Capitalized leased assets are depreciated using the straight-line method over the estimated economic useful life of the asset as for own assets within the same class, with consideration of the contractual terms the assets can be used.

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the statement of operations on a straight-line basis over the lease term.

2. Summary of Significant Accounting Policies (continued)

Revenue

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

The Company categorizes the revenue sources in thirteen major categories:

1. Long distance telephone services - domestic;
2. Long distance telephone services - international;
3. Local telephone services;
4. Installation and connecting fees;
5. Documentary services;
6. Mobile telecommunication services;
7. Radio and TV broadcasting;
8. Data transfer and telematic services;
9. New services;
10. Rent of telephone channels;
11. Revenue from national telephone operators;
12. Other telecommunications services;
13. Other revenues.

Long distance telephone services (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. 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 services

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. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

Installation and connecting fees

The Company recognizes installation and connecting fees for indefinite contracts with its subscribers as revenues when the installation and connection are complete.

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.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Mobile telecommunication services

Major revenues from cellular services arise from airtime services including local, intercity long distance and international long distance calls, subscription fees, value added services, outbound and inbound roaming. The Company recognizes revenues related to mobile telecommunications services in the period when the services are rendered.

Radio and TV broadcasting

The Company maintains a wireline radio broadcasting network. The revenues comprise monthly fees from subscribers and installation fees for wireline radio sets. The Company recognizes the revenues related to radio broadcasting in the period when the services are rendered.

Data transfer and telematic services

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

New services

Major revenues from new services include internet services, ISDN, 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.

Revenue from national telephone operators

Revenue from national service providers includes two different groups.

The first group of revenues represents services rendered to OAO “Rostelecom” for termination of long-distance traffic of its operators-partners in the network of the Company.

In 2003 the Ministry of the Russian Federation for Antimonopoly Policy and Entrepreneurial Support (MAP) has conducted a reform of the settlements system of multi regional OAO “Svyazinvest” companies with OAO “Rostelecom” for transit of intercity long-distance traffic. Till August 1, 2003 the revenue calculation had been based on the integral settlement rate, multiplied by the total number of minute-distances (transfer of 1 minute of traffic on 50 kilometer intervals of OAO “Rostelecom” network), transferred through the period.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Revenue from national telephone operators (continued)

Integral settlement rate has been calculated as the sum of linear settlement rate between zones and difference between inbound and outbound termination settlement rates of the regional companies. The rate has been calculated and agreed by the MAP once per year according to traffic statistics of the previous year, thus it has not reflected real economical benefits and costs related to changes of the incoming and outgoing structure of the traffic in the current settlement period.

In August 2003 a new and more transparent inter-operators settlement system for intercity traffic has been introduced. The new system separates (i) payments of regional operators for the transfer of intercity traffic in OAO “Rostelecom”’s network and termination of the traffic in the zone, where outgoing intercity calls of its own subscriber reaches its destination, and (ii) payments for the termination of the incoming intercity traffic from other operators in the network of the Company.

Calculation of the costs for the transit of intercity traffic is based on the new settlement rate, that is equal to the sum of linear settlement rate multiplied by the quantity of 50 kilometer intervals between zones, using the termination settlement rate for the zone where the calls are terminated. Revenue calculation for the transit of intercity traffic from the OAO “Rostelecom” to the customers of the regional telecommunication companies is based on the termination settlement rates. New rates have been defined by the order of the MAP dated July 4, 2003.

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 the Company’s network.

Major revenues are recognized from the services for transit of local, intercity and international traffic and interconnection to the network (one time fees).

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

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. 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.

2. Summary of Significant Accounting Policies (continued)

Income Tax

Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 “Income Taxes”.

IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values. The Company’s principal temporary differences arise in respect of property, plant and equipment. 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 utilized.

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.

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax liability is recognized for all taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied: the Company is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

Value-Added Tax

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the subscriber. VAT incurred for purchases and paid to suppliers may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT that is not currently reclaimable as of the balance sheet date is recognized in the balance sheet on a gross basis.

Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote.

Contingent assets are not recognized in the financial statement but disclosed when an inflow of economic benefits is probable.

Subsequent Events

Post-year-end events that provide additional information about the Company’s position at the balance sheet date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed when material.

3. Segment Information

	2003					2002 as restated				
	Fixed line	Mobile	Intercompany eliminations	Other	Total for the Company	Fixed line	Mobile	Intercompany eliminations	Other	Total for the Company
REVENUE										
Sales to third parties	6,518,767	234,476	–	134,203	6,887,446	5,362,331	182,808		120,455	5,665,594
Inter-segment sales	–	–	–	–	–	–	–	–	–	–
Total revenue	6,518,767	234,476	–	134,203	6,887,446	5,362,331	182,808		120,455	5,665,594
GROSS PROFIT										
Segment result	503,239	25,599		10,509	539,347	506,400	17,264		11,375	535,039
Unallocated corporate expenses					(266,374)					(181,454)
Operating income					272,973					353,585
Income from associates		217,747			217,747		46,665			46,665
Interest expenses, net					(106,134)					(83,275)
Other (expenses), net					(37,915)					(1,498)
Foreign exchange loss, net					(10,038)					(67,767)
Net monetary gain					–					70,479
Income tax expense, net					(140,620)					(244,457)
Minority interest					(91)					–
Net income					195,922					73,732

3. Segment Information (continued)

	2003					2002 as restated				
	Fixed line	**Mobile**	**Intercompany eliminations**	**Other**	**Total for the Company**	**Fixed line**	**Mobile**	**Intercompany eliminations**	**Other**	**Total for the Company**
OTHER INFORMATION										
Segment assets	**8,264,131**	**283,551**		**181,764**	**8,729,446**	6,974,808	237,779		156,677	7,369,264
Investments in associates					**346,765**					129,018
Unallocated corporate assets					**1,359,592**					1,075,929
Consolidated total assets					**10,435,803**					**8,574,211**
Segment liabilities	**(231,714)**	**(7,813)**			**(239,527)**	(162,980)	(6,972)			(169,952)
Unallocated corporate liabilities					**(4,148,612)**					(2,502,606)
Consolidated total liabilities					**(4,388,139)**					**(2,672,558)**
Capital expenditure	**1,549,137**	**53,399**		**34,214**	**1,636,750**	732,835	24,983		16,462	774,280
Depreciation and amortization	**(667,349)**	**(25,061)**		**(16,065)**	**(708,475)**	(616,456)	(21,016)		(13,847)	(651,319)
Other non-cash expenses, excl. depreciation (bad dept expenses, impairment of assets)					**(131,021)**					(82,875)

The Company provides fixed line and mobile telecommunication services, as well as other services. Management believes that the Company operates in one geographical segment, i.e. on the territory of Far East region of Russia.

4. Revenues

	2003	2002
By revenue types		
Long distance telephone services - domestic	**2,383,640**	1,927,596
Long distance telephone services - international	**484,875**	448,679
Local telephone services	**1,732,195**	1,426,720
Installation and connecting fees	**444,528**	450,359
Documentary services	**124,181**	125,881
Mobile telecommunication services	**234,476**	182,808
Radio and TV broadcasting	**183,728**	135,848
Data transfer and telematic services	**54,604**	29,606
New services	**331,232**	225,674
Rent of telephone channels	**135,696**	164,296
Revenues from national telephone operators	**312,153**	92,228
Other telecommunications services	**331,936**	335,444
Other revenue	**134,202**	120,455
Total	**6,887,446**	5,665,594

The change to the new scheme of settlements with OAO “Rostelecom” in August 2003 allowed the Company to receive revenue for the termination of traffic on its network depending on the actual amount of traffic in the period leading to an increase in revenue of 111,327. The costs of settlements with OAO “Rostelecom” for the transfer of intercity traffic due to the change of the scheme increased by 350,257.

The Company identifies revenue by the following major customer groups:

Customer groups	2003	2002
Residential customers	**3,693,450**	3,151,303
Corporate customers	**2,245,033**	1,814,751
Government customers	**676,090**	572,660
Tariff compensation from the state budget	**272,873**	126,880
Total	**6,887,446**	5,665,594

5. Other Operating Expenses

	2003	2002
General and administrative expenses	**278,712**	185,334
Cost of goods sold	**23,253**	24,667
Rent of premises	**46,439**	27,962
Audit and consulting fees	**22,239**	21,481
Advertising expenses	**23,591**	9,609
Property insurance	**31,497**	11,655
Contributions to Non-Commercial Partnership (Note 28)	**80,059**	46,652
Other expenses	**145,556**	149,098
Total	**651,346**	476,458

Other expenses primarily consist of expenses for accounting for payments from subscribers, measures to prevent default in payments and general activity for direction and management.

5. Other Operating Expenses (continued)

General and Administrative Expenses

	2003	2002
Payments to Gossvyaznadzor	**20,058**	23,107
Fire and other security services	**96,711**	46,708
Business travel expenses and representation costs	**46,083**	22,247
Repair of office premises	**12,727**	12,830
Transportation services	**50,679**	16,153
Post services	**8,272**	7,687
Education expenses	**11,619**	4,150
Other general and administrative expenses	**32,563**	52,452
Total	**278,712**	185,334

6. Interest Expense, net

	2003	2002
Interest income	**(1,767)**	(416)
Interest expense	**34,481**	36,650
Interest expense accrued on financial leases	**73,420**	47,041
Total	**106,134**	83,275

7. Income Tax

The income tax charge for the years ended December 31, 2003 and 2002 comprised the following:

	2003	2002
Current income tax expense	**148,634**	191,339
Prior-year income tax adjustments	**–**	–
Carryforward of tax losses and unused tax credits resulting in the decrease of current income tax expense	**–**	–
Total current income tax expense	**148,634**	191,339
Deferred income tax (benefit) charges relating to origination and reversal of temporary differences	**(8,014)**	53,118
Total deferred income tax (benefit) charge	**(8,014)**	53,118
Total income tax charge for the year	**140,620**	244,457

7. Income Tax (continued)

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

	2003	2002
Profit before income tax and minority interest	**336,633**	318,189
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**80,792**	76,365
Increase (decrease) resulting from the effect of:		
Non-taxable income	**(10,907)**	–
Expenses not deductible for tax purposes	**70,735**	107,601
Permanent elements of monetary gain	–	81,785
Inflation effect on deferred tax at beginning of the year	–	(21,294)
Total income tax charge for the year at the effective rate of 42% (2002:77%)	**140,620**	244,457

The composition of deferred income tax assets and liabilities as of December 31, 2003 and 2002, and their movement in the year ended December 31, 2003 and 2002, were as follows:

	December 31, 2003	December 31, 2002
Tax effects of deferred income tax assets:		
Accounts payable	**102,042**	84,349
Accounts receivable	**31,612**	36,262
Equipment contributions	**23,860**	15,761
Other	**3,591**	6,435
Deferred income tax asset, total	**161,105**	142,807
Tax effects of deferred income tax liabilities:		
Property, plant and equipment	**(790,592)**	(829,329)
Investments	**(75,484)**	(25,872)
Other	**(214)**	–
Deferred income tax liability, total	**(866,290)**	(855,201)
Net deferred income tax liability	**(705,185)**	(712,394)

The movement in net deferred income tax liability for the year ended December 31, 2003 was as follows:

Deferred income tax liability as of December 31, 2002	(712,394)
Deferred income tax benefit	**8,014**
Deferred income tax expense related to changes in fair value of investments available-for-sale	**(805)**
Deferred income tax liability as of December 31, 2003	**(705,185)**

8. Earnings per Share

Basic and diluted earnings per share are calculated by dividing the net income for the year attributable to ordinary shareholders (net income for the period less preferred dividends) by the weighted average number of ordinary shares outstanding during the year.

	2003	2002
Net income attributable to ordinary shareholders (basic and diluted)	**173,169**	55,654
Weighted average number of ordinary shares for basic and diluted earnings per share	**95,581,421**	95,581,421
Earnings per ordinary share, Rubles (basic and diluted)	**1.81**	0.58

The Company has no financial instruments that can be converted into ordinary shares.

9. Dividends Declared and Proposed for Distribution

Dividends declared in 2003 for the year 2002

Dividends on ordinary shares, 0.31 Rubles per share	29,630
Dividends on preferred shares, 0.58 Rubles per share	18,078
Total	**47,708**

*Approved at the annual shareholders meeting for the year 2003 (*see Note 30 “Subsequent Events”*)*

Dividends on ordinary shares, 0.40 Rubles per share	38,233
Dividends on preferred shares, 0.73 Rubles per share	22,753
Total	**60,986**

Earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations.

10. Property, Plant and Equipment

	Buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Machines and other	Total
Cost					
At December 31, 2002	10,126,960	8,513,890	344,436	1,250,466	20,235,752
Additions	–	–	1,636,750	–	1,636,750
Disposals	(244,674)	(100,185)	(36,551)	(21,142)	(402,552)
Transfers	310,682	1,041,215	(1,548,001)	196,104	–
At December 31, 2003	**10,192,968**	**9,454,920**	**396,634**	**1,425,428**	**21,469,950**
Impairment					
At December 31, 2002	(918,146)	(937,040)	(156,551)	(97,077)	(2,108,814)
Accrued for the year	–	–	(5,301)	–	(5,301)
Transfer	–	–	60,325	(60,325)	–
Impairment loss on disposal of Property, Plant and Equipment	12,597	12,857	26,171	1,332	52,957
At December 31, 2003	**(905,549)**	**(924,183)**	**(75,356)**	**(156,070)**	**(2,061,158)**
Accumulated depreciation					
At December 31, 2002	(5,759,211)	(4,150,213)	–	(848,250)	(10,757,674)
Charge for the year	(164,723)	(430,261)	–	(109,389)	(704,373)
Disposals	196,458	95,662	–	20,729	312,849
At December 31, 2003	**(5,727,476)**	**(4,484,812)**	**–**	**(936,910)**	**(11,149,198)**
Net book value as of December 31, 2002	**3,449,603**	**3,426,637**	**187,885**	**305,139**	**7,369,264**
Net book value as of December 31, 2003	**3,559,943**	**4,045,925**	**321,278**	**332,448**	**8,259,594**

The net book value of plant and equipment held under finance leases at December 31, 2003 is 1,155,271 (2002 - 372,769). Leased assets are pledged as security for the related finance lease obligations (see Note 23 “Finance Lease Obligations”).

In 2003, the Company increased construction in progress by the amount of capitalized interest totaling 37,159 (2002 - 4,765).

Property, plant and equipment for the total of 101,622 as of December 31, 2003 (2002 - 208,602) is pledged as security for the Company’s borrowings (see Note 22 “Loans and Borrowings”).

The Company’s accounting records related to property, plant and equipment are not designed to support their presentation in accordance with IAS 16, “Property, Plant and Equipment”, IAS 29, “Financial Reporting in Hyperinflationary Economies” and IAS 36, “Impairment of Assets”. As such, certain estimates and assumptions were made by management to present fixed assets in the accompanying consolidated financial statements.

In the future, the Company expects to hire an independent appraiser to assist in reconstruction of the fair value of the Property, Plant and Equipment, in order to make the necessary adjustments, if any, to the Company’s books and records, to comply with IFRS.

11. Intangible Assets

	Licenses	Software	Total
Cost			
At December 31, 2002	1,998	18,136	20,134
Additions	1,884	246,855	248,739
Disposals	(392)	(1,861)	(2,253)
At December 31, 2003	**3,490**	**263,130**	**266,620**
Accumulated amortization			
At December 31, 2002	(182)	(6,788)	(6,970)
Charge for the year	(1,741)	(2,361)	(4,102)
Disposals	392	970	1,362
At December 31, 2003	**(1,531)**	**(8,179)**	**(9,710)**
Net book value at December 31, 2002	**1,816**	**11,348**	**13,164**
Net book value at December 31, 2003	**1,959**	**254,951**	**256,910**

In accordance with the Board decision of OAO "Svyazinvest", the Company's parent, dated April 14, 2003 the Company was instructed to proceed with the purchase and implementation of an enterprise management system (ERP) based on Oracle E-business Suite software. The Company's Board of Directors confirmed this decision on May 29, 2003 and approved a supply contract with ZAO "Otkrytye tekhnologii 98" in the amount of 8,045 thousand US Dollars excluding VAT (approximately 246,327, at the exchange rate as of May 29, 2003).

In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 18,914 users of E-business Suite among other license applications.

The Company will commence amortization of the cost of upon substantial completion of implementation. Prior to this time management will periodically assess this intangible asset for impairment. The Company expects to complete this system implementation in 2006.

As of December 31, 2003 software includes Oracle E-business Suite software with a net book value of 242,161. The Company estimated useful life of this software as being approximately 5 years.

Licenses and software are amortized on a straight-line basis over their estimated useful lives determined equal to the term of the license or the license agreement for software. Useful lives of other intangible assets are 5-10 years.

12. Investments in Subsidiary

The consolidated financial statements include the assets, liabilities and financial results of OAO "Dalsvyaz" and its 60% owed subsidiary ZAO "Sotovye Sety Birobidjana", whose main activity is providing cellular services. This subsidiary is a Russian legal entity registered in accordance with Russian regulations.

13. Investments in Associates

Investments in associates at December 31, 2003 and 2002 comprised the following:

		As of December 31, 2003		As of December 31, 2002	
Associate	**Activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
ZAO "Primtelephone"	Cellular services	**50%**	**238,803**	50%	90,140
ZAO "DVSS-900"	Cellular services	**40%**	**80,480**	40%	13,980
OOO "Magalyaskom"	Cellular services	**50%**	**18,289**	50%	15,987
ZAO "TeleRoss Vladivostok"	Communication services	**50%**	**8,368**	50%	8,345
OOO "Kamalyaskom"	Cellular services	**50%**	**825**	50%	566
ZAO "Khabarovskiy Sotoviy Telephone"	Cellular services	**30%**	**–**	30%	–
Total			**346,765**		129,018

Movement in investments in associates in 2003 is presented below:

Investments in associates at December 31, 2002	129,018
Acquisition of associates	–
Share in change in net assets of associates, net of dividends received	**217,747**
Sale of investments in associates	–
Investments in associates at December 31, 2003	**346,765**

The carrying value of investments in associates shown in these consolidated financial statements is equivalent to the Company's share in the net assets of investees, except for investments in ZAO "Khabarovskiy Sotoviy Telephone".

ZAO "Khabarovskiy Sotoviy Telephone" reported accumulated losses in the amount of 45,385 and 29,411 as of December 31, 2003 and December 31, 2002, respectively. As the Company share in accumulated losses of this associate exceeded the cost of the respective investment, in accordance with IAS 28 "Accounting for Investments in Associates" carrying amount of the investment was reduced to zero.

14. Other Long-term Investments and Short-term Investments

As of December 31, 2003 and 2002, the Company's investments comprised the following:

	2003	2002
Long-term investments held-to-maturity	**96**	96
Long-term investments available-for-sale	**9,461**	10,196
Total long-term investments	**9,557**	10,292
Short-term investments available-for-sale	**3,215**	–
Total investments	**12,772**	10,292

As of December 31, 2003 and 2002 financial investment available-for-sale comprised the following:

The name of company	2003 Ownership interest	2003 Fair value	2002 Ownership interest	2002 Fair value
Long-term investments				
OAO "Daltelecom International"	**6.40%**	**2,624**	6.40%	2,624
OAO AKB "Primorie"	**8.20%**	**2,152**	8.20%	2,152
OAO SEZ "Nakhodka"	**8.47%**	**1,101**	8.47%	1,101
OAO AKB "Dalkombank"	**1.40%**	**858**	1.40%	858
OAO "Sberbank"	**0.71%**	**759**	0.71%	5
OAO AKB "Svyazbank"	**5.40%**	**1,180**	5.40%	1,180
OAO "Imperial"	**19.60%**	**240**	19.60%	240
Other		**547**		2,036
Total long-term investments		**9,461**		10,196
Short-term investments				
ZAO "Amurskiy Sotoviy Telephone"	**19.00%**	**3,215**		–
Total investments available-for-sale		**12,676**		10,196

15. Advances to Suppliers of Equipment

As of December 31, 2003 and 2002 advances to suppliers of equipment comprised the following:

	2003	2002
Acquisition of Property, Plant and Equipment	**208,252**	45,464
Acquisition of Oracle E-Business Suite software	**25,022**	–
Total	**233,274**	45,464

16. Inventories, net

Inventories at December 31, 2003 and 2002 included the following:

	2003	2002
Cable, materials and spare parts for telecommunications equipment	**166,967**	144,778
Finished goods and goods for resale	**8,544**	14,525
Other inventories	**77,795**	81,613
Less: provision for obsolescence	**(915)**	(915)
Total	**252,391**	240,001

17. Trade Accounts Receivable, net

Trade accounts receivable as of December 31, 2003 and 2002 comprised the following:

	2003	2002
Trade receivables – telecommunication services	**809,573**	567,970
Less: allowance for doubtful accounts	**(339,482)**	(250,200)
Total	**470,091**	317,770

The Company identified trade receivables by the following major customer groups:

	2003	2002
Corporate customers	**210,225**	134,889
Residential customers	**210,996**	149,061
Government customers, including tariff compensation from the state budget	**388,352**	284,020
Total	**809,573**	567,970

18. Other Financial Assets

As of December 31, 2003 and 2002, other financial assets included:

	2003	2002
Long-term accounts receivable	**–**	–
Long-term loans given to employees	**13,762**	1,477
Other long-term financial assets	**–**	–
Total	**13,762**	1,477

As of December 31, 2003 and 2002 long-term loans given are carried at amortized cost using the effective interest rate of 18%.

19. Other Current Assets

As of December 31, 2003 and 2002 other current assets comprised the following:

	2003	2002
Prepayments and advance paid	**163,226**	99,216
Settlements with personnel	**5,891**	4,864
Short-term loans given to employees	**7,603**	10,408
VAT recoverable	**180,211**	127,835
Prepaid income tax	**36,159**	441
Other prepaid taxes	**10,077**	27,448
Other receivables	**58,942**	92,303
Less: allowance for other current assets	**(11,975)**	(14,339)
Total	**450,134**	348,176

20. Cash and Cash Equivalents

As of December 31, 2003 and 2002 cash and cash equivalents comprised the following:

	2003	2002
Cash at bank and on hand	**139,997**	99,511
Cash equivalents	**113**	74
Total	**140,110**	99,585

21. Share Capital

	2003		2002	
	Shares	Share capital	Shares	Shares capital
Preferred shares at par value 10 Rubles:				
• shares authorized	**31,168,901**		31,168,901	
• shares issued and outstanding as of December 31	**31,168,901**	**311,689**	31,168,901	311,689
Ordinary shares at par value 10 Rubles:				
• shares authorized	**95,581,421**		95,581,421	
• shares issued and outstanding as of December 31	**95,581,421**	**955,814**	95,581,421	955,814
Total share capital		**1,267,503**		1,267,503

As a result of the reorganization (see Note 1 “General Information”) the state registration of amendments to the charter documents was completed on September 30, 2002.

21. Share Capital (continued)

The share capital account represents the authorized capital of the Company as stated in the charter documents. The Company had 95,581,421 ordinary shares and 31,168,901 Class A preferred shares as of December 31, 2003. There was no treasure stock as at the end of December 2003 and as at the end of December 2002.

All shares have a par value of 10 Rubles per share. Of the share capital issued as of December 31, 2003, 75% was attributable to ordinary shares, and 25% attributable to Class A preferred shares. The ordinary shareholders are allowed one vote per share. Class A preferred shares are non-voting. All ordinary shares and Class A preferred shares are eligible for distribution of Ruble earnings available in accordance with Russian statutory accounting regulations. Each Class A preferred share is entitled to a minimum annual dividend in the amount 10% of statutory net income available for dividends. Dividends on Class A preferred shares may not be less than dividends on ordinary shares. Shareholders of Class A preferred shares have a preferential right to recover the par value of preferred shares in liquidation.

In August 2001, the Company concluded a Depositary Agreement with JP Morgan Chase Bank in respect of American Depositary Receipts (ADRs), Level 1. The issue was registered on August 22, 2001. The depositary agreement between the Company and JP Morgan Chase Bank was revised on August 16, 2002 in accordance with the reorganization (see Note 1 "General Information"). In accordance with the depositary agreement each ADR is equal to 30 ordinary shares of the Company. As of the end of 2003, 78,866 ADRs represented 2,365,980 deposited ordinary shares, which constituted 2.7% of total ordinary shares issued.

The Company's shareholding structure as of December 31, 2003 was as follows:

	Ordinary shares		**Preferred shares**		
	Number	**%**	**Number**	**%**	**Total**
OAO "Svyazinvest"	48,330,683	51%	–	0%	483,307
Other legal entities	40,507,701	42%	20,923,235	67%	614,309
Individuals	6,743,037	7%	10,245,666	33%	169,887
Total	**95,581,421**	**100%**	**31,168,901**	**100%**	**1,267,503**

22. Loans and Borrowings

As of December 31, 2003 and 2002 loans and borrowings comprised the following:

	Interest rate	Maturity date	2003	2002
Short-term loans and borrowings				
Bank loans:				
Bank loans (Rubles)	14%-16%	2004	**82,278**	134,640
Total bank loans			**82,278**	134,640
Bond interest (Rubles)		2004	**17,082**	–
Promissory notes (Rubles)	14%	2004	**32,953**	12,490
Other short-term loans and borrowings (Rubles)			–	3,303
Total short-term loans and borrowings			**132,313**	150,433

	Interest rate	Maturity date	2003	2002
Long-term loans and borrowings				
Bonds and related interest (Rubles)	14.2%	2006	**1,000,000**	–
Vendor financing:				
Vendor financing (Rubles)			–	–
Vendor financing (US Dollars)			**468**	38,898
Vendor financing (Euro)	10-11%	2004-2005	**27,158**	278,752
Vendor financing (Yens)	5%	2004-2005	**4,122**	8,422
Total vendor financing			**31,748**	326,072
Promissory notes (Rubles)	6-8.5%	2006	**212,422**	12,219
Less: Current portion of long-term loans and borrowings			**(124,320)**	(227,649)
Total long-term loans and borrowings			**1,119,850**	110,642

As of December 31, 2003 short-term borrowings comprised 18,178 of interest payable (2002 - 286). This amount includes accrued coupon interest for bonds, totaling 17,082 and payable in May 2004 and interest accrued under loans with Alfa-bank and Vneshtorgank in the total amount of 1,096.

22. Loans and Borrowings (continued)

As of December 31, 2003, long-term borrowings had the following maturity schedule:

	Bank loans	Bonds	Vendor financing	Promissory notes	Other	Total
2004	82,278	17,082	22,959	134,314	–	256,633
2005	–	–	8,789	68,648	–	77,437
2006	–	1,000,000	–	42,413	–	1,042,413
Total	**82,278**	**1,017,082**	**31,748**	**245,375**	**–**	**1,376,483**

Short-term borrowings

Bank loans

Short-term ruble borrowings mainly represent bank loans received for working capital financing purposes. Most of these loans are collateralized with telecommunications equipment.

MDM-bank

On June 21, 2003 the Company entered into a loan agreement with MDM-bank. The loan matures on June 1, 2004. As of December 31, 2003 the outstanding liability under this agreement equated to 20,000. Interest is accrued at 16%. The loan is secured by equipment in the total amount of 30,630.

Alfa-bank

In September-November of 2003 the Company entered into two loan agreements with Alfa-bank. The loans are due on September-November 2004. As of December 31, 2003 the outstanding liabilities under these agreements amounted to 62,143, including interest accrued of 143. Interest is accrued at 14%. The loans are not secured.

Promissory Notes

Vneshtorgbank

On October 15, 2003 the Company entered into an agreement for promissory notes remittance with Vneshtorgbank. Promissory notes mature on October 13, 2004. The total liability as of December 31, 2003 amounted to 32,953.

22. Loans and Borrowings (continued)

Long-term borrowings

Bonds

On July 18, 2003, the Company registered the issue of interest-bearing bearer’s bonds, series D1, par value of 1 thousand Rubles each. Bonds have 6 coupons. Payments against the first coupon are made on the 182-nd day from the date of issue; interest per other coupons are payable every subsequent 182-nd day. The coupon interest rate is determined at 14.5% per annum for the 1st and 2nd coupons, 15% for the 3rd and 4th coupons, and 13% for the 5th and 6th coupons. The bonds mature in 1092 days from the date of issue, in November 2006. Early redemption option may be executed by bond holders during the fifth coupon period, which commences two years after the day of bonds issuance, i.e. in November 2005.

Vendor Financing

Italtel

In 1996 the Company entered into an agreement with Italtel, under which Italtel delivered telecommunication equipment to the Company. The amounts payable under this agreement were denominated in USD and were repaid during 2003. Interest was accrued at 7.5% per annum. The loan was not secured.

Siemens

In 1995-2000 the Company concluded vendor-financing agreements with Siemens. Under these contracts, Siemens delivered and installed telecommunication equipment to the Company. The amounts payable under these agreements are denominated in Euro and are repayable in equal installments during 2003 – 2005. Interest is accrued at 10%-11% per annum. The borrowing is secured by equipment amounting to 70,992 until the last installment is paid.

Sumitomo

In 1998 the Company entered into an agreement with Sumitomo, under which Sumitomo delivered telecommunication equipment to the Company. The amounts payable under this agreement are denominated in Japanese yen and are repayable during 2003-2004. Interest is accrued at 5% per annum. The loan is not secured.

Promissory Notes

Alfa-bank

In 1996-1997 the Ministry of Finance (hereafter “the Ministry”) granted the Company long-term financing for purchases of telecommunication equipment from various foreign vendors. Vnesheconombank has been acting as an agent of the Ministry on collection of payments from the Company. The liability was initially denominated in Deutsche Mark (DM), and later in Euro after introduction of the Euro. Interest is accrued at 7.5%. The loan was not secured.

22. Loans and Borrowings (continued)

Long-term borrowings (continued)

Following the crisis of 1998 and the significant increase of the exchange rate of DM to ruble, repayments on these agreements were ceased. As a result, as at January 1, 2003 approximately 52,664 of loans due to Vnesheconombank, which were included in current portion of long-term borrowings in the consolidated balance sheet as at that date, were overdue.

In December 2003 under the agreement signed with Alfa-bank and Vnesheconombank the Company converted loans due to Vnesheconombank in the amount of 209,704 (5,907 thousand Euro at the exchange rate as of December 1, 2003) into promissory notes payable to Alfa-bank for the aggregate amount of 200,225 (6,796 thousand US Dollars). The notes mature on December 30, 2006. Interest rate is 6-8.5%. The liability is not secured. Debt principle in the amount of 9,479 and penalty interest payable to Vnesheconombank in the amount of 18,217 (552 thousand Euro) were forgiven and included in consolidated statement of operation as part of Other Expenses, net.

23. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2003 and 2002 are as follows:

	2003		**2002**	
	Minimum payments	**Present value of payments**	**Minimum payments**	**Present value of payments**
Current portion	**460,241**	**247,404**	128,403	71,717
2 to 5 years	**958,636**	**606,718**	142,197	104,750
More than 5 years	**1,850**	**1,025**	3,480	1,881
Total minimum lease payments	**1,420,727**	**855,147**	274,080	178,348
Less amounts representing finance charges	**(565,580)**	**–**	(95,732)	–
Present value of minimum lease payments	**855,147**	**855,147**	178,348	178,348

In 2003 and 2002, the Company’s primary lessors were OAO “RTC-Leasing” and OOO “Promsvyazleasing”. In 2003, effective interest rate on leasing liabilities ranged from 20% to 40% per annum (2002 - from 20% to 40%).

In accordance with agreements concluded with OAO “RTC-Leasing”, the lessor is entitled to adjust the lease payments schedule subject to certain changes in economic environment, in particular, change in the refinancing rate of the Central Bank of the Russian Federation.

24. Trade Accounts Payable and Accrued Liabilities

As of December 31, 2003 and 2002, the Company’s trade accounts payable and current liabilities comprised the following:

	2003	2002
Trade accounts payable	**30,224**	39,545
Advances received from subscribers	**222,612**	186,696
Accounts payable for capital investments	**133,975**	116,297
Salaries and wages payable	**345,165**	268,969
Other accounts payable	**110,607**	120,197
Total	**842,583**	731,704

25. Taxes and Payroll Related Obligations

As of December 31, 2003 and 2002, the Company had the following taxes payable:

	2003	2002
Value-added tax	**177,342**	192,673
Income tax	–	15,854
Property tax	**20,340**	15,724
Personal income tax	**23,328**	15,512
Sales tax	**20,952**	17,936
Unified social tax	**37,193**	29,584
Other	**16,560**	863
Total	**295,715**	288,146

26. Pension Plans and Employee Benefits

In 2003 the Company made various payments to employees in addition to salary. These payments generally represent financial aid to the Company’s employees with limited abilities and bonuses to employees, which had made no breaches of internal policies during the last fiscal year. Such benefits were included in salary, benefits, salary taxes and other social expenditures in the accompanying consolidated statements of operations for the year ended December 31, 2003 and approximated 57,481 (2002 - 29,694).

In addition to statutory pension benefits, the Company also contributes to defined benefit plans, which covers most of its employees. Non-government pension fund “Telecom-Soyuz”, which is related to the Company (see Note 28 “Related Parties Disclosure”), maintains the plan. 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 recognizing minimal statutory pension, length of service both in the Company and in the telecommunications industry, as well as final average earnings and position in the Company at retirement. The benefits are not vesting and are subject to the employee retiring from the Company on or after the above-mentioned ages. The Company makes contributions to the pensions funds as a set percentage of the employees’ salaries or in the amount set forth in the agreement with the pension fund subject to a specific pension arrangement.

26. Pension Plans and Employee Benefits (continued)

The Company has not made an actuarial determination of current debt under these agreements as is required by accounting policy (see Note 2 "Summary of Significant Accounting Policies"), and hence has not recorded its obligations or made disclosures required under IAS 19, "Employee Benefits", pertaining to the value of obligations and assets of the plan as of December 31, 2003 and December 31, 2002.

27. Commitments and Contingencies

General Contingencies

The Russian economy while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition. These characteristics have in the past included higher than normal historic inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be significantly impacted by the government's continued actions with regard to supervisory, legal, and economic reforms.

Management cannot predict what effect changes in fiscal, political or tariffing policies may have on the Company's current financial position or its ability to make future investments in property, plant and equipment. The consolidated financial statements do not include any adjustments that might result from these uncertainties. Related effects will be reported in the financial statements, as they become known and estimable.

Tax Laws and Regulations

Legislation and regulations regarding taxation and foreign currency transactions in Russia continue to evolve as the government manages the transformation from a command to a market-oriented economy.

During 2002, the Russian Federation enacted a new tax code with significant modifications from the prior law.

The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities, the Central Bank and Ministry of Finance. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia's laws, decrees and related regulations are severe. Interest (at the Central Bank of RF official rates) and fines are levied when an understatement of tax liability is discovered. As a result, penalties and interest can result in amounts that are multiples of any unreported taxes.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management's best estimate. The Company's policy is to accrue for contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable. No such accruals have been made as at 31 December 2003.

Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as at 31 December 2003.

27. Commitments and Contingencies (continued)

Insurance Coverage

The Russian insurance industry is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. During 2003, the Company did not maintain insurance coverage on a significant part of its property, plant and equipment asset bases, business interruption, or third party liability in respect of property or environmental damage arising from accidents on the Company’s property or relating to the Company’s operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company’s operation and financial position. As of December 31, 2003 the Company’s insured fixed assets amounted to 688,793.

Litigations, Claims and Assessments

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 of judges and courts in interpreting legislation; and (5) a high degree of discretion on the part of governmental authorities.

Management is unable to estimate what developments may occur in respect of the Russian legal system or the resulting effect of any such developments on the Company’s financial condition or future results of operations. The financial statements do not include any adjustment that may result from these uncertainties.

Telecommunication Reforms

On January 1, 2004, a new law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The new law may increase the degree of regulators’ oversight over the Company’s operations and until such time as appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Under the new law, the Company is obliged to provide services under similar circumstances and equal conditions for connecting telecommunications networks and for carrying traffic from communications operators rendering similar services and to render connection services and the services involved in carrying traffic to these operators under the same terms and of the same standard, like for its own structural subdivisions and for affiliated parties.

According to the new telecommunication law, the individual subscriber has an option for local service to be paid based on subscription or by-the-minute payment system.

Management cannot predict with any certainty to what degree (if at all) the new law will affect the Company.

Capital Commitments

Oracle E-business

The Company contracted to invest approximately 2 million US dollars into installation of Oracle E-business system in 2004.

27. Commitments and Contingencies (continued)

Capital Commitments (continued)

Guarantees issued

As of December 31, 2003 the Company issued guarantees for the amount of 800,404 (December 31, 2002 – 0) with regard to bank loans drawn by OAO “RTC-Leasing” (see also Note 23 “Finance Lease Obligations”). The Company’s management doesn’t expect occurrence of any material obligations related to these guarantees.

Capital Investments

At December 31, 2003 the Company has commitments of 143,446 (2002 – 15,551) for capital investments into modernization and expansion of its network.

28. Related Parties

OAO “Svyazinvest”

The Company regards OAO “Svyazinvest” as its parent entity. OAO “Svyazinvest” was wholly owned by the Russian Government until July 1997 when the Government sold 25% plus one share of the Charter Capital of OAO “Svyazinvest” to the private sector.

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 Svyazinvest and its subsidiary companies.

The Government’s influence is not confined to its share holdings in 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.

OAO “Rostelecom”

OAO “Rostelecom”, a majority owned subsidiary of OAO “Svyazinvest”, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OAO “Rostelecom” and terminated outside of the Company’s network is stated as interconnection charges (see also Note 2 “Summary of Significant Accounting Policies”). Further, OAO “Rostelecom” uses the Company’s network to provide incoming long-distance and international traffic to its subscribers and partner operators. Transactions undertaken by the Company with OAO “Rostelecom” reported in the accompanying consolidated financial statements as at December 31, 2003 and 2002 and for the years then ended were as follows:

	2003	**2002**
Expenses on traffic transfer and rent of channels from Rostelecom	**920,128**	569,871
Revenue received from Rostelecom	**203,555**	92,228
Accounts payable to Rostelecom as at the year-end	**143,918**	109,878

28. Related Parties (continued)

OAO “RTC-Leasing”

OAO “RTC-Leasing” purchases telecommunication equipment from domestic and foreign suppliers and leases the equipment. In October 2003, OAO “Rostelecom” which owned 27% of ordinary shares of OAO “RTC-Leasing and exercised financial and operational control over the company’s activities, sold all shares of OAO “RTC-Leasing” to a third party.

As a result of this transaction, starting from December 1, 2003 OAO “RTC-Leasing” is not considered to be the Company’s related party and is not included into the Group of companies owned by OAO “Svyazinvest”.

The Company’s obligations under capital leases to OAO “RTC-Leasing” as at December 31, 2003 comprised 662,293 (2002 – 46,289), was 77% (2002 – 26%) of the Company’s total obligations for finance leases (see Note 23 “Finance Lease Obligations”).

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 Ministry of Antimonopoly Policies and Entrepreneurship Support 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.

Government subscribers accounted for approximately 48% of trade accounts receivable as of December 31, 2003 (2002 – 50%). Amounts outstanding from government subscribers as of December 31, 2003, amounted to 338,352 (2002 – 284,020).

Associates

The Company also provided services to its associates, including connection to public network, and rent of space for equipment and premises.

28. Related Parties (continued)

Associates (continued)

The Company's consolidated financial statements included the following amounts as of December 31, 2003 and 2002:

	2003	2002
Accounts receivable from affiliates:		
ZAO "DVSS-900"	**9,512**	2,006
ZAO "Khabarovskiy sotoviy telephone"	**3,286**	2,017
ZAO "Primtelephone"	**1,477**	952
ZAO "TeleRoss Vladivostok"	**1,969**	1,078
ZAO "Klondeik"	**801**	801
Total:	**17,045**	6,854
Accounts payable to affiliates:		
ZAO "Primtelephone"	**4,178**	5,292
ZAO "TeleRoss Vladivostok"	–	1,681
Total:	**4,178**	6,973
Sales to affiliates:		
ZAO "DVSS-900"	**79,625**	8,382
ZAO "Khabarovskiy sotoviy telephone"	**15,519**	5,803
ZAO "TeleRoss Vladivostok"	**6,280**	4,944
ZAO "Primtelephone"	**23,286**	10,358
Total:	**124,710**	29,487
Purchases from affiliates:		
ZAO "DVSS-900"	**759**	432
ZAO "Khabarovskiy sotoviy telephone"	**1,436**	697
ZAO "Primtelephone"	**5,304**	2,819
OOO "Magalyaskom"	**5,734**	–
ZAO "TeleRoss Vladivostok"	–	3,715
Total:	**13,233**	7,663

Sales to and purchases from related parties are made at normal market prices.

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 related to OAO "Svyazinvest". The Company has an agreement with the Partnership, under which it provides financing for mutually beneficial projects undertaken by the Partnership on behalf of the Company and other subsidiaries and associates of Svyazinvest. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2003 amounted to 80,059 (2002 – 46,652).

28. Related Parties (continued)

NPF "Telecom-Soyuz"

Payments to this pension fund in 2003 amounted to 43,154 (2002 - 37,050).

Compensation of the Company's management

In 2003, compensation to the members of the Company's Board of Directos totaled 34,633 (2002 – 20,877).

29. Financial Instruments

Fair value

The management believes that the value at which the financial instruments are carried in the accompanying consolidated balance sheet as of December 31, 2003 and 2002, approximates their fair value.

Interest rate risk

The following table presents the carrying amount by maturity of the Company's financial instruments that are exposed to interest rate risk:

Year ended December 31, 2003:

	< 1 year	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term loans and borrowings	**(132,313)**	–	–	**(132,313)**
Long-term loans and borrowings	**(124,320)**	**(1,119,850)**	–	**(1,244,170)**
Finance lease obligations	**(247,404)**	**(606,718)**	**(1,025)**	**(855,147)**

Year ended December 31, 2002:

	< 1 year	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term loans and borrowings	(150,433)	–	–	(150,433)
Long-term loans and borrowings	(227,649)	(110,642)	–	(338,291)
Finance lease obligations	(71,717)	(104,750)	(1,881)	(178,348)

Interest on financial instruments classified as fixed rate is fixed until maturity of the instrument. The other financial instruments of the Company that are not included into the tables above are non-interest bearing and are therefore not subject to interest rate risk. The Company has no financial instruments with floating rate of interest.

30. Subsequent Events

Dividends

On June 15, 2004, the general meeting of the Company’ shareholders approved dividends for 2003 in the amount of 0.73 Rubles per preferred share and 0.40 Rubles per ordinary share. Total dividends declared amounted to 22,753 and 38,233 for preferred and ordinary shares, respectively. Preferred dividends were accrued as of December 31, 2003 based on the preferred shareholders’ minimum dividend rights. Ordinary dividends were accrued when declared in 2004.

Increase in par value of common and preferred shares

On June 11, 2003 the general shareholders meeting of OAO “Dalsvyaz” approved the increase of par value of each common and preferred share from 10 Rubles to 20 Rubles per share. The conversion of shares into shares with increased par value was executed on February 24, 2004.

Finance lease agreements with OAO “RTC-Leasing”

In 2004, the Company entered into new finance lease agreements with OAO “RTC-Leasing”. The aggregate cost of equipment leased under these agreements, inclusive of installation and other capitalizable services’ costs, approximated 185,362, with the respective non-discounted future cash flows of approximately 282,440.

Bank Loan agreements with Sberbank and Far East Bank

In March - June 2004, OAO “Dalsvyaz” entered into several loan agreements with Sberbank and Far East Bank for the aggregate amount of 133,000. The loans mature in 2005. The interests on the bank loans are accrued at the rates of 10.5-13 % per annum. The loans are secured with telecommunications equipment valued at 149,392.

Purchase of Investments

On June 11, 2004 the Board of Directors of the Company approved the decision to purchase controlling shares in OOO “Besprovodnye infomatsionnye technologii” and ZAO “Integrator.ru”. OOO “Besprovodnye infomatsionnye technologii” holds licenses for providing cellular communication services under GSM-900 standard in Sakhalin Region and Chukotsky Autonomous District. ZAO “Integrator.ru” possesses a controlling share in ZAO “Akos”, rendering GSM services in Primorskiy region.

Sale of Investments

ZAO “Primtelephone”

In accordance with the decision of the Company’s Board of Directors of February 27, 2003 the Company sold its 50% share in ZAO “Primtelephone” for 31,000 thousand US Dollars to OAO “MTS” on June 30, 2004.

ZAO “DVSS-900”

In April 2004 the Company sold its 40% share in ZAO “Dalnevostochnye Sotovye Systemi-900” to OAO “MTS” for 8,300 thousand US Dollars. The sale was approved by the Board of Directors in March 2004.

31. Subsequent Events (continued)

Purchase of Investments (continued)

Other Investments

On December 26, 2003 the Company's Board of Directors approved the decision to sell ownership interests held by the Company in the following companies as of December 31, 2003:

Company	**Ownership Interest sold**	**Selling Price, US Dollars**
ZAO "Khabarovskiy Sotoviy Telephone"	30%	323,283
ZAO "Sotovye Sety Birobidjana"	60%	114,472
ZAO "Amurskiy Sotoviy Telephone"	19%	112,245
Total		**550,000**

The Company sold these investments in May 2004.

Constitutional Court Resolution

In 2004, Resolution No. 169-O of the Constitutional Court of the Russian Federation dated April 8, 2004 has become publicly available. The resolution has the possible effect of deferring the timing in which companies are able to offset input VAT to the extent the creation of such VAT is deemed to be attributable to the utilization of borrowed funds. In the event local taxing authorities would assert and successfully defend such an interpretation, the result could have a material adverse impact on the Company's financial condition. As of the date of this report, management is unable to predict the outcome of this uncertainty.

Agreement with non-state pension fund "Telecom-Soyuz"

In February 2004 the Company entered into an agreement with non-state pension fund "Telecom-Soyuz" for non-state retirement insurance under a defined benefit plan. Amounts of benefits should be defined annually based on NPF's actuarial workings and should be stated in additional agreements.

Decrease of VAT rate

Commencing from January 1, 2004 VAT rate was decreased from 20% to 18%.