OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
Years Ended December 31, 2002, 2001 and 2000

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the shareholders of OAO Moscow City Telephone Network:

We have audited the accompanying consolidated balance sheets of OAO Moscow City Telephone Network ("MGTS") and its subsidiaries (collectively – the "Group") as of December 31, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

June 16, 2003

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001
(in U.S. dollars and in thousands)

	2002	2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents (Note 5)	43,330	31,270
Accounts receivable, advances and taxes receivable, net (Note 6)	65,763	61,557
Inventories	11,747	12,330
Short-term investments (Note 7)	354	861
Deferred income taxes, net (Note 15)	4,771	3,588
Total current assets	125,965	109,606
NON-CURRENT ASSETS:		
Property, plant and equipment, net (Note 8)	879,970	838,697
Advance payments for property, plant and equipment	2,258	2,811
Goodwill, net (Note 9)	19,251	22,026
Long-term investments (Note 10)	73,482	74,018
Deferred income taxes, net (Note 15)	34,211	35,942
Other long-term assets	3,369	2,848
Total non-current assets	1,012,541	976,342
TOTAL ASSETS	1,138,506	1,085,948
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Debt maturing within one year (Note 11)	82,359	69,008
Accounts payable, taxes payable and other accrued liabilities (Note 12)	36,772	46,190
Deferred revenue (Note 13)	41,534	34,427
Total current liabilities	160,665	149,625
NON-CURRENT LIABILITIES:		
Long term debt (Note 11)	105,551	157,993
Deferred revenue (Note 13)	66,384	54,915
Postretirement benefits (Note 14)	4,235	6,810
Property, plant and equipment contributions	64,493	48,388
Deferred income taxes (Note 15)	13,649	10,226
Total non-current liabilities	254,312	278,332
TOTAL LIABILITIES	414,977	427,957
MINORITY INTERESTS IN EQUITY OF SUBSIDIARIES	71,478	56,457
SHAREHOLDERS' EQUITY:		
Preferred stock, 15,965,850 shares authorized, issued and outstanding (Note 16)	22,538	12,346
Common stock, 79,829,200 shares authorized, issued and outstanding (Note 16)	112,462	61,502
Retained earnings	455,245	463,431
Additional paid-in capital	35	35
Other additional capital	61,771	64,220
Total shareholders' equity	652,051	601,534
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	1,138,506	1,085,948

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(in U.S. dollars and in thousands except for earnings per share)

	2002	2001	2000
Operating revenues (Note 17)	417,825	387,636	314,693
Operating expenses, net (Note 18)	(292,895)	(264,376)	(202,561)
OPERATING PROFIT	124,930	123,260	112,132
Income/(loss) from affiliates	3,025	2,287	(4,012)
Interest income	1,971	937	1,288
Interest expense	(30,158)	(29,309)	(15,599)
Currency translation gain/(loss)	1,753	3,375	(9,888)
PROFIT BEFORE INCOME TAX EXPENSE AND MINORITY INTEREST	101,521	100,550	83,921
Income tax expense (Note 15)	(22,455)	(30,682)	677
Minority interest	(20,841)	(14,802)	(11,741)
PROFIT BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	58,225	55,066	72,857
Cumulative effect of accounting change, net of tax of $11,153 (Note 3)	-	-	(63,442)
NET PROFIT	58,225	55,066	9,415
Earnings per common share before cumulative effect of accounting change, diluted and basic	0.68	0.67	0.87
Cumulative effect of accounting change (Note 3)	-	-	(0.79)
Earnings per common share, diluted and basic (Note 20)	**0.68**	**0.67**	**0.08**
Weighted average number of common shares outstanding adjusted for share split in 2000 (Note 20)	79,829,200	79,829,200	79,829,200

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(in U.S. dollars and in thousands)

	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net profit	58,225	55,066	9,415
Adjustments to reconcile net profit to cash provided by operating activities			
Allowance for doubtful accounts	278	1,313	(97)
Depreciation and amortization	65,899	63,992	44,188
Currency translation (gain)/loss	(1,753)	(3,375)	9,888
(Income)/loss from affiliates	(3,025)	(2,287)	4,012
Deferred revenue amortization	(735)	(735)	(735)
Deferred taxes	3,844	4,154	(25,620)
Post-retirement benefits	(2,575)	3,046	(1,532)
Loss/(gain) on disposal of property, plant and equipment	1,327	(311)	(1,652)
Gain on disposal of long-term investments	-	(1,195)	(3,787)
Gain on disposal of subsidiary	(1,983)	-	-
Minority interest	20,841	14,802	11,741
Cumulative effect of accounting change, net of tax $11,153 (Note 3)	-	-	63,442
Changes in certain assets and liabilities			
Accounts receivable, advances and taxes receivable	2,585	(17,942)	2,332
Inventories	832	2,597	249
Other assets	(668)	-	76
Accounts payable, taxes payable and other accrued liabilities	(20,091)	4,424	16,481
Deferred revenue	18,273	(6,677)	3,131
Net cash provided by operating activities	141,274	116,872	131,532
CASH FLOWS FROM INVESTING ACTIVITIES:			
Dividends received from investees	1,643	1,721	-
Acquisition of subsidiary, net of cash received	(6,517)	(11,563)	5,137
Purchases of property, plant and equipment	(77,853)	(94,603)	(83,491)
Advances to minority shareholders	-	-	(12,111)
Proceeds from disposal of property, plant and equipment	3,151	1,979	4,597
Purchases of long-term investments	-	-	(4,424)
Redemptions of promissory notes, net	3,421	4,468	4,982
Cash received from sale of investment in affiliates	-	1,196	2,300
Net cash used in investing activities	(76,155)	(96,802)	(83,010)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	44,896	166,544	38,085
Repayments of borrowings	(73,342)	(155,065)	(63,093)
Repayments of vendor financing	(13,488)	(8,885)	(17,924)
Payments on capital leases	(5,201)	(5,243)	-
Dividends paid	(5,259)	(4,996)	(1,344)
Net cash used in financing activities	(52,394)	(7,645)	(44,276)
EFFECTS OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	(665)	(2,266)	(725)
INCREASE IN CASH AND CASH EQUIVALENTS	12,060	10,159	3,521
CASH AND CASH EQUIVALENTS, beginning of year	31,270	21,111	17,590
CASH AND CASH EQUIVALENTS, end of year	43,330	31,270	21,111

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (continued)
(in U.S. dollars and in thousands)

	2002	2001	2000
SUPPLEMENTAL INFORMATION:			
Cash paid for interest net of amounts capitalized	29,859	30,825	15,970
Income taxes paid	21,222	22,640	20,684
NON CASH INVESTING AND FINANCING ACTIVITIES:			
Assets contributed by shareholder	-	-	312
Property, plant and equipment received free of charge	18,050	12,736	6,428
Equipment acquired through vendor financing (Note 11)	8,522	18,314	11,819
Equipment acquired under capital leases (Note 11)	4,770	13,217	-

In addition, non-cash investing activities during the year ended December 31, 2002 included disposals of shares of subsidiaries and affiliates, as described in Notes 4 and 10.

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(in U.S. dollars and in thousands)

	Preferred stock		Common stock		Additional paid-in capital	Other additional capital	Retained earnings	Total
	Shares	Amount	Shares	Amount				
Balances at January 1, 2000	**15,965,850**	**12,346**	**79,829,200**	**61,502**	**35**	**63,908**	**406,521**	**544,312**
Investment contributions	-	-	-	-	-	312	-	312
Net profit	-	-	-	-	-	-	9,415	9,415
Dividends on preferred shares	-	-	-	-	-	-	(2,686)	(2,686)
Dividends on common shares	-	-	-	-	-	-	(1,866)	(1,866)
Balances at December 31, 2000	**15,965,850**	**12,346**	**79,829,200**	**61,502**	**35**	**64,220**	**411,384**	**549,487**
Net profit	-	-	-	-	-	-	55,066	55,066
Dividends on preferred shares	-	-	-	-	-	-	(1,218)	(1,218)
Dividends on common shares	-	-	-	-	-	-	(1,801)	(1,801)
Balances at December 31, 2001	**15,965,850**	**12,346**	**79,829,200**	**61,502**	**35**	**64,220**	**463,431**	**601,534**
Increase of par value of shares	-	10,192	-	50,960	-	-	(61,152)	-
Net profit	-	-	-	-	-	-	58,225	58,225
Effect of acquisition from a related party (Note 4)	-	-	-	-	-	(2,449)	-	(2,449)
Dividends on preferred shares	-	-	-	-	-	-	(3,549)	(3,549)
Dividends on common shares	-	-	-	-	-	-	(1,710)	(1,710)
Balances at December 31, 2002	**15,965,850**	**22,538**	**79,829,200**	**112,462**	**35**	**61,771**	**455,245**	**652,051**

Number of shares was restated for the share split in 2000 (Note 16).

Dividends paid per share in 2001 were $0.02 (2000: $0.02) on the common shares and $0.07 (2000: $0.17) on the preferred shares.
Dividends declared in 2002 were $0.02 on the common shares and $0.23 on the preferred shares.

See notes to consolidated financial statements.

(in U.S. dollars and in thousands)

1. THE GROUP

Description of Business - OAO Moscow City Telephone Network ("MGTS") operates one of the largest metropolitan communication networks in the world. Founded in 1882 and nationalized in 1917, MGTS was privatized and became an open joint stock company in 1994. MGTS provides telecommunication services to residential subscribers, state-financed institutions and businesses within the city of Moscow.

The Group has two reportable segments, (1) Wireline Voice Phone Communications and (2) Data Transmission and Wireless Communications (see Note 19 for additional information on segments). The Wireline Voice Phone Communications segment is represented by operations of MGTS while the Data Transmission and Wireless Communications segment is represented by the operations of its subsidiary, MTU-Inform (which itself is a group of three entities as of December 31, 2002).
The Group's controlling shareholder is AFK Sistema.

The principal activities of the Group's subsidiaries of are as follows:

Operating Entities	**Short Name**	**Principal activity**
ZAO "Company MTU-Inform"	MTU-Inform	Providing direct lines, digital channels and blocks of phone numbers to other telecom operators; providing data transmission services.
OAO "Personal Communications"	PeCom	Telecommunication services to residential subscribers and businesses of Moscow metropolitan area in CDMA standard.
ZAO "Petrodvor"	Petrodvor	Providing services to the entities of the Group.

Affiliates of MGTS provide cellular telecommunication, data transmission, internet, electronic and voice mail, and teleconferencing services throughout the Moscow metropolitan area.

MGTS's license to operate in the city of Moscow and the Moscow region expires on January 1, 2004. The management believes that the term of the license will be prolonged (Note 23).

Local telephone services are regulated tariff services and changes in rate structure are subject to Ministry of Antimonopoly Policy approval. The last change in rates structure was approved by the Ministry in 2003 (Note 24). There are three main categories of rates: residential customers, state financed institutions and corporate entities. Residential customers are charged a fixed monthly fee while corporate entities and state-financed institutions are charged for local traffic in addition to a fixed monthly fee. In 2002, approximately 64% of Wireline Voice Phone Communications segment revenues were generated from regulated tariff services.

2. WORKING CAPITAL

As of December 31, 2002 and 2001 the Group had a net working capital deficit of $34.7 mln and $40.0 mln respectively. In addition, the Group is planning extensive capital expenditure including expansion and full digitalization of the Moscow telephone network, which cannot be financed internally.

Management believes, on the basis of cash flow forecasts prepared, that the total facilities available to the Group will be sufficient to cover all of the Group's current obligations.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Basis of Presentation* -** The accompanying financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records in Russian Rubles ("RUR") in accordance with the requirements of Russian accounting legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in the Russian Federation (the "RF") in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

***Principles of Consolidation* -** The consolidated financial statements include the accounts of MGTS and its subsidiaries after the elimination of significant intercompany transactions and balances. The ownership interest of MGTS and proportion of voting power of the Group in the significant subsidiaries as of December 31, 2002 and 2001 are as follows:

Operating entities	**Ownership interest**		**Proportion of voting power**	
	2002	**2001**	**2002**	**2001**
MTU-Inform	51%	51%	51%	51%
PeCom	42%	40%	83%	79%
MTU-Intel	Affiliate	31%	Affiliate	38%

The Group's ownership structure includes interests in subsidiaries owned by entities, related by means of common control. Net assets and operating results of the subsidiaries related to such holdings are accounted for as minority interests.

***Use of Estimates* -** The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

***Concentration of Business Risk* -** The Group's principal business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes, which could impact the Group's assets and operations.

***Foreign Currency Translation* -** The Group follows a translation policy in accordance with Statement on Financial Accounting Standards No. 52, "Foreign Currency Translation". Due to the hyperinflationary economy in the RF in 2002, 2001 and 2000, the U.S. Dollar (the Group's reporting currency, "USD") has been designated as the Group's functional currency. Accordingly, all foreign currency amounts are translated into USD using the remeasurement method. Monetary assets and liabilities are translated into USD at the rate in effect as of the balance sheet date. Non-monetary balance sheet amounts are translated at the rate prevailing on the date of the transaction. Revenue and expenses are translated at the average rate for the quarter in which such transactions occurred. Translation gains and losses are included in the statements of operations. As discussed in more details in Note 24, the Russian economy ceased to be considered highly inflationary for accounting purposes starting from January 1, 2003.

The official rate of exchange, as determined by the Central Bank of the RF, between the Ruble and the U.S. Dollar at December 31, 2002 was 31.78 (2001: 30.14; 2000: 28.16).

The Ruble is not a fully convertible currency outside of the territory of the RF. The translation of RUR denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

***Revenue Recognition* -** The Group earns service revenues from usage of its local exchange networks and facilities. The Group receives subscription revenues from customers, which are recognized as revenue, net of rebates, in the period in which service is provided. Revenue based on minutes of traffic is recognized when the service is provided. Prepaid call card sales are deferred until the customer uses the stored value in the card to pay for the relevant calls or the prepaid card expires.

In December 1999 the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101 (SAB 101). Based on SAB 101, revenues associated with new service activation, including non-refundable connection fees received by telecommunications companies, should be deferred over the customer relationship period. According to management estimates, the customer relationship period for wireline voice phone subscribers is 15 years for residential customers and 5 years for all other categories of subscribers. The customer relationship period for subscribers for data transmission services and cellular communication is estimated at three years.

In 2000 the Group changed its accounting method for the recognition of connection fees in compliance with the provisions of SAB 101. For the year ended December 31, 2000, net income was charged with the amount of cumulative effect resulting from the application of SAB 101 provisions to prior years operations in the amount of $63.4 mln, net of income taxes of $11.2 mln.

MGTS is required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners, military veterans and disabled individuals, and is entitled to reimbursement from the federal budget for these discounts. Due to the lack of certainty of reimbursement, MGTS accounts for such revenues upon collection.

***Cash and Cash Equivalents* -** Cash and cash equivalents include cash on hand, amounts on deposit in banks and cash invested temporarily in various instruments with maturities of three months or less at time of purchase.

***Financial Instruments and Fair Value* -** Financial instruments carried on the balance sheets include cash and bank balances, receivables, short-term investments, accounts payable and long-term debt. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Current financial instruments that potentially expose the Group to concentrations of credit risk consist primarily of cash and bank balances, receivables, short-term investments and accounts payable.

Long-term financial instruments that potentially expose the Group to concentrations of credit risk consist primarily of long-term investments and long-term debt. It is not practicable to estimate the fair value of most of these financial instruments. This is due to quoted market prices not being readily available and valuations not being completed or obtained due to the excessive costs involved. Fair values of corporate bonds issued by MGTS are disclosed in Note 11.

As of January 1, 2001 the Group adopted FAS No. 133 “Accounting for Derivative Instruments and Hedging Activities”. This statement requires that all derivatives, including some embedded derivatives, be measured at fair value and recognized as either assets or liabilities. Changes are recorded in comprehensive income, depending on the designated use and effectiveness of the instruments. The effects of adoption were not material to the Group's financial position or results of operations.

Accounts Receivable - Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such provisions reflect either specific cases of delinquency or defaults or estimates based on evidence of collectibility.

Concentrations of credit risk with respect to trade receivables are limited due to a highly diversified customer base, which includes a large number of individuals, private businesses and state-financed institutions.

Inventories - Inventories comprise cables, spare parts, telephones and accessories and are stated at the lower of cost or market. Cost is computed on an average cost basis, except PeCom that accounts for its inventories using the FIFO cost method.

Property, Plant and Equipment - Property, plant and equipment is stated at cost less accumulated depreciation, except for assets contributed by the majority shareholder under the investment program and assets received free of charge from third parties. These assets have been included at fair values based on the estimated market values at the time of the transfer.

Significant renovations are capitalized if these extend the life of the asset or significantly increase its revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

Property, plant and equipment is depreciated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	47
Operating voice phone communications equipment	17
Data transmission equipment	10
Transfer devices	31
Site improvements	44
Other equipment	3 – 25

Property, plant and equipment held and used by the Group are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may have been impaired. Management believes that no impairment has occurred relating to the Group's investments in property, plant and equipment as of December 31, 2002.

The Group incurs costs associated with operating and other equipment, which require installation and related works to enable assets to commence revenue generating activities. All costs necessarily incurred which are directly attributable to the construction, preparation and installation of an item to commence revenue generating activities are capitalized.

Goodwill **-** As of January 1, 2002, the Group adopted Financial Accounting Standard ("FAS") No. 142, "Goodwill and Other Intangible Assets". This Standard eliminates goodwill amortization from the consolidated statement of operations and requires an evaluation of goodwill for impairment (at the reporting unit level) upon adoption of this Standard, as well as subsequent evaluations on an annual basis, and more frequently if circumstances indicate a possible impairment. This impairment test is comprised of two steps. The initial step is designed to identify potential goodwill impairment by comparing an estimate of the fair value of the applicable reporting unit to its carrying value, including goodwill. If the carrying value exceeds fair value, a second step is performed, which compares the implied fair value of the applicable reporting unit's goodwill with the carrying amount of that goodwill, to measure the amount of goodwill impairment, if any.

Substantially all goodwill recorded by the Group resulted from increase of MTU-Inform share in PeCom from 55% to 79% in 2001. Upon adoption, the Group performed a transitional impairment test on goodwill, assigned to PeCom. As a result of this test, no impairment was recorded. Subsequent impairment tests will be performed, at a minimum, in the fourth quarter of each year, in conjunction with the Group's annual planning process.

If FAS No. 142 have been applied retroactively to January 1, 2000, the net profit for the year ended December 31, 2001 would increase by $0.9 mln and the net profit for the year ended December 31, 2000 would not change.

Investments **-** Investments in businesses in which the Group does not have control, but exercises significant influence over operating and financial policies ("affiliates"), are accounted for using the equity method. The Group's share of net profit of affiliates is included in the statement of operations, and the Group's share of the net assets of affiliates is included in the balance sheet.

Investments in corporate shares where the Group owns more than 20% of share capital, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition. Management periodically assesses realizability of the carrying values of such investments and provides valuation reserves, if required.

The promissory notes purchased by the Group are carried at cost and the discount against the nominal value is accrued over the period to maturity, if it exceeds one year. A provision is made, based on management assessment, for notes that are considered uncollectible.

Retirement and Post-Retirement Benefits **-** Contributions are made to the Government's social and medical insurance and retirement benefit schemes at the statutory rates in force during the year. The costs of these benefits are charged to the statement of operations as incurred.

During the year ended December 31, 2002 MGTS established a defined contribution plan to provide eligible employees with additional income upon retirement. MGTS's contributions to the plan, totaling $0.6 mln in 2002 (2,000 RUR a year per eligible employee) are managed by a pension fund "Sistema", a party related by means of common control.

In addition, MGTS has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service.

Property, Plant and Equipment Contributions **-** Property, plant and equipment which has been transferred to the Group free of charge is capitalized at its market value at the date of transfer and deferred revenue is recorded and amortized to the consolidated statement of operations over the contributed assets' life (Note 14).

Income Taxes **-** Income taxes have been computed in accordance with RF laws. From April 1, 1999, the RF enacted an income tax rate of 30% and beginning January 1, 2001, this rate was increased to 35%. The new income tax legislation was enacted in the RF in September 2001. In accordance with the new legislation, effective January 1, 2002, the tax rate decreased to 24%. Also, income tax on dividends paid within Russia was decreased to 6% (from 15% in 2001 and 2000), investment allowances were abandoned and carryforward period for unused taxable losses was increased to 10 years.

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Borrowing Costs **-** The Group capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. For the years ended December 31, 2002, 2001 and 2000 capitalized borrowing costs amounted to $0.6 mln, $1.2 mln and $12.5 mln, respectively. Other borrowing costs were recognized as an expense in the period in which they were incurred. Debt issue costs are amortized to expense over the term to maturity.

MGTS historically issued offers to repurchase its outstanding bonds at a certain date. The offer price for the first issue of the bonds is stated above par value. This premium is amortized into interest expense over the bonds' term.

Earnings Per Share **-** Earnings per share is computed using the two-class method. Net income available to common shareholders is divided by the weighted average number of common shares outstanding in the year. Net income available to common shareholders is determined by reducing net income by the greater of dividends declared in the accounting period on preferred shares or of dividends on preferred shares guaranteed under MGTS Charter.

Dividends **-** Annual dividends are recommended by the Board of Directors for approval of the shareholders in a general meeting. This occurs subsequent to year-end and dividends are recognized in the year to which they relate.

Reclassifications **-** Certain reclassifications of prior years' amounts have been made to conform to the presentation adopted for 2002.

4. ACQUISITIONS AND DISPOSALS

In October 2002, the Group sold 7.5% of its shareholding in PeCom to Qualcomm for a promissory note with par value of $5.1 mln, thus decreasing its voting power in the subsidiary from 78.8% to 71.3%. This transaction resulted in an increase in minority interest of $1.1 mln and a decrease in the net book value of goodwill recorded on the acquisition of these shares from third parties in 2001 by $2.0 mln. The net gain on the disposal amounting to $2.0 mln is included in operating profit for 2002 (Note 18).

In December 2002 the Group increased its voting power in PeCom from 71.3% to 83.3% by purchasing shares from a related party for a cash consideration of $6.5 mln. The excess of consideration paid over the respective share of PeCom's net assets as of the acquisition date decreased the Group's consolidated equity by $2.4 mln.

In July 2002 MTU-Inform disposed of its holding in MTU-Intel, then a subsidiary of MTU-Inform, to the Group's controlling shareholder for a cash consideration of $0.1 mln. As a result, the Group's voting power in MTU-Intel decreased from 38.0% to 25.5%.

Concurrently, control over operating and financial policies of MTU-Intel was transferred from MTU-Inform to the controlling shareholder. The Group changed its method of accounting for investment in MTU-Intel shares from consolidation in 2000 and 2001 to equity method in 2002.

If the Group's investment in MTU-Intel would be accounted for under equity method for all periods presented, consolidated assets as of December 31, 2001 and 2000 would decrease for $10.1 mln and $3.0 mln, respectively, and consolidated revenues for the years then ended would decrease for $9.0 mln and $5.7 mln, respectively.

Subsequently, the Group's interest in MTU-Intel was increased from 25.5% to 30.0%, while control over MTU-Intel operations remained with the controlling shareholder.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
Rubles	26,469	19,508
U.S. Dollars	3,195	2,954
Restricted cash – U.S. Dollars	1,321	-
Other currencies	13	157
Cash equivalents	12,332	8,651
Total	**43,330**	**31,270**

Cash equivalents as of December 31, 2002 include USD denominated promissory notes from Moscow Bank for Reconstruction and Development ("MBRD"), a company related by means of common control. Such notes have original maturities of three months or less.

Cash and cash equivalents held by the Group in MBRD as of December 31, 2002 and 2001 amounted to $18.6 mln in both years.

Restricted cash balance maintained under the terms of a letter of credit opened in Citibank for the redemption of Citibank loan amounted to $1.3 mln as at December 31, 2002.

6. ACCOUNTS RECEIVABLE, ADVANCES AND TAXES RECEIVABLE, NET

Accounts receivable, advances and taxes receivable as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
Customers	18,679	27,891
Related parties, including affiliates, Rostelecom and state-financed institutions	16,514	9,109
Other receivables and advances	11,350	9,813
VAT recoverable	20,056	15,973
Other taxes receivable	1,874	1,203
Allowance for doubtful accounts	(2,710)	(2,432)
Total	**65,763**	**61,557**

Rostelecom, provider of national long distance and international telecommunications services, is a subsidiary of Svyazinvest, which owns 28% of MGTS voting shares. Svyazinvest is controlled by the Government of the RF.

Rostelecom pays a fee to MGTS for the transit of domestic long distance and international calls originated by MGTS subscribers. Respective revenue amounts are disclosed in Note 17.

7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
Investment Pension Company RUR loan, non-interest bearing	-	836
Other non-interest bearing loans to related parties	354	25
Total	**354**	**861**

A loan to Investment Pension Company, an entity related by means of common control, was prolonged till December 2005. The loan is reclassified to long-term investments as of December 31, 2002.

8. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
Buildings and site improvements	168,108	153,560
Switches and transmission devices	782,113	716,224
Other fixed assets	137,430	113,328
Construction in progress	74,210	82,125
Total cost	1,161,861	1,065,237
Accumulated depreciation	(281,891)	(226,540)
Total	**879,970**	**838,697**

Construction-in-progress and equipment for installation are not depreciated until an asset is placed into service.

9. GOODWILL, NET

Goodwill as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
Goodwill	19,916	22,894
Accumulated amortization	(665)	(868)
Total	**19,251**	**22,026**

10. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2002 and 2001 consisted of the following:

	2002		2001	
	Ownership, %	**Investment**	**Ownership, %**	**Investment**
Investments in affiliates:				
ZAO Comstar	50	32,906	50	32,450
ZAO Telmos	40	17,190	40	17,178
OAO MCC	23.5	6,730	23.5	6,730
ZAO MTU-Intel	30	5,349	Consolidated	-
ZAO Golden Line	-	-	50	4,435
Total investments in affiliates		62,175		60,793
Other investees, at cost	Various	10,217	Various	6,936
Interest free loans to investees		1,090		6,289
Total		**73,482**		**74,018**

In October 2002, the Group sold 50% of ZAO Golden Line common shares to MTU-Intel in exchange for 4.5% of MTU-Intel common shares, an interest-free promissory note with a face value of 23.2 mln RUR and $0.1 mln in cash. As a result, the Group increased its ownership in MTU-Intel from 25.5% to 30.0% and MTU-Intel accumulated 100% of Golden Line common shares.
The transaction, being a transaction between related parties, was accounted for at historical cost. The promissory note maturing in 2007 is included in other long-term assets at a discounted value of $0.3 mln. Discounted value has been determined using current interest rates at which similar loans would be extended to the Group by non-related borrowers.

Equity accounting for investments in MCC was discontinued in 2001 as shares were transferred under trust management of a related party.

During 1999, the Group disposed of its 10% holding in ZAO Combellga, a Moscow telecommunications operator. In April 2002 the Group agreed to defer repayment of $3.1 mln outstanding on the respective note receivable to April 2005. The note receivable is stated at discounted value. As of December 31, 2002 and 2001 it is included in other long-term assets in the amounts of $2.7 mln and $2.4 mln respectively

Distributable retained earnings of the Group’s investees are based on amounts extracted from their statutory financial statements and may significantly differ from the amounts calculated on the basis of U.S. GAAP.

11. DEBT OBLIGATIONS

Debt obligations as of December 31, 2002 and 2001 consisted of the following:

	Note	2002	2001
Collateralized bank loans	**(a)**	**89,957**	**91,159**
Sberbank RUR denominated loan		58,333	72,854
Sberbank USD denominated loan		700	-
Vneshtorgbank USD denominated loan		12,565	7,420
Vneshtorgbank RUR denominated loan		2,359	4,479
Raiffeisenbank USD denominated loan		15,000	-
Alfabank USD denominated loan		1,000	-
MBRD USD denominated loan		-	4,500
Avtobank USD denominated loan		-	1,906
USD denominated bank loans guaranteed by third parties	**(b)**	**7,577**	**12,516**
Credit Suisse loan		-	3,090
Citibank loan		7,577	9,426
Uncollateralized RUR denominated corporate bonds	**(c)**	**41,002**	**53,086**
1st issue, 1st tranche		9,540	11,944
1st issue, 2nd tranche		-	7,963
2nd issue		31,462	33,179
Uncollateralized USD denominated borrowings from third parties	**(d)**	**9,252**	**8,004**
Promissory notes issued		3,831	-
Gutabank loan		5,421	8,004
Uncollateralized borrowings from related parties		**189**	**16,036**
RUR denominated promissory notes issued		189	896
MBRD USD denominated loan		-	8,009
Dottie Enterprises Ltd. USD denominated loan		-	7,131
Vendor financing	**(e)**	**31,856**	**37,691**
Long-term portion		8,904	7,615
Short-term portion		22,952	30,076
Capital leases	**(f)**	**8,077**	**8,509**
Long-term portion		3,967	5,335
Short-term portion		4,110	3,174
Total borrowings		**187,910**	**227,001**
Less amounts maturing within one year		(82,359)	(69,008)
Total long-term debt		**105,551**	**157,993**

(a) In December 2000 MGTS signed a credit facility with Sberbank for a total amount equivalent to 90 mln USD to refinance its obligations under Eurobond borrowings. The loan was received in three tranches during the first quarter of 2001. In September 2002 MGTS prolonged repayment of $31.5 mln of the outstanding balance to the first quarter of 2005. The remaining balance was fully repaid in 2003. Starting January 1, 2003 the interest rate on the prolonged loan will vary between 18% and 20%, depending on the volume of cash flows that MGTS will maintain on its accounts with Sberbank. Equipment valued by independent appraiser at $80.9 mln is pledged to collateralize the outstanding balance as of December 31, 2002.

During the year ended December 31, 2002 the Group received a number of loans from Vneshtorgbank maturing in 2003-2007 to finance working capital. The loans are collateralized by pledge of equipment valued by the parties at $14.2 mln. The weighted average interest rate on the Vneshtorgbank loans is 11.6%.

In September 2002 MGTS entered a credit line with Raiffeisenbank limited to $15.0 mln. The equipment pledged under the credit line as at December 31, 2002 is valued at $22.7 mln. In addition, MGTS is required to maintain monthly gross cash flows with the bank of not less than $1.5 mln. The loan bears interest of LIBOR+5% and matures in 2007. As of December 31, 2002 the LIBOR rate specified in the agreement equaled 1.4%.

In August 2002, a loan of $0.7 mln was provided to PeCom by Sberbank, bearing interest at 10% per annum and repayable in July 2003. The loan is secured by equipment.

In December 2002, MTU-Inform received a loan from Alfabank for $1.0 mln, bearing interest at 6.5% per annum, repayable in January 2003.

(b) An uncollateralized bank loan was provided to MGTS by Citibank at LIBOR plus 1.6% for the purchase of equipment. The Citibank loan is guaranteed by Export Guarantee and Insurance Corporation, Czech Republic and AFK “Sistema”.

Based on restrictive covenants of the Citibank loan agreement the Debt to Equity and Debt Service to Earnings Before Interest and Taxes (EBIT) ratio of MGTS should not exceed 1:1. MGTS is not allowed to obtain borrowings exceeding $30 mln or alienate more than 10% of its assets without the written approval of the Bank and its aggregate debt may not exceed $250 mln. The loan is repayable in quarterly installments to be finally settled in 2004.

(c) In the fourth quarter of 2000 MGTS issued two tranches of RUR denominated bonds (first issue) with aggregate face value of 600 mln RUR (approximately $18.9 mln) due in 2003. Interest is payable every 4 months. Both tranches have a floating interest rate, which is set for each coupon payment 14 days before the date of the prior coupon payment. Interest (11.5% as at December 31, 2002) is linked to the weighted average interest rate of OFZ (Russian Government Federal Bonds) as at the date the interest rate is fixed. As of December 31, 2002 the Group has repurchased on the open market approximately $9.3 mln of the first issue.

In the fourth quarter of 2001 MGTS issued RUR denominated bonds (second issue) with face value of 1,000 mln RUR (approximately $31.5 mln) due in 2004. Interest is payable semi-annually. The issue has a floating interest rate, which is set for each coupon payment not later than 6 days before the date of the prior coupon payment. Interest (18.5% as at December 31, 2002) should not be less than the weighted average interest rate of OFZ as at the date the interest rate is fixed.

Market value of the bonds approximates their carrying value as of December 31, 2002 and 2001.

(d) In 2002 MGTS issued discounted notes to Donau-Bank. The notes have value of $5.3 mln at maturity in December 2003 and a yield of 12%.

In 1999 and 2000 loans were provided to MGTS by Gutabank for the purchase of equipment from a foreign vendor. Under the terms of the agreements MGTS is required to maintain monthly gross cash flows on the specified bank accounts in the amount of $14 mln. The loans are repayable in equal semiannual installments to be settled in 2005. The weighted average interest rate on the Gutabank loans is 13.0%.

(e) Foreign suppliers of telecommunications equipment provide noncollateralized commercial credit to the Group denominated in various currencies on short-term and long-term bases, mostly interest free.

(f) During 2002 MGTS entered several lease agreements for telecommunications equipment. The agreements expire in 2004 -2005 and assume transfer of ownership for equipment to MGTS after the last lease payment is effected. The net book value of leased assets comprised $14.1 mln and $13.2 mln as of December 31, 2002 and 2001, respectively, while rent expense for the years then ended amounted to $1.3 mln and $0.5 mln, respectively.

The weighted average interest rate of all borrowings denominated in hard currency at December 31, 2002 and 2001 was 7.96% and 9.28%, respectively, while it was 20.13% and 21.88%, respectively, for borrowings denominated in RUR. These figures are calculated without taking into account borrowings from related parties, vendor financing arrangements and capital lease agreements.

The debt obligations as of December 31, 2002 have the following maturities:

2003	82,359
2004	45,633
2005	38,578
2006	3,649
2007	17,358
Thereafter	333
Total	**187,910**

12. ACCOUNTS PAYABLE, TAXES PAYABLE AND OTHER ACCRUED LIABILITIES

Accounts payable, taxes payable and other accrued liabilities as of December 31, 2002 and 2001 consisted of the following:

	2002	**2001**
Trade accounts payable	15,526	22,297
Taxes payable	9,928	13,367
Accrued payroll	2,563	2,785
Accrued interest	3,161	3,018
Other liabilities	5,594	4,723
Total	**36,772**	**46,190**

13. DEFERRED REVENUE

Deferred revenue as of December 31, 2002 and 2001 consisted of the following:

	2002	**2001**
Short-term portion		
Deferred revenue from connection fees	23,233	19,780
Advances from customers	17,566	13,912
Deferred gain on disposal of an investment	735	735
Total	**41,534**	**34,427**
Long-term portion		
Deferred revenue from connection fees	65,632	53,428
Deferred gain on disposal of an investment	752	1,487
Total	**66,384**	**54,915**

The gain on sale of an investment to a related party has been deferred to future accounting periods and is recognized as the Group fulfills its obligations under the transaction.

14. RETIREMENT AND POST-RETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently such benefits include bonus payments of a fixed amount to retiring employees with at least five years of service (5,700 RUR or 11,400 RUR per employee, or approximately 180 and 360 USD, respectively, at the exchange rate current at the balance sheet date, depending on actual years of service); lifetime payments of a fixed amount to employees retiring with at least fifteen years of service (1,200 RUR per employee, or approximately 40 USD at the exchange rate current at the balance sheet date, for the year 2003); and discounted telephone service to employees retiring with at least thirty years of service.

An employee is withdrawn from the benefit scheme if their employment with MGTS is discontinued prior to retirement. As of January 1, 2002 management changed its estimate of the scheme's withdrawal rate to recognize increasing turnover of MGTS employees mostly caused by a rapid development of telecommunications industry in the RF and growing competition. As a result of the change, the estimated projected obligations of the Group as of December 31, 2002 and employee costs for the year then ended decreased by $2.6 mln.

15. INCOME TAX EXPENSE

The Group's current provision for income tax for the years ended December 31, 2002 and 2001 is as follows:

	2002	**2001**	**2000**
Current income taxes	18,611	26,528	24,943
Deferred taxes	3,844	4,154	(36,774)
Total income tax expense/(benefit)	**22,455**	**30,682**	**(11,831)**
Add tax effect of accounting change (Note 3)	-	-	11,154
Income tax expense/(benefit) excluding accounting change	**22,455**	**30,682**	**(677)**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate to net income before income tax, minority interest, extraordinary item and cumulative effect of accounting change. The items causing this difference are as follows:

	2002	**2001**	**2000**
Income tax charge computed on income before taxes at standard tax rate applicable to the Group of 24% (35% in 2001, 30% in 2000)	24,365	35,193	1,219
Effect of changes in income tax rate	-	10,918	(2,924)
Tax credits	-	(10,374)	(10,447)
Currency exchange and translation differences	(1,218)	1,681	10,317
Effect of rates different from standard	(545)	(457)	611
Non-deductible items	430	12,523	5,900
Goodwill amortization	(577)	(537)	(721)
Change in valuation allowance	-	(18,265)	(15,786)
Income tax expense (benefit)	**22,455**	**30,682**	**(11,831)**

Deferred tax assets and liabilities comprise the following:

	2002	2001
Deferred tax assets		
Accrued operating expenses	2,630	2,079
Post-retirement benefits	1,062	1,634
Property, plant and equipment contributions	10,999	11,613
Deferred revenues	15,948	9,421
Tax losses carry forward	8,343	14,783
Total	**38,982**	**39,530**
Deferred tax liabilities		
Valuation of affiliates	(4,076)	(3,751)
Depreciation of PPE	(8,971)	(4,477)
Other	(602)	(1,998)
Total	**(13,649)**	**(10,226)**

16. SHAREHOLDERS' EQUITY

Common shares carry voting rights with no guarantee of dividends.

Preferred shares carry guaranteed dividend rights amounting to the higher of (a) 10% of the income of MGTS as disclosed in the Russian statutory accounting reports prepared under Russian accounting regulations and (b) the dividends paid on common shares. No dividends may be declared on common shares before dividends on preferred shares are declared. Where the preferred dividend payable according to the Charter is not paid in any year the preferred shares also carry voting rights. At the annual shareholders meetings in June 2001 and 2000 the payment of a dividend to preferred shareholders was approved.

Preferred shares usually carry no voting rights except on resolutions regarding liquidation or reorganization of MGTS, changes to dividend levels of preferred shares, or the issuance of additional preferred stock. Such resolutions require two-thirds approval of preferred shareholders. The preferred shares have no rights of redemption.

In the event of liquidation, preferred shares have priority over common shares. In this circumstance, holders of preferred shares receive the par value of their shares, or the amounts payable to common shareholders, if higher.

In accordance with the Charter, MGTS is permitted to repurchase, on the open market, up to 10% of its common and preferred shares each year. Repurchased shares must either be sold or cancelled within one year of being purchased. MGTS has no treasury shares as at December 31, 2002.

In 1999 MGTS increased the par value of each share of its common and preferred stock from 1 RUR to 1,000 RUR. In 2000 MGTS split both common and preferred shares. Each common and preferred share with nominal value 1,000 RUR was split into 50 new shares of the same equity class with nominal value 20 RUR.

In June 2002 MGTS increased the par value of each share of its common and preferred stock from 20 RUR to 40 RUR. Consequently, the aggregate par value of the issued stock was increased by reclassifying the respective amount from the Group's retained earnings as of the date of approval of this transaction by shareholders.

17. OPERATING REVENUES

Operating revenues for the years ended December 31, 2002, 2001 and 2000 consisted of the following:

	2002	2001	2000
Fixed monthly charges			
Companies	58,225	56,406	46,466
State financed institutions	17,648	14,569	10,778
Residential customers	74,096	57,036	45,225
Local traffic fees			
Companies	23,022	25,140	23,603
State financed institutions	2,337	2,567	1,982
Service activation fees			
Companies	13,286	14,062	14,307
State financed institutions	1,220	1,376	2,164
Residential customers	4,056	3,053	2,866
Data transmission and wireless	135,799	123,859	91,822
OAO Rostelecom interconnect	21,244	32,459	23,128
Rental of lines	27,241	17,720	19,115
Other	39,651	39,389	33,237
Total	**417,825**	**387,636**	**314,693**

Data transmission and wireless revenues for the year ended December 31, 2002, 2001 and 2000 include data transmission services provided by Wireline Voice Phone Communication segment in the amount of $6.4 mln, $nil and $nil, respectively (Note 19).

MGTS is not licensed to provide domestic long-distance and international long-distance, or DLD/ILD, telecommunications services directly to its subscribers, but must route such traffic through a DLD/ILD licensed operator. As a result, DLD/ILD traffic originated by MGTS subscribers is carried by Rostelecom, which bills MGTS subscribers directly. In 2002 MGTS had an agreement with Rostelecom pursuant to which Rostelecom paid MGTS approximately $1.7 mln per month of its DLD/ILD revenues generated by MGTS subscribers.

18. OPERATING EXPENSES, NET

Operating expenses for the years ended December 31, 2002, 2001 and 2000 consisted of the following:

	2002	2001	2000
Employee costs	93,238	81,158	55,766
Depreciation and amortization	65,899	63,992	44,189
Repairs and maintenance	41,882	37,606	23,507
Taxes other than income taxes	17,686	17,054	23,277
Network traffic	11,691	8,983	5,507
Utilities and energy	10,257	9,984	6,482
Rent	8,249	7,017	5,570
Advertising	7,656	6,015	1,895
Insurance	4,733	3,282	3,929
Transportation	1,902	1,875	2,108
Provision for bad debts	1,673	1,313	143
Net gain on disposal of shares of subsidiary	(1,983)	-	-
Sundry expenses	30,012	26,097	30,188
Total	**292,895**	**264,376**	**202,561**

19. SEGMENT INFORMATION

An analysis of the Group’s business segment information for the years ended December 31, 2002, 2001and 2002 is as follows:

	2002	2001	2000
Revenues:			
Wireline Voice Phone Communication	303,021	274,371	226,747
Data Transmission and Wireless Communications	129,378	123,859	91,822
Intersegment revenue	(14,574)	(10,594)	(3,876)
Consolidated revenue	417,825	387,636	314,693
Operating profit:			
Wireline Voice Phone Communication	70,282	67,412	67,981
Data Transmission and Wireless Communications	54,648	55,848	44,151
Consolidated operating profit	124,930	123,260	112,132
Depreciation:			
Wireline Voice Phone Communication	52,367	51,377	35,766
Data Transmission and Wireless Communications	13,532	12,615	8,423
Consolidated depreciation	65,899	63,992	44,189
Capital expenditures:			
Wireline Voice Phone Communication	82,504	100,103	82,137
Data Transmission and Wireless Communications	31,091	41,033	15,353
Consolidated capital expenditures	113,595	141,136	97,490
Assets:			
Wireline Voice Phone Communication	966,952	920,931	891,365
Data Transmission and Wireless Communications	189,764	190,524	119,435
Intersegment assets	(18,210)	(25,507)	(21,210)
Consolidated assets	1,138,506	1,085,948	989,590

20. EARNINGS PER SHARE

Earnings per common share have been calculated using the two-class method on the basis of earnings and weighted average number of common shares outstanding calculated as follows:

	2002	2001	2000
Net profit	58,225	55,066	9,415
Less: dividends declared on preferred shares	(3,549)	(1,218)	(2,686)
Net profit available to common shareholders	**54,676**	**53,848**	**6,729**

Weighted average number of common shares outstanding was 79,829,200 for each of three years in the period ended December 31, 2002.

21. OPERATING LEASES

(a) As lessor - The Group leases excess office space through operating leases, the majority of which are cancelable. Assets under operating leases are included in property, plant and equipment. The amount of rent income under these agreements is not significant to the Group's results.

(b) As lessee - The land on which the Group's buildings and other facilities are located is owned by the City of Moscow. The Group pays the city rent for the land based on the total area and location of land occupied. Land rental expense was approximately $0.9 mln for each of three years in the period ended December 31, 2002.

The Group leases buildings and office space mainly from Moscow Government through contracts, which expire in various years through 2007. Rental expenses under operating leases are included in the statement of operations (Note 18).

Future minimum lease payments due under non-cancelable leases at December 31, 2002 are:

2003	4,560
2004	1,458
2005	1,075
2006	938
2007	938
Thereafter	13,972
Total	**22,941**

22. RELATED PARTY TRANSACTIONS

The Group provides services to affiliates and companies related by means of common control. The revenues generated from these companies in 2002, 2001 and 2000 were approximately $53 mln, $51 mln and $34 mln, respectively.

The Group purchases insurance services from a company related by means of common control. The respective insurance expense in 2002, 2001 and 2000 amounted to $4.7 mln, $3.3 mln and $3.9 mln, respectively.

The Group purchases telecommunication equipment from a company related by means of common control. The cost of equipment purchased from this company in 2002 and 2001 was approximately $8.1 mln and $17.1 mln, respectively.

23. COMMITMENTS AND CONTINGENCIES

Guarantees **-** MGTS is a guarantor under the credit facility with a limit of $65.0 mln provided to Comstar by Vnesheconombank. The facility is effective till January 2005. The guarantee amounted to $12.3mln and $19.8 mln as of December 31, 2002 and 2001, respectively.

MGTS is a guarantor under the credit facility with a limit of $4.2 mln provided to RTK-Leasing, a related party, by Vneshtorgbank. The facility is to be settled prior to July 2004. The guarantee amounted to $3.1mln and $4.0 mln as of December 31, 2002 and 2001, respectively.

In December, 2002 MTU-Inform and Alfabank signed a Guarantee agreement. According to the agreement MTU-Inform guaranteed a loan of $4 mln provided to Golden Line by Alfabank. The loan matures in November, 2005. In addition, MTU-Inform pledged equipment with a fair value of $4.7 mln.

As of December 31, 2002, no liability is recorded in respect of the guarantees since the Group believes it is unlikely that it would be required to perform or otherwise incur any losses associated with these guarantees.

Legal proceedings **-** The Group is involved in litigation and other claims that are in the ordinary course of its business activities. Management believes that the resolution of such matters will not have a material impact on its financial position or operating results.

Taxation **-** Due to the presence in Russian commercial and tax legislation of provisions allowing more than one interpretation, and also due to the practice by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on management's judgment of the Company's business activities was to be challenged by the tax authorities, the Group may by assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years.

Licenses **-** Substantially all the Group's revenues are derived from operations conducted pursuant to licenses to operate in Moscow and the Moscow region granted by the Russian Government. The Voice Phone Communication license expires on January 1, 2004. Suspension or termination of the Group's main license or any failure to renew it could have a material adverse effect on the financial position and operations of the Group. However, the Group has no reason to believe that the license will not be renewed or suspended or terminated, and the management estimates the possibility of such events as very low.

Commitments **-** In December 2002 MTU-Inform signed an agreement to acquire telecommunications equipment and related services from Alcatel. The vendor financing amounting to $10 mln will bear interest of LIBOR + 0.75% and be repayable in 8 equal semi-annual installments starting June 2004.

Interest of the Moscow City Government in the telecommunications sector in the Moscow metropolitan area **-** The operations of the telecommunications network in Moscow are of considerable interest to the City Government. The City Government has exercised and may be expected to continue to exercise influence over the Group's operations. In particular, the City Government may influence setting of tariffs charged to customers to protect low income groups, such as pensioners.

24. SUBSEQUENT EVENTS

The Group follows a translation policy in accordance with FAS No. 52, “Foreign Currency Translation”. Due to a highly inflationary economy in the RF in 2002, 2001 and 2000, the U.S. dollar (the Group’s reporting currency) has been designated as the Group’s functional currency. Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. Management has determined that for the fiscal year beginning January 1, 2003 the functional currency of MGTS is the Ruble and the functional currency of MTU-Inform and PeCom is the U.S. Dollar.

In February 2003, MGTS issued 2-year RUR denominated bonds in the amount of 1,000 mln RUR (approximately 31.5 mln USD). The bonds carry a coupon of 12.3% during the first year of trading and of 17.0% during the second year. Prior to the placement of the third issue the Group repurchased on the open market the first issue of its bonds. The repurchase of the bonds did not have a material effect on the Group’s financial results.

In February 2003, MGTS borrowed $12.0 mln under a RUR-denominated credit facility with Vneshtorgbank. The loans bears interest at 21% per annum, is secured by a pledge of equipment and is due in August 2004.

In February 2003, a fire occurred in one of MGTS’ switching stations, damaging approximately 40,000 telephone lines. Management estimates damages from the fire to approximate $7.6 mln. The insurance compensation amounted to approximately $0.8 mln. In addition, management filed a lawsuit to prove negligence of a third party being the cause of the accident and will seek compensation of damages from this third party.

In April 2003, the Ministry of Antimonopoly Policy approved the increase of MGTS’s fixed monthly charges for residential customers from 110 RUR to 126 RUR effective June 1, 2003 and to 140 RUR effective August 1, 2003 (net of sales tax of 5%). Fixed monthly charges for state-financed institutions will also increase from 125 RUR to 126 RUR effective June 1, 2003 and to 140 RUR effective August 1, 2003.

25. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, FASB issued FAS No. 143, “Accounting for Asset Retirement Obligations”. FAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as an operating item in the statement of operations. FAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Group does not anticipate that adoption of FAS No. 143 will have a material impact on its results of operations or its financial position.

In April 2002, FASB issued FAS No. 145, “Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections”. This Standard rescinds FAS No. 4, “Reporting Gains and Losses from Extinguishments of Debt”, and an amendment of that Standard, Standard No. 64, “Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements”. This Standard also rescinds Standard No. 44, “Accounting for Intangible Assets of Motor Carriers” and amends Standard No. 13, “Accounting for Leases”, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions.
This Standard also amends other existing authoritative pronouncements to make various technical

corrections, clarify meanings, or describe their applicability under changed conditions.
The provisions of this Standard related to the rescission of Standard 4 applied in fiscal years beginning after May 15, 2002. The provisions of this Standard related to Standard 13 will be effective for transactions occurring after May 15, 2002, with early application encouraged. All other provisions of this Standard shall be effective for financial statements issued on or after May 15, 2002, with early application encouraged. The Group does not anticipate that adoption of FAS No. 145 will have a material impact on its results of operations or its financial position.

In June 2002, the FASB issued FAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost as defined in EITF No. 94-3 was recognized at the date of an entity's commitment to an exit plan. FAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Group will adopt the provisions of FAS No. 146 for exit or disposal activities that are initiated after December 31, 2002. The Group does not anticipate that adoption of FAS No. 146 will have a material impact on its results of operations or its financial position.

In December 2002, FASB issued FAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment of FASB Statement No. 123". FAS No. 148 amends FAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition FAS No. 148 amends the disclosure requirements of FAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Amendments to transition provisions and annual financial statements disclosure requirements of FAS No. 123 are effective for the annual financial statements as of and for the year ended December 31, 2002. Amendments to interim period disclosure requirements are effective for the interim periods beginning after December 15, 2002. The Group does not expect the adoption of FAS No. 148 to have a material impact on its financial position or results of operations.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosure requirements about the guarantor’s obligations under certain guarantees that it has issued. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements are effective for financial statement periods ending after December 15, 2002. The Group is currently evaluating effect of the adoption of FIN 45 on its financial position or results of operations.

In January 2003, FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities” (“FIN 46”). FIN 46 clarifies the application of Accounting Research Bulletin No. 51 “Consolidated Financial Statements” to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional support from other parties (“variable interest entities” or “VIEs”). FIN 46 requires VIEs to be consolidated by their primary beneficiaries. FIN 46 applies immediately to the VIEs in which interest is obtained after January 31, 2003 and in the financial statement periods beginning after June 15, 2003, to VIEs in which interest was acquired before February 1, 2003. The Group does not expect the adoption of FIN 46 to have a material impact on its financial position or results of operations.