**OJSC ROSTELECOM**

**CONSOLIDATED FINANCIAL STATEMENTS**
**PREPARED IN ACCORDANCE WITH**
**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2008**

**CONTENT**

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

**To the Shareholders of OJSC Rostelecom**

1. International convention requires that management prepare consolidated financial statements which present fairly, in all material respects, the state of affairs of the Group at the end of each financial period and of the results of operations and cash flows for each period. Management is responsible for ensuring that all Group entities keep accounting records which disclose with reasonable accuracy the financial position of each entity and which enable them to ensure that the consolidated financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board and that their statutory accounting reports comply with Russian laws and regulations. They also have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

2. Management believes that, in preparing the consolidated financial statements set out on pages 6 to 62, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates, and that appropriate International Financial Reporting Standards as issued by the International Accounting Standards Board have been followed.

3. The consolidated financial statements, which are based on the statutory accounting reports adjusted to comply with International Financial Reporting Standards, are hereby approved on behalf of the Board of Directors.

For and on behalf of the Board of Directors:

A.Yu.Kolpakov
General Director

June 10, 2009

OJSC Rostelecom
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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
OJSC Rostelecom:

We have audited the accompanying consolidated balance sheet of OJSC Rostelecom and its subsidiaries (hereinafter referred to as the "Group"), as of December 31, 2008, and the related consolidated statements of income, changes in equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2008, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 10, 2009 expressed an adverse opinion on the effectiveness of the Group's internal control over financial reporting.

KPMG Limited

Moscow, Russia

June 10, 2009

**Reference for audit opinion in respect of consolidated financial statements for 2006, 2007.**

For audit opinion in respect of consolidated balance sheets as of December 31, 2007 and December 31, 2006 and related consolidated statements of income, consolidated statements of cash flows and consolidated statements of changes in equity for 2006 and 2007, presented in consolidated financial statements of OAO “Rostelecom” for 2008, please refer to consolidated financial statements of OAO “Rostelecom” for 2007.

**OJSC Rostelecom**
**CONSOLIDATED BALANCE SHEETS**
**(In millions of Russian Rubles)**

| | Notes | December 31, 2008 | December 31, 2007 | December 31, 2006 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | 6 | 39,586 | 38,480 | 39,186 |
| Goodwill and other intangible assets | 7 | 3,875 | 2,745 | 2,795 |
| Investments in associates | 9 | 178 | 494 | 330 |
| Long-term investments | 10 | 294 | 11,847 | 5,728 |
| Other non-current assets | | 49 | 20 | 71 |
| **Total non-current assets** | | **43,982** | **53,586** | **48,110** |
| **Current assets** | | | | |
| Inventory | | 459 | 447 | 564 |
| Accounts receivable | 11 | 10,133 | 8,429 | 8,821 |
| Prepaid income tax | | 1,375 | 778 | 154 |
| Short-term investments | 12 | 8,762 | 6,920 | 8,496 |
| Cash and cash equivalents | 13 | 11,992 | 3,284 | 2,353 |
| **Total current assets** | | **32,721** | **19,858** | **20,388** |
| **Total assets** | | **76,703** | **73,444** | **68,498** |
| | | | | |
| **EQUITY AND LIABILITIES** | | | | |
| **Equity attributable to equity holders of the parent** | | | | |
| Share capital | 14 | 100 | 100 | 100 |
| Retained earnings and other reserves | | 59,285 | 56,027 | 50,820 |
| **Total equity attributable to equity holders of the parent** | | **59,385** | **56,127** | **50,920** |
| Minority interest | | 40 | 26 | 25 |
| **Total equity** | | **59,425** | **56,153** | **50,945** |
| **Non-current liabilities** | | | | |
| Borrowings, net of current portion | 18 | 117 | 172 | 298 |
| Finance lease payable | 16 | 461 | 396 | 427 |
| Accounts payable, provisions and accrued expenses | 15 | 243 | 269 | 326 |
| Vendor financing payable | 17 | - | - | 362 |
| Deferred tax liability | 19 | 1,590 | 4,119 | 3,444 |
| **Total non-current liabilities** | | **2,411** | **4,956** | **4,857** |
| **Current liabilities** | | | | |
| Accounts payable, provisions and accrued expenses | 15 | 9,495 | 7,445 | 7,372 |
| Finance lease payable | 16 | 103 | 108 | 78 |
| Taxes payable | | 1,126 | 533 | 426 |
| Vendor financing payable | 17 | 1,608 | 1,637 | 1,640 |
| Current portion of long-term borrowings | 18 | 2,522 | 2,585 | 3,005 |
| Short-term borrowings | | 13 | 27 | 175 |
| **Total current liabilities** | | **14,867** | **12,335** | **12,696** |
| | | | | |
| **Total liabilities** | | **17,278** | **17,291** | **17,553** |
| | | | | |
| **Total equity and liabilities** | | **76,703** | **73,444** | **68,498** |

The notes on pages 10 through 62 are an integral part of these consolidated financial statements.

**(In millions of Russian Rubles unless otherwise stated)**

| | | Year ended December 31, | | |
|---|---|---|---|---|
| | **Notes** | **2008** | **2007** | **2006** |
| **Revenue** | | | | |
| Telephone traffic | | 48,143 | 50,000 | 49,121 |
| Rent of channels | | 7,710 | 7,725 | 7,116 |
| Other revenue | | 10,776 | 6,877 | 5,322 |
| **Total revenue** | 20 | **66,629** | **64,602** | **61,559** |
| **Operating expenses** | | | | |
| Wages, salaries, other benefits and payroll taxes | | (9,473) | (8,763) | (7,147) |
| Depreciation and amortization | 6, 7 | (7,174) | (7,613) | (8,418) |
| Impairment of property, plant and equipment, goodwill and other intangible assets | 6, 7 | (215) | (271) | - |
| Charges by network operators – international | | (8,706) | (7,817) | (7,304) |
| Charges by network operators – national | | (25,743) | (27,860) | (29,355) |
| Administration and other costs | 22 | (6,948) | (6,670) | (5,553) |
| Taxes other than on income | | (618) | (703) | (621) |
| Repairs and maintenance | | (899) | (864) | (866) |
| Bad debt recovery/ (expense) | 11 | 32 | (815) | (389) |
| Loss on sale of property, plant and equipment | | (65) | (197) | (601) |
| **Total operating expenses** | | **(59,809)** | **(61,573)** | **(60,254)** |
| **Operating profit** | | **6,820** | **3,029** | **1,305** |
| (Loss)/ income from associates | | (71) | 156 | 19 |
| Interest expense | | (268) | (238) | (133) |
| Interest income | | 1,646 | 907 | 900 |
| Gain on sale of investments | | 8,670 | - | 52 |
| Other non-operating income/(loss) | | 64 | (37) | 81 |
| Foreign exchange (loss)/ gain, net | | (788) | 183 | 219 |
| **Profit before income tax** | | **16,073** | **4,000** | **2,443** |
| Current tax charge | 19 | (4,331) | (1,854) | (2,411) |
| Deferred tax benefit | 19 | 440 | 660 | 1,424 |
| **Income tax expense** | 19 | **(3,891)** | **(1,194)** | **(987)** |
| **Profit after tax** | | **12,182** | **2,806** | **1,456** |
| Attributable to: | | | | |
| Equity holders of the parent | | 12,178 | 2,805 | 1,458 |
| Minority interest | | 4 | 1 | (2) |
| | | **Rubles** | **Rubles** | **Rubles** |
| **Earnings per share attributable to equity holders of the parent – basic and diluted (in Russian Rubles)** | 24 | **12.54** | **2.89** | **1.50** |

The notes on pages 10 through 62 are an integral part of these consolidated financial statements.

(In millions of Russian Rubles)

| | Notes | Year ended December 31, 2008 | 2007 | 2006 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Profit before income tax | | 16,073 | 4,000 | 2,443 |
| *Adjustments to reconcile profit before tax to cash generated from operating activities:* | | | | |
| Depreciation and amortization | 6, 7 | 7,174 | 7,613 | 8,418 |
| Impairment losses | 6, 7 | 215 | 271 | - |
| Bad debt (recovery)/ expense | 11 | (32) | 815 | 389 |
| Loss/ (income) from associates | | 71 | (156) | (19) |
| Loss on sale of property, plant and equipment | | 65 | 197 | 601 |
| Gain from sale of investments | | (8,670) | - | (52) |
| Net interest | | (1,378) | (669) | (767) |
| Other non-operating (income)/ loss | | (64) | 37 | (81) |
| Foreign exchange loss/ (gain), net | | 788 | (183) | (219) |
| *Changes in net working capital:* | | | | |
| Decrease/ (increase) in accounts receivable | | 448 | (487) | (4,242) |
| (Increase)/ decrease in inventories | | (8) | 117 | 198 |
| Increase/ (decrease) in payables and accruals | | 336 | (116) | 2,449 |
| **Cash generated from operations** | | **15,018** | **11,439** | **9,118** |
| Interest paid | | (212) | (257) | (426) |
| Interest received | | 1,194 | 1,059 | 778 |
| Income tax paid | | (4,740) | (2,454) | (2,049) |
| **Net cash provided by operating activities** | | **11,260** | **9,787** | **7,421** |
| **Cash flows from investing activities** | | | | |
| Purchase of property, plant and equipment and intangible assets | | (7,640) | (7,157) | (7,177) |
| Proceeds from sale of property, plant and equipment | | 316 | 231 | 414 |
| Purchase of available-for-sale investments | | - | (570) | - |
| Purchase of financial assets, other than available-for-sale investments | | (12,515) | (20,279) | (14,594) |
| Proceeds from sale of available-for-sale investments, net of direct costs | | 11,385 | 38 | 67 |
| Proceeds from sale of investment other than available-for-sale, net of direct costs | | 10,882 | 21,518 | 18,218 |
| Dividends received from associates | | 20 | 4 | 97 |
| Purchase of subsidiaries, net of cash acquired | | (1,454) | - | (1,481) |
| Purchase of minority interest | 8 | - | (25) | - |
| **Net cash provided by/ (used in) investing activities** | | **994** | **(6,240)** | **(4,456)** |
| **Cash flows from financing activities** | | | | |
| Drawdown of interest bearing loans | | 460 | 415 | 898 |
| Repayment of interest bearing loans and loan facilities | | (1,218) | (927) | (1,297) |
| Repayment of lease obligations | | (154) | (105) | (55) |
| Repayment of vendor financing payable | | (410) | (362) | (711) |
| Dividends paid to equity holders of the parent, net of tax | | (2,128) | (1,630) | (1,839) |
| **Net cash used in financing activities** | | **(3,450)** | **(2,609)** | **(3,004)** |
| **Effect of exchange rate changes on cash and cash equivalents** | | **(96)** | **(7)** | **(6)** |
| **Net increase/(decrease) in cash and cash equivalents** | | **8,708** | **931** | **(45)** |
| **Cash and cash equivalents at beginning of year** | | **3,284** | **2,353** | **2,398** |
| **Cash and cash equivalents at the end of year** | | **11,992** | **3,284** | **2,353** |
| Non-monetary transactions: | | | | |
| Non-cash additions to property, plant and equipment and intangible assets | | 216 | 49 | 962 |

(In millions of Russian Rubles)

| | | Attributable to equity holders of the parent | | | | | | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Unrealized gain/ (loss) on available-for-sale investments | Asset revaluation surplus on acquisitions | Retained earnings | Total | | | |
| **Balances at December 31, 2005** | | **100** | **888** | **-** | **48,709** | **49,697** | | **-** | **49,697** |
| Acquisition of minority interest | | - | - | - | - | - | | 27 | 27 |
| Available-for-sale investments | | | | | | | | | |
| Valuation gain on available-for-sale investments, net of tax | | - | 1,806 | - | - | 1,806 | | - | 1,806 |
| **Total income and expense for the period recognized directly in equity** | | **-** | **1,806** | **-** | **-** | **1,806** | | **-** | **1,806** |
| Profit for the period | | - | - | - | 1,458 | 1,458 | | (2) | 1,456 |
| **Total income and expense** | | **-** | **1,806** | **-** | **1,458** | **3,264** | | **(2)** | **3,262** |
| Dividends | 14 | - | - | - | (2,041) | (2,041) | | - | (2,041) |
| **Balances at December 31, 2006** | | **100** | **2,694** | **-** | **48,126** | **50,920** | | **25** | **50,945** |
| Acquisition of minority interest | | - | - | - | (25) | (25) | | - | (25) |
| Available-for-sale investments | | | | | | | | | |
| Valuation gain on available-for-sale investments, net of tax | | - | 4,223 | - | - | 4,223 | | - | 4,223 |
| **Total income and expense for the period recognized directly in equity** | | **-** | **4,223** | **-** | **(25)** | **4,198** | | **-** | **4,198** |
| Profit for the period | | - | - | - | 2,805 | 2,805 | | 1 | 2,806 |
| **Total income and expense** | | **-** | **4,223** | **-** | **2,780** | **7,003** | | **1** | **7,004** |
| Dividends | 14 | - | - | - | (1,796) | (1,796) | | - | (1,796) |
| **Balances at December 31, 2007** | | **100** | **6,917** | **-** | **49,110** | **56,127** | | **26** | **56,153** |
| Acquisition of subsidiaries | | - | - | 258 | - | 258 | | 10 | 268 |
| Available-for-sale investments | | | | | | | | | |
| Valuation loss on available-for-sale investments, net of tax | | - | (386) | - | - | (386) | | - | (386) |
| Transferred to profit on sale | | | (6,436) | - | - | (6,436) | | - | (6,436) |
| **Total income and expense for the period recognized directly in equity** | | **-** | **(6,822)** | **258** | **-** | **(6,564)** | | **10** | **(6,554)** |
| Profit for the period | | - | - | - | 12,178 | 12,178 | | 4 | 12,182 |
| **Total income and expense** | | **-** | **(6,822)** | **258** | **12,178** | **5,614** | | **14** | **5,628** |
| Dividends | 14 | - | - | - | (2,356) | (2,356) | | - | (2,356) |
| **Balances at December 31, 2008** | | **100** | **95** | **258** | **58,932** | **59,385** | | **40** | **59,425** |

## 1. REPORTING ENTITY

These consolidated financial statements are presented by OJSC Rostelecom ("Rostelecom" or the "Company"), and its subsidiaries (together the "Group"), which are incorporated in the Russian Federation ("Russia"). The principal activity of the Group is the provision of long-distance domestic and international telecommunication services to the Government, businesses and individuals of Russia. The Group operates the main intercity network and the international telecommunications gateways of the Russian Federation, carrying traffic that originates in other national and international operators' networks to other national and international operators for termination.

The Company's headquarters are located in Moscow at 1st Tverskaya-Yamskaya Street, 14, Russia.

These consolidated financial statements incorporate the results of operations of the Company and its subsidiaries, as detailed in Note 8.

Rostelecom was established as an open joint stock company on September 23, 1993 in accordance with the Directive of the State Committee on the Management of State Property of Russia No. 1507-r, dated August 27, 1993. As of December 31, 2008, the Government of the Russian Federation controls OJSC Svyazinvest ("Svyazinvest"), the parent company of Rostelecom, by virtue of 75% less one share direct holding. Svyazinvest holds 50.67% of the voting shares in Rostelecom.

## 2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with and comply with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The Group maintains its accounting records and prepares its statutory accounting reports in accordance with Russian accounting legislation and instructions in Russian Rubles (Rbl). These consolidated financial statements are based on the underlying accounting records, appropriately adjusted and reclassified for fair presentation in accordance with the standards and interpretations prescribed by the IASB.

The consolidated financial statements have been prepared using the historical cost convention, except for restatement of property, plant, equipment and share capital for the effects of inflation up to December 31, 2002, and measurement of available-for-sale investments at fair value and some other items when IFRS requires accounting treatment other than historical cost accounting (refer to Note 4). The functional currency of the Company and each of its subsidiaries and the reporting currency for these consolidated financial statements is the Russian Ruble. All financial information presented in Russian Rubles has been rounded to the nearest million, unless otherwise stated.

## 3. OPERATING ENVIRONMENT OF THE GROUP

### General

The Russian Federation has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks that typically do not exist in other markets. In addition, the recent contraction in the capital and credit markets has further increased the level of economic uncertainty in the environment. The consolidated financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

**Inflation**

The Russian economy has been characterized by relatively high rates of inflation. The following table summarizes the annual rate of inflation for the past three years:

| For the year ended December 31, | Annual inflation |
|---|---|
| 2008 | 13.3% |
| 2007 | 11.9% |
| 2006 | 9.0% |

Source: Federal Service of Public Statistics

## 4. PRINCIPAL ACCOUNTING POLICIES

Set out below are the principal accounting policies used to prepare these consolidated financial statements:

**Changes in Accounting Policies**

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted those new/revised standards and interpretations mandatory for financial years beginning on or after January 1, 2008. The changes in accounting policies result from adoption of the following new or revised standards and interpretations:

- IFRIC No. 11 "IFRS 2 - Group and Treasury Shares Transactions";
- IFRIC No. 12 "Service Concession Arrangements";
- IFRIC No. 14 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction".

The adoption of Interpretations issued by the International Financial Reporting Interpretations Committee did not have material impact on the Group's results of operations, financial position and cash flows.

**Significant Accounting Judgments and 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to the recoverability and depreciable lives of property, plant and equipment, fair values of assets and liabilities acquired in business combinations, post employment benefits, allowance for doubtful accounts, and deferred taxation. Actual results could differ from these estimates.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Changes in estimate of useful lives*

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

In March 2006 the Company formalized a plan to gradually discontinue using analog trunk lines and equipment beginning from January 2006 and through the end of 2010. The Company has accordingly revised its estimate of the remaining period of use of the analog lines and equipment prospectively effective January 1, 2006. The net effect of change in useful lives of analog trunk lines for the year ended December 31, 2008 was to increase depreciation by 164 (2007: 243, 2006: 1,393). The change in useful lives is expected to result in a decrease of depreciation for the year ended December 31, 2009 by 63. Management believes this difference will be decreasing in subsequent years.

*Fair Values of Assets and Liabilities Acquired in Business Combinations*

The Group is required to recognize separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in a business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions.

*Site Restoration Provisions*

The Group reviews site restoration provisions at each balance sheet date and adjusts them to reflect the current best estimate in accordance with IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

*Post-Employment Benefits*

The Group uses actuarial valuation methods for measurement of the present value of defined post-employment benefit obligations and related current service cost (refer to Note 23). This involves the use of demographic assumptions about the future characteristics of current and former employees who are eligible for benefits (mortality, both during and after employment, rates of employee turnover, etc.) as well as financial assumptions (discount rate, future salary and benefit levels, etc.).

*Allowances*

The Group makes allowances for doubtful accounts receivable. Significant judgment is used to estimate doubtful accounts. In estimating doubtful accounts historical and anticipated customer performance are considered. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements. As of December 31, 2008, 2007 and 2006, allowances for doubtful accounts have been created in the amount of 2,042, 2,187 and 1,594, respectively (refer to Note 11).

*Goodwill*

The Group determines whether goodwill is impaired on an annual basis. This requires an estimation of the value in use of the cash-generating unit(s) to which goodwill is allocated. Estimating the value in use requires the Group to make an estimate of expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate present value of those cash flows. As at the balance sheet date the Group estimated the value in use of cash-generating unit CJSC Globus Telecom to be lower than the carrying amount of respective net assets including goodwill. The carrying amount of consolidated goodwill as of December 31, 2008 is 1,118 (refer to Note 7).

*Litigations*

The Group exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgment is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

**Principles of consolidation**

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of December 31 each year.

A subsidiary is an entity that is controlled by the Company, either through ownership, directly or indirectly, of more than 50% of the voting share capital of the entity. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases.

The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. Losses in excess of minority interest are allocated to the Group.

Associates in which the Group has significant influence but not a controlling interest are accounted for using the equity method of accounting. Significant influence is usually demonstrated by the Group owning, directly or indirectly, between 20% and 50% of the voting ownership interest or by power to participate in the financial and operating policy decisions of associates. The Group's share of the net income or losses of associates is included in the consolidated statements of income, the Group's share of movement in reserves is recognized in equity and the Group's share of the net assets of associates is included in the consolidated balance sheets.

An assessment of investments in associates for possible impairment or reversal of impairment recognized previously is performed when there is an indication that the asset has been impaired or the impairment losses recognized in prior years no longer exist. When the Group's share of losses exceeds the carrying amount of the investment, the investment is reported at nil value and recognition of losses is discontinued except to the extent of the Group's commitment to fund future losses. Unrealized profits and losses that arise from transactions between the Group and its associates are eliminated in the proportion to the Group's share in such associates.

**Goodwill and excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost**

Goodwill represents the excess of the cost of acquisition over the net fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in the investments in associate. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Impairment losses for goodwill may not be reversed. If the impairment loss recognized for the cash-generating unit exceeds the carrying amount of the allocated goodwill, the additional amount of the impairment loss is recognized by allocating to other assets on pro rata basis, but not below their fair value unless another basis is more appropriate.

Goodwill is not amortized. Instead, it is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. For the purposes of impairment testing, goodwill acquired in a business combination is, from the acquisition date allocated to each of the cash-generating units or groups of cash-generating units expected to benefit from the combination's synergies, irrespective of whether other assets and liabilities of the Group are assigned to those units or group of units. Each unit or group of units to which goodwill is so allocated:

- Represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

- Is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with IAS 14 Segment Reporting.

Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit and part of the operations within that unit are disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of cash-generating unit retained.

In case of excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost of business combination the Group:

(a) reassesses the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination:

(b) recognizes in profit or loss any excess remaining after that reassessment immediately.

Acquisitions of minority interests are accounted for using the entity concept method, whereby the difference between the consideration paid and the carrying value of net assets attributable to minority interests acquired is recognized directly in equity by charging or crediting retained earnings.

**Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value. The cost of the network comprises all qualifying expenditures up to and including the cabling and wiring to the local telephone operator's intercity exchange, and includes contractors' charges and payments on account, materials, direct labour, and interest costs on specific project financing up to the date of commissioning of the relevant assets. Dismantling costs are included in cost of property, plant and equipment.

Subsequent expenditures are capitalized if it can be clearly demonstrated that they extend the life of the asset or significantly increase its revenue generating capacity beyond its originally assessed standard of performance. Expenditure for continuing repairs and maintenance are charged to the statement of income as incurred.

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 difference between the net disposal proceeds and carrying amount of the item is reported as a gain or loss on derecognition. The gain or loss resulting from such retirement or disposal is included in the determination of net income.

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

| | Number of years |
|---|---|
| Buildings and site services | 10 – 50 |
| Cable and transmission devices: | |
| • Channels | 10 – 40 |
| • Cable | 30 – 40 |
| • Radio and fixed link transmission equipment | 8 – 20 |
| • Telephone exchanges | 15 |
| Other | 5 - 10 |

The useful life of assets encompasses the entire time they are available for use, regardless of whether during that time they are in use or idle. The useful lives and residual value of assets and methods are reviewed at each balance sheet date or more frequently if events occur that suggest a change is necessary and, if expectations differ from previous estimates, the changes are accounted for prospectively. Depreciation of an asset ceases at the earlier of the date the asset is classified as held for sale and the date the asset is derecognized.

At each balance sheet date or more frequently if events occur that suggest a change is necessary, an assessment is made as to whether there is any indication that the Group's assets may be impaired. If any such indication exists, an assessment is made to establish whether the recoverable amount of the assets has declined below the carrying amount of those assets as disclosed in the financial statements. When such a decline has occurred, the carrying amount of the assets is reduced to the recoverable amount. The amount of any such reduction is recognized immediately as a loss in the statement of income. Any subsequent increase in the recoverable amount of the assets is reversed when the circumstances that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. Increase of the recoverable amount is limited to the lower of its recoverable amount and carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. The recoverable amount is determined as the higher of the assets' fair value less cost to sell, or value in use. The value in use of the asset is estimated based on forecast of future cash inflows and outflows to be derived from continued use of the asset and from the estimated net proceeds on disposal, discounted to present value using an appropriate discount rate. Based on management's analysis there were indicators of impairment of property, plant and equipment as of December 31, 2008 (refer to Note 6).

The determination of impairment of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunication industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate an impairment exists. The recoverable amount and the fair values are typically determined using a discounted cash flow method, which incorporates reasonable market participant assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values for assets (or group of assets) requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. Methods used to determine the value in use include discounted cash flow-based methods and methods that use quoted stock market prices as a basis. These estimates, including the methodologies used, can have a material impact on the fair value and ultimately the amount of any property, plant and equipment impairment.

Construction in progress represents properties under construction and is stated at cost. This includes cost of construction, plant and equipment and other direct costs. Construction in progress is not depreciated until the constructed or installed asset is ready for its intended use.

Advances given to suppliers of property, plant and equipment are included in construction in progress.

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

### Leases

Service contracts that do not take the legal form of a lease but convey rights to the Group to use an asset or a group of assets in return for a payment or a series of fixed payments are accounted for as leases. Determining whether an arrangement contains a lease is determined based on the facts and circumstances of each arrangement to determine whether fulfilment of the arrangement is dependent on the use of a specific asset or assets and whether the arrangement conveys a right to use that asset. Contracts meeting these criteria are then evaluated to determine whether they are either an operating lease or finance lease.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the commencement of lease term 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 directly against income. Capitalized leased assets are depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term unless there is a reasonable certainty that the Group will obtain ownership by the end of the lease term, in which case the assets are depreciated over their estimated useful lives.

Indefeasible Rights of Use (IRU) represent the right to use a portion of the capacity of a terrestrial or submarine transmission cable granted for a fixed period. IRUs are recognized as an asset when the Group has the specific indefeasible right to use an identified portion of the underlying asset, generally optical fibers or dedicated wavelength bandwidth, and the duration of the right is for the major part of the underlying asset's economic life. Such assets are included in property, plant and equipment in the consolidated balance sheet. They are depreciated over the shorter of the expected period of use and the life of the contract.

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

### Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment when there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end and, if expectations differ from pervious estimates, the changes are accounted for as changes in accounting estimates. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The Group assesses whether there is any indication that a finite lived intangible asset may be impaired at each reporting date. The Group also performs annual impairment tests for finite lived assets not yet placed in use. The amortization expense on intangible assets with finite lives is included in depreciation and amortization expenses in the consolidated statements of income.

Intangible assets with indefinite useful lives are not amortized, but tested for impairment annually or more frequently when indicators of impairment exist, either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

### Inventory

Inventory principally consists of fuel and spare parts for the network. Inventory is stated at the lower of cost incurred in bringing each item to its present location and condition and its net realizable value. Cost is calculated on a first-in first-out basis. Items used in the construction of new plant and equipment are capitalized as part of the related asset. Net realizable value is determined with respect to current market prices less expected costs to dispose. Inventory used in the maintenance of equipment is charged to operating costs as utilized and included in repair and maintenance and other costs in the consolidated statements of income.

### Accounts receivable

Trade and other accounts receivable are stated in the balance sheet at original invoice amount less an allowance for any uncollectible amounts. The allowance is created based on the historical pattern of collections of accounts receivable and specific analysis of recoverability of significant accounts. Bad debts are written off in the period in which they are identified.

### Financial instruments

Financial instruments carried on the balance sheet include cash and cash equivalents, investments (other than in consolidated subsidiaries and equity method investees), non-hedge derivatives, accounts receivable, accounts payable and borrowings. The particular recognition methods adopted for financial instruments are disclosed in the individual policy statements associated with each item. The Group classifies financial assets and liabilities into the following categories: loans and receivables, financial assets and liabilities at fair value through profit or loss, available-for-sale financial assets, financial liabilities at amortized cost.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and not originated with the intent to be sold immediately. Such assets are carried at amortized cost using the effective interest method less any allowance for impairment. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are integral part of the effective interest rate. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through amortization process.

Financial assets and liabilities at fair value through profit and loss are financial assets or liabilities, which are either classified as held for trading or derivatives or are designated by the Group as at fair value through profit or loss upon initial recognition. Financial assets are classified as held for trading if they are acquired for the purposes of selling in the near term. Gains and losses on investments held for trading are recognized in income.

All financial liabilities are carried at amortized cost using effective interest method, except for derivative financial liabilities which are carried at their fair values.

Transactions with financial instruments are recognized using settlement date accounting. Assets are recognized on the day they are transferred to the Group and derecognized on the day that they are transferred by the Group.

All other investments not classified in any of the two preceding categories are classified as available-for-sale. After initial recognition, available-for-sale investments are measured at fair value with gains and losses being recognized as a separate component of equity until the investment is derecognized at which time the cumulative gain or loss previously reported in equity is included in the determination of net income. At each balance sheet date or more frequently if events occur that suggest a change is necessary, an assessment is made as to whether there is any indication that the Group's investments may be impaired. The fair value of investments that are actively traded in organized markets is determined by reference to the quoted market bid price at the close of business on the balance sheet day. For investment where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length transactions; references to current market value of other instruments which is substantially the same; discounted cash flow analysis or other valuation models.

Interest income from investments is accrued during the period in which it is earned.

The Group invests temporarily available funds in bills of exchange issued by various Russian companies maturing within 12 months after the balance sheet date or with no fixed maturity, which the Group plans to sell during the next year.

**Borrowings**

Borrowings are initially recognized at fair value less directly attributable transaction costs, and have not been designated 'as at fair value through profit or loss'. In subsequent periods, borrowings are measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the amortization process.

**Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand, balances with banks, and highly liquid investments with original maturities of three months or less, with insignificant risks of diminution in value.

**Deferred income taxes**

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences:

- except where the deferred income tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax credits and unused tax losses can be utilized:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognized to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference 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. Any such previously recognized reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

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

**Revenue and operating costs recognition**

Revenue and operating costs for all services supplied and received are recognized at the time the services are rendered. Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenue can be reliably measured. Revenues and expenses are reported net of respective value added tax.

Revenues from directly billed subscribers are recognized in the period where the services were provided based on the Group’s billing system’s data. Revenues from subscribers billed via agents are recognized in the period where the services were provided based on agent reports.

The Group charges all its subscribers throughout Russia for outgoing telephone traffic based on pre-set per minute tariffs regulated by the Ministry of Telecommunications. The Group is charged by regional local operators for originating and terminating calls. The Group also incurs agent fees in connection with the service contracts concluded with regional local operators.

The Group charges amounts to foreign network operators for incoming calls and other traffic that originate outside Russia. The Group is charged by foreign operators for completing international calls. These revenues and costs are shown gross in the consolidated financial statements.

Amounts payable to and receivable from the same operators are shown net in the balance sheet where a legal right of offset exists and there is intention either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Revenues from the sale of transmission capacity on terrestrial and submarine cables, which relates to IRU under operating leases where the Group is a lessor, are recognized on a straight-line basis over the life of the contract.

**Provisions**

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in Other non-operating income or loss or capitalized in an asset if it is required by IFRS.

**Employee benefits**

The Group operates a defined benefit pension scheme which requires one-off contributions, representing net present value of future monthly payments to employees, to be made by the Group to a separately administered pension fund upon employees' dismissal. A participating employee with fifteen or more years of service in the telecommunication industry is eligible for the pension provided dismissal is accepted within one month after the statutory retirement age. The pension fund is liable for payments to the retired employees. Under the scheme benefits payable are indexed periodically. Actuarial gains and losses are recognized in the statements of income immediately.

The Group uses the Project Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.

The Group also participates in a defined contribution plan. Contributions made by the Group on defined contribution plans are charged to expenses when incurred. Effective January 1, 2004, maximum contribution is established at 100.00 Rubles per month per employee.

The Group accrues for the employees' compensated absences (vacations) as the additional amount that the Group expects to pay as a result of the unused vacation that has accumulated at the balance sheet date.

Under provision of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Group by the application of a regressive rate (from 26% to 2%) to the annual gross remuneration of each employee. The Group allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension funds varies from 20% to 2% depending on the annual gross salary of each employee. The Group's contributions relating to UST are expensed in the year to which they relate.

**Borrowing costs**

Borrowing costs are expensed, except for those that would have been avoided if the expenditure to acquire the qualifying asset had not been made. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average rate of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining the qualifying asset. Qualifying borrowing costs are capitalized with the relevant qualifying asset from the date the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred until the related asset is substantially ready for its intended use. Capitalized borrowing costs are subsequently charged to the statement of income in the period over which the asset is depreciated.

**Foreign currency transactions**

Transactions denominated in foreign currencies are translated into Rubles at the exchange rate as of the transaction date. Foreign currency monetary assets and liabilities are translated into Rubles at the exchange rate as of the balance sheet date. Exchange differences arising on the settlement of monetary items, or on reporting the Group's monetary items at rates different from those at which they were initially recorded in the period, or reported in previous financial statements, are recorded as foreign currency exchange gains or losses in the period in which they arise.

As at December 31, 2008, 2007 and 2006, the rates of exchange used for translating foreign currency balances were (in Russian Rubles for one unit of foreign currency):

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| US Dollar (USD) | 29.38 | 24.55 | 26.33 |
| Japanese Yen (100) | 32.58 | 21.84 | 22.16 |
| Special Drawing Rights (SDR) | 45.73 | 38.75 | 39.58 |
| EURO (EUR) | 41.44 | 35.93 | 34.70 |

Source: the Central Bank of Russia

At the date these financial statements were authorized for issue at June 10, 2009 USD equals to 31.26, Japanese Yen equals to 31.86, SDR equals to 47.79, EUR equals to 43.49 Russian Rubles, respectively.

**Dividends**

Dividends are recognized when the shareholder's right to receive the payment is established. Dividends in respect of the period covered by the financial statements that are proposed or declared after the balance sheet date but before approval of the financial statements are not recognized as a liability at the balance sheet date in accordance with IAS 10 Events After the Balance Sheet Date. The amount of dividends declared after the balance sheet date but before the financial statements were authorized for issue is disclosed in Note 33.

**Minority interest**

Minority interest includes that part of the net results of operations and of net assets of subsidiaries attributable to interests which are not owned, directly or indirectly through subsidiaries, by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair values of identifiable assets and liabilities of the subsidiary at the acquisition date, and the minority's portion of movements in net assets since the date of the combination.

The excess, and any further losses applicable to the minority, are charged against the majority interest, except to the extent that the minority has a binding obligation to, and is able to, compensate for the losses. If the subsidiary subsequently reports profits, the majority interest holder is allocated all such profits until the minority's interest holder share of losses previously absorbed by the majority has been recovered. If a subsidiary or an associate has outstanding cumulative preferred shares, which are held outside the Group, the Company computes its share of profits or losses after adjusting for the preferred dividends, whether or not the dividends have been declared.

The difference between consideration paid and the carrying values of net assets attributable to minority interests acquired was recognized directly in equity.

**Earnings per share**

IAS 33, as revised, requires the application of the "two-class method" to determine earnings applicable to ordinary shareholders, the amount of which is used as a numerator to calculate earnings per ordinary share. The application of the "two-class method" requires that the profit or loss after deducting preferred dividends is allocated to ordinary shares and other participating equity instruments to the extent that each instrument shares in earnings as if all of the profit or loss for the period had been distributed. The total profit or loss allocated to each class of equity instrument is determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.

### Segment information

Effective December 1, 2003, the Group determined the primary segment reporting format to be business segments and the Group operates in one business segment for the provision of telecommunication services. This reportable segment was identified based on the organizational structure of the Group and types of activities the Company and its subsidiaries are engaged in.

### IFRSs and IFRIC Interpretations not yet effective

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

- IAS No. 1 "Presentation of Financial Statements (Revised)";
- IAS No. 23 "Borrowing Costs (Revised)";
- IAS No. 27 "Consolidated and Separate Financial Statements (Revised)";
- IAS No. 32 "Financial Instruments: Presentation (Revised)";
- IAS No. 39 "Financial Instruments: Recognition and Measurement (Revised)";
- IFRS No.1 "First-time adoption of International Financial Reporting Standards (Revised);
- IFRS No. 2 "Share-based Payment (Revised)";
- IFRS No. 3 "Business Combinations (Revised)";
- IFRS No. 8 "Operating Segments";
- IFRIC No. 13 "Customer Loyalty Programmes";
- IFRIC No. 15 "Agreements for the Construction of Real Estate";
- IFRIC No. 16 "Hedges of a Net Investment in a Foreign Operation";
- IFRIC No. 17 "Distributions of Non-cash Assets to Owners";
- IFRIC No 18 "Transfers of Assets from Customers";
- Improvements to International Financial Reporting Standards 2008.

The revised IAS 1 *Presentation of Financial Statements* is effective for annual periods beginning on or after January 1, 2009. The changes require information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. The revised standard gives preparers of financial statements the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The Group is still evaluating whether it will have one or two statements.

One more amendment to IAS 1 requires disclosure of certain information relating to puttable financial instruments classified as equity. The Group does not expect this amendment to impact the financial statements of the Group.

The principal change to IAS 23 *Borrowing Costs* is to eliminate the previously available option to recognize all borrowing costs as expense when incurred and will have no impact on the Group's financial statements because it has always been the Group's accounting policy to capitalize borrowing costs incurred on qualifying assets. The provisions of revised IAS 23 *Borrowing Costs* are effective for financial statements covering periods beginning on or after January 1, 2009.

Revised IAS 27 was issued in January 2008 and becomes effective on or after July 2009. It requires that a change in ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as loss of control of a subsidiary. The changes introduced by IAS 27 must be applied prospectively and will affect future acquisitions and transactions with minority interests.

Amendment to IAS 32 becomes effective for annual periods beginning on or after January 1, 2009. It requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The Group does not expect this amendment to impact the financial statements of the Group.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment, which becomes mandatory for the Group's 2010 consolidated financial statements, with retrospective application required, is not expected to have any impact on the consolidated financial statements of the Group.

Amendments to IFRS 1 *First-time adoption of International Financial Reporting Standards* will come into effect on July 1, 2009. There is no effect on the consolidated financial statements as a result of the adoption of the standard.

Amendments to IFRS 2 *Share-based Payment – Vesting conditions and cancellations* clarify the definition of vesting conditions, introduce the concept of non-vesting conditions, require non-vesting conditions to be reflected in grant-date fair value and provide the accounting treatment for non-vesting conditions and cancellations. The amendments to IFRS 2 will become mandatory for the Group's 2009 consolidated financial statements, with retrospective application. There is no effect on the consolidated financial statements, as the Group has no share-based payment transactions.

IFRS 3 *Business Combinations* introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. The changes introduced by IFRS 3 will be effective for financial years beginning on or after July 1, 2009. They must be applied prospectively and will affect future acquisitions and transactions with minority interests.

IFRS 8 *Operating Segments* requires disclosure of information about the Group's operating segments and replaces the requirements to determine primary (business) and secondary (geographical) reporting segments of the Group. The Standard is effective for periods beginning on or after January 1, 2009. The Group is in the process of determining the effect of adoption of the Standard on the Group's results of operations and financial position.

IFRIC 13 *Customer Loyalty Programmes* was issued in June 2007 and became effective for annual periods beginning on or after July 1, 2008. This Interpretation requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Group is now considering whether their arrangements with customers include terms which potentially may be subject to the requirements of this Interpretation. The adoption of the Interpretation may lead to deferral of some revenues. The Group is in the process of determining the effect of adoption of the Interpretation on the Group's results of operations and financial position.

IFRIC 15 *Agreements for the Construction of Real Estate* provides some limited additional guidance on the distinction between 'construction contracts' (falling within the scope of IAS 11) and other agreements for the construction of real estate (falling within the scope of IAS 18). Agreements involving the construction of real estate will need to be examined carefully to determine whether they should be accounted for in accordance with IAS 11 or IAS 18. IFRIC 15 is effective for annual periods beginning on or after January 1, 2009. The Group does not expect this Interpretation to impact the financial statements of the Group.

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* becomes effective for annual periods beginning on or after October 1, 2008. This Interpretation provides guidance on net investment hedging regarding risks and amounts qualified for hedge accounting. The Group doesn't expect this Interpretation will have material effect on the Group's financial statements.

IFRIC 17 *Distributions of Non-cash Assets to Owners* was issued in November 2008 and becomes effective for annual periods beginning on or after July 1, 2009. The Interpretation provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends to its shareholders. IFRIC 17 follows the principle that an entity should recognize a liability at the point when the dividend is appropriately authorized, the liability should be measured at the fair value of the non-cash assets to be distributed and the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable, if any, should be recognized in profit and loss. The Group does not expect this Interpretation to impact the financial statements of the Group.

IFRIC 18 *Transfers of Assets from Customers* was issued to address divergent practice in the accounting by recipients for transfers of property, plant and equipment from 'customers'. The Interpretation concludes that when the item of property, plant and equipment transferred meets the definition of an asset from the perspective of the recipient, the recipient should recognize the asset at its fair value on the date of the transfer, with the credit recognized as revenue in accordance with IAS 18 *Revenue.* The Interpretation is to be applied prospectively to transfers of assets from customers received on or after July 1, 2009. The Group doesn't expect this Interpretation will have material effect on the Group's financial statements.

On May 22, 2008, the International Accounting Standards Board (IASB) issued its latest Standard, titled *Improvements to International Financial Reporting Standards 2008*. This is the first Standard published under the IASB's annual improvements process, which is intended to deal with non-urgent, minor amendments to Standards. The Standard includes 35 amendments, and is split into two parts:

- Part I – amendments that result in accounting changes for presentation, recognition or measurement purposes and
- Part II – amendments that are terminology or editorial changes only, which the Board expects to have no or minimal effect on accounting.

The Group evaluated the effect of adoption of the Standard on the Group's results of operations and financial position and concluded than its adoption will not have material impact.

## 5. BUSINESS COMBINATIONS

### OJSC RTComm.RU

In March 2008, the Group‘s Board of Directors authorized the purchase of an additional 68.4% equity interest in OJSC RTComm.RU from CJSC Sinterra, a non-related party.

Control was passed to the Group on July 1, 2008. The Group's share in RTComm.RU before the acquisition was 31.1%. RTComm.RU is one of the leading companies in the Russian telecommunication market, providing Internet access services to enterprises and individuals. The purchase of RTComm.RU was aimed to increase the diversification of activities of the Group. The cost of the additional investment amounted to 1,560, including costs directly attributable to the acquisition of 15 and was settled in cash.

OJSC RTComm.RU has three subsidiaries: CJSC RTComm-Sibir, LLC Bashrtcomm, LLC RTComm-Yug.

The Group accounted for the acquisition of RTComm.RU by applying the purchase method, in accordance with provisions of IFRS 3 *Business combinations.*

The results of operations and financial position of RTComm.RU were consolidated by the Group starting from July 1, 2008. The following table summarizes the fair values of identifiable net assets of RTComm.RU acquired as at the acquisition date:

| | Pre-acquisition carrying amounts on a comparable IFRS basis | Fair value adjustments | Recognized fair values on acquisition |
|---|---|---|---|
| Property, plant and equipment | 669 | 128 | 797 |
| Intangible assets | | | |
| Trademark | - | 76 | 76 |
| Contract-based intangible assets | - | 298 | 298 |
| Customer list | - | 424 | 424 |
| Computer software | 46 | (5) | 41 |
| Other | - | 3 | 3 |
| Inventories | 5 | (1) | 4 |
| Trade and other receivables | 849 | (12) | 837 |
| Cash and cash equivalents | 113 | - | 113 |
| Other current assets | 524 | (8) | 516 |
| Deferred tax liabilities | 98 | (265) | (167) |
| Short-term debt | (122) | - | (122) |
| Accounts payable and accrued liabilities | (1,414) | 188 | (1,226) |
| Other current liabilities | (16) | - | (16) |
| **Fair value of net assets** | **752** | **826** | **1,578** |
| Less: minority interest (0.49%) | | | (10) |
| Less: fair value of previously acquired 31.1% share | | | (490) |
| Group's share of the fair value of net assets acquired (68.4%) | | | 1,078 |
| Consideration paid | | | 1,560 |
| **Goodwill** | | | **482** |

The Group's share of the identifiable assets, liabilities and contingent liabilities acquired in previous transactions was revalued, with the adjustment of 258 recognized directly in equity.

From the date of acquisition until December 31, 2008, OJSC RTComm.RU has contributed 15 to the increase of the net profit of the Group for 2008. If the combination had taken place at the beginning of 2008, the profit of the Group would have been 11,921 and revenue would have been 68,883.

### CJSC Globus-Telecom

On April 3, 2006, the Group in a linked transaction acquired 95% of the shares of CJSC Globus-Telecom, of which 60% was acquired from CJSC Alsean-N for 666, 15% was acquired from OJSC RTC-Leasing for 155 and 20% was acquired through the purchase of 100% of the shares in LLC Telecomcenter for 281. Costs directly attributable to the business combination amounted to 21 and consisted of payments for legal and consulting services. The main activity of CJSC Globus-Telecom is the provision of telecommunication services, including provision of local telecommunication services, data transmission services, rent of channels, to governmental, corporate and individual customers in Moscow and other regions throughout Russia. The purchase of CJSC Globus-Telecom was aimed to strengthen the competitive position of the Group in the retail market by increasing its share of the Moscow corporate market and expanding the range of services provided to end-customers.

The results of operations and financial position of CJSC Globus-Telecom were consolidated by the Group beginning from April 3, 2006. The following table summarizes the fair values of identifiable net assets of CJSC Globus-Telecom acquired as at the acquisition date:

| | **April 3, 2006** |
|---|---|
| Property, plant and equipment | 171 |
| Intangible assets | |
| Number capacity | 326 |
| Contract-based intangible assets | 147 |
| Computer software | 27 |
| Inventories | 2 |
| Trade and other accounts receivable | 88 |
| Cash | 12 |
| Other current assets | 53 |
| Deferred tax liability | (98) |
| Long-term accounts payable | (49) |
| Short-term debt | (51) |
| Accounts payable and accrued liabilities | (167) |
| Other current liabilities | (17) |
| **Fair value of net assets** | **444** |
| Less: minority interest (5.1%) | (23) |
| Group's share of the fair value of net assets | 421 |
| Consideration paid | 1,123 |
| **Goodwill** | **702** |

The disclosure of carrying amounts of assets, liabilities and contingent liabilities of CJSC Globus-Telecom in accordance with IFRS, immediately before the business combination, is impracticable as CJSC Globus-Telecom had not been an IFRS reporter.

From the date of acquisition until December 31, 2006, CJSC Globus-Telecom has contributed 6 to the increase of the net profit of the Group for 2006. If the combination had taken place at the beginning of 2006, the profit of the Group would have been 1,447 and revenue would have been 61,652.

### CJSC Zebra Telecom

On June 13, 2006, the Group acquired 100% of the shares of CJSC Zebra Telecom from Starford Investments Company Ltd., an unrelated party, for 374 in cash. The main activity of CJSC Zebra Telecom is the provision of local telecommunication services and Internet services mostly in Moscow to individual customers. The purchase of CJSC Zebra Telecom was aimed to increase diversification of activities of the Group and to develop the activities related to sale of prepaid telephone cards.

The results of operations and financial position of CJSC Zebra Telecom were consolidated by the Group beginning from June 13, 2006. The following table summarizes the fair values of net assets acquired as at the acquisition date:

| | **June 13, 2006** |
|---|---|
| Property, plant and equipment | 42 |
| Intangible assets | |
| Trademarks | 197 |
| Contract-based intangible assets | 3 |
| Number capacity | 1 |
| Computer software | 4 |
| Inventories | 10 |
| Trade and other accounts receivable | 35 |
| Cash | 1 |
| Other current assets | 17 |
| Deferred tax liability | (29) |
| Short-term debt | (49) |
| Accounts payable and accrued liabilities | (95) |
| **Fair value of net assets** | **137** |
| Consideration paid | 374 |
| **Goodwill** | **237** |

The disclosure of carrying amounts of assets, liabilities and contingent liabilities of CJSC Zebra Telecom in accordance with IFRS, immediately before the business combination, is impracticable as CJSC Zebra Telecom had not been an IFRS reporter.

From the date of obtaining control until December 31, 2006 CJSC Zebra Telecom has contributed 13 to the decrease of the net profit of the Group for 2006. If the control was obtained at the beginning of the year, the profit of the Group would have been 1,417 and revenue would have been 61,741.

## 6. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2008, 2007, and 2006 was as follows:

| | Buildings and site services | Cable and transmission devices | Other | Construction in progress | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At January 1, 2008 | 24,108 | 96,908 | 24,889 | 9,486 | 155,391 |
| Additions | - | - | 341 | 7,490 | 7,831 |
| Acquisition through business combination | 43 | 589 | 72 | 93 | 797 |
| Disposals | (966) | (11,160) | (1,691) | (353) | (14,170) |
| Transfer | 579 | 3,653 | 2,237 | (6,469) | - |
| Reclassification | 15 | (198) | 183 | - | - |
| At December 31, 2008 | 23,779 | 89,792 | 26,031 | 10,247 | 149,849 |
| **Accumulated Depreciation and Impairment Losses** | | | | | |
| At January 1, 2008 | (19,002) | (79,607) | (18,189) | (113) | (116,911) |
| Depreciation expense | (984) | (3,693) | (2,091) | - | (6,768) |
| Impairment losses | (3) | (57) | (65) | - | (125) |
| Disposals | 888 | 11,013 | 1,627 | 13 | 13,541 |
| Reclassification | (8) | 60 | (52) | - | - |
| At December 31, 2008 | (19,109) | (72,284) | (18,770) | (100) | (110,263) |
| **Net book value at December 31, 2008** | **4,670** | **17,508** | **7,261** | **10,147** | **39,586** |

| | Buildings and site services | Cable and transmission devices | Other | Construction in progress | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At January 1, 2007 | 24,329 | 103,039 | 25,129 | 8,293 | 160,790 |
| Additions | - | - | - | 7,144 | 7,144 |
| Disposals | (1,070) | (9,782) | (1,620) | (71) | (12,543) |
| Transfer | 489 | 3,708 | 1,683 | (5,880) | - |
| Reclassification | 360 | (57) | (303) | - | - |
| At December 31, 2007 | 24,108 | 96,908 | 24,889 | 9,486 | 155,391 |
| **Accumulated Depreciation and Impairment Losses** | | | | | |
| At January 1, 2007 | (18,767) | (85,265) | (17,436) | (136) | (121,604) |
| Depreciation expense | (1,197) | (4,007) | (2,150) | - | (7,354) |
| Disposals | 967 | 9,640 | 1,417 | 23 | 12,047 |
| Reclassification | (5) | 25 | (20) | - | - |
| At December 31, 2007 | (19,002) | (79,607) | (18,189) | (113) | (116,911) |
| **Net book value at December 31, 2007** | **5,106** | **17,301** | **6,700** | **9,373** | **38,480** |

| | Buildings and site services | Cable and transmission devices | Other | Construction in progress | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At January 1, 2006 | 26,143 | 112,816 | 24,307 | 6,789 | 170,055 |
| Additions | - | - | - | 7,706 | 7,706 |
| Acquisition through business combination | - | 157 | 31 | 25 | 213 |
| Disposals | (2,022) | (13,313) | (1,801) | (48) | (17,184) |
| Transfer | 208 | 3,379 | 2,592 | (6,179) | - |
| At December 31, 2006 | 24,329 | 103,039 | 25,129 | 8,293 | 160,790 |
| **Accumulated Depreciation and Impairment Losses** | | | | | |
| At January 1, 2006 | (18,449) | (93,659) | (17,183) | (136) | (129,427) |
| Depreciation expense | (1,805) | (4,674) | (1,919) | - | (8,398) |
| Disposals | 1,487 | 13,068 | 1,666 | - | 16,221 |
| At December 31, 2006 | (18,767) | (85,265) | (17,436) | (136) | (121,604) |
| **Net book value at December 31, 2006** | **5,562** | **17,774** | **7,693** | **8,157** | **39,186** |

As of December 31, 2008, the balance of construction in progress includes advances given to suppliers of property, plant and equipment in the amount of 3,050 (2007: 4,278, 2006: 2,508).

As of December 31, 2008, the cost of fully depreciated property, plant and equipment was 64,005 (2007: 69,222, 2006: 68,212).

*Interest capitalization*

Interest amounting to 159, 239 and 273 was capitalized in property, plant and equipment for the years ended December 31, 2008, 2007 and 2006, respectively. The capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 7.7%, 9.1% and 7.8%, respectively.

*Pledged property, plant and equipment*

Property, plant and equipment with a carrying value of 1,610, 2,097 and 3,240 was pledged in relation to loan agreements entered into by the Group as of December 31, 2008, 2007 and 2006, respectively. Included in pledged property, plant and equipment as of December 31, 2008, 2007 and 2006 is also the Satellite Gateway equipment with a carrying value of nil, 102 and 154, respectively, pledged in connection with vendor financing received from Globalstar L.P. (minority shareholder of CJSC GlobalTel). Currently, CJSC GlobalTel is in default on this vendor financing (refer to Note 17).

*Impairment of property, plant and equipment*

Management believes that the capital and credit crisis and the world economic decline is an indicator for probable deterioration of performance of the Group and therefore performed an assessment of the impact of such events on its business and result of operations.

The recoverable amount of the assets that were assessed for impairment was based on value in use and was determined at the cash-generating unit level. The cash generating units of the Group consist of:

- OJSC Rostelecom including its subsidiary CJSC Westelcom, CJSC Zebra Telecom and CJSC RTComm.RU;

- CJSC Globus Telecom;

- CJSC MC NTT;

- CJSC Global Tel.

In determining value in use for the cash-generating unit, the cash flows were based on cash flow projections from financial budgets and forecasts approved by senior management for the period from 2009 to 2013 and discounted at rates ranging from 18.17% to 20.60% on a pre-tax basis. Cash flows beyond the 5-year period were extrapolated using growth rate ranging from 2 % to 3%.

As a result of impairment testing, the value in use of cash generating unit CJSC Global Tel appears to be lower than its carrying amount by 149, of which 125 was allocated to property, plant and equipment and 24 to intangible assets.

## 7. GOODWILL AND OTHER INTANGIBLE ASSETS

The net book value of other intangible assets as of December 31, 2008, 2007 and 2006 was as follows:

| | Goodwill | Number capacity | Trademarks | Computer software | Customer list | Contract-based intangible assets | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| At January 1, 2008 | 948 | 354 | 197 | 1,435 | - | - | 370 | 3,304 |
| Additions | - | 17 | - | 357 | - | - | 76 | 450 |
| Acquisition through business combination | 482 | - | 76 | 41 | 424 | 298 | 3 | 1,324 |
| Disposals | - | - | - | (147) | - | - | (1) | (148) |
| Reclassification | - | - | - | - | 147 | - | (147) | - |
| At December 31, 2008 | 1,430 | 371 | 273 | 1,686 | 571 | 298 | 301 | 4,930 |
| **Accumulated Amortization and Impairment Losses** | | | | | | | | |
| At January 1, 2008 | (246) | - | (34) | (264) | - | - | (15) | (559) |
| Amortization expense | - | - | (5) | (343) | (38) | (16) | (4) | (406) |
| Impairment losses | (66) | - | - | (24) | - | - | - | (90) |
| Reclassification | - | - | - | - | (13) | - | 13 | - |
| At December 31, 2008 | (312) | - | (39) | (631) | (51) | (16) | (6) | (1,055) |
| **Net book value at December 31, 2008** | **1,118** | **371** | **234** | **1,055** | **520** | **282** | **295** | **3,875** |

| | Goodwill | Number capacity | Trademarks | Computer software | Other | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At January 1, 2007 | 948 | 353 | 197 | 1,176 | 150 | 2,824 |
| Additions | - | 1 | - | 259 | 220 | 480 |
| At December 31, 2007 | 948 | 354 | 197 | 1,435 | 370 | 3,304 |
| **Accumulated Amortization and Impairment Losses** | | | | | | |
| At January 1, 2007 | (9) | - | - | (13) | (7) | (29) |
| Amortization expense | - | - | - | (251) | (8) | (259) |
| Impairment losses | (237) | - | (34) | - | - | (271) |
| At December 31, 2007 | (246) | - | (34) | (264) | (15) | (559) |
| **Net book value at December 31, 2007** | **702** | **354** | **163** | **1,171** | **355** | **2,745** |

| | Goodwill | Number capacity | Trademarks | Computer software | Other | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At January 1, 2006 | 9 | - | - | - | - | 9 |
| Additions | - | 26 | - | 1,145 | - | 1,171 |
| Acquisition through business combination | 939 | 327 | 197 | 31 | 150 | 1,644 |
| At December 31, 2006 | 948 | 353 | 197 | 1,176 | 150 | 2,824 |
| **Accumulated Amortization** | | | | | | |
| At January 1, 2006 | (9) | - | - | - | - | (9) |
| Amortization expense | - | - | - | (13) | (7) | (20) |
| At December 31, 2006 | (9) | - | - | (13) | (7) | (29) |
| **Net book value at December 31, 2006** | **939** | **353** | **197** | **1,163** | **143** | **2,795** |

The intangible assets recognized separately as a result of the acquisition of OJSC RTComm.RU, CJSC Globus-Telecom and CJSC Zebra Telecom (refer to Note 5) represent resources from which future economic benefits are expected to flow to the Group, and include the following classes:

- number capacity,
- trademarks,
- computer software,
- customer list,
- contract-based intangible assets.

The owned number capacity with the carrying amount of 371 (2007: 354, 2006: 353) are intangible assets with indefinite useful lives and are not amortized. These assets have no legal restrictions on the term of their use and the Group can derive economic benefits from their use during indefinite term. These assets are tested for impairment annually or more frequently if there is an indication that the intangible assets may be impaired.

As of December 31, 2007 and December 31, 2006 intangible assets include trademark of CJSC Zebra Telecom which was considered to have indefinite useful life. As of December 31, 2008, as a result of change of business model of CJSC Zebra Telecom the management of the Group reassessed the useful life of the trademark as finite and determined the remaining useful life of the trademark of 5 years. The carrying amount of the trademark as of December 31, 2008, 2007 and 2006 amounted to 163, 163 and 197, respectively.

The estimated useful life of the trademark of OJSC RTComm.RU is 7.5 years.

The computer software includes internally generated and acquired intangible assets and has estimated useful lives from 1 to 10 years.

Interest amounting to 4, 5 and 76 was capitalized primarily in computer software for the years ended December 31, 2008, 2007 and 2006, respectively.

The goodwill recognized is attributed to the acquisitions of OJSC RTComm.RU, CJSC Globus-Telecom and CJSC Zebra Telecom (refer to Note 5).

CJSC Globus-Telecom’s telecommunication service was identified as separate cash-generating unit with goodwill and indefinite life intangible assets acquired through business combination allocated to it. The recoverable amount of CJSC Globus-Telecom’s telecommunication service was lower than its carrying amount by 66 at December 31, 2008. An impairment loss of 66 reduced the carrying amount of goodwill allocated to CJSC Globus Telecom. The pre-tax discount rate applied to the cash flow projections is 20.42% (2007:13.7%, 2006: 10.6%) and the annual growth rate for the period beyond 5 years is 3%. The gross margin was based on 63%. An increase of one percentage point in the discount rate used would have increased the impairment loss by 99. A 5% decrease in future planned gross margin would have increased the impairment loss by 339.

CJSC Zebra Telecom was identified as a separate cash-generating unit at its acquisition date in June 2006 with goodwill and indefinite life intangible assets allocated thereto. In the last half of 2007, the Group determined that there were indications of impairment of goodwill and indefinite life intangible assets related to CJSC Zebra Telecom due to a decline in market conditions for their services. Therefore, the Group compared the recoverable amount of CJSC Zebra Telecom with its carrying amount and recognized an impairment loss of 271, of which 237 was allocated to goodwill and 34 was allocated to the respective trademark, which is an indefinite lived intangible asset. Consequently, goodwill was fully written off in 2007. The recoverable amount of ZAO Zebra Telecom has been determined based on its value in use calculated using the cash flow projection from financial budget approved by senior management for 2008 and extrapolated for the next four-year period. Cash flows beyond this period are extrapolated using nil growth rate. The pre-tax discount rate applied to the cash flow projection is 15.1% (2006: 14.7%). The gross margin was based on a range of 41% - 44%.

in 2008, as a result of the decline in market conditions, the Group decided to change the business model where CJSC Zebra Telecom will provide termination services to the Group. This change in business model is expected to result in CJSC Zebra Telecom producing a significant amount of internally generated cash inflows from the provision of the termination services using CJSC Zebra Telecom's zone network. Thus, CJSC Zebra Telecom ceased to be a separate cash-generating unit since that time and is tested for impairment within the cash generating unit, OJSC Rostelecom.

The carrying amount of goodwill and the number capacity as of December 31, 2008, allocated to each of the cash-generating units, is as follows:

| | **CJSC Globus-Telecom** | **Rostelecom** | **MTs NTT** | **Total** |
|---|---|---|---|---|
| Goodwill | 636 | 482 | 0 | 1,118 |
| Number capacity | 357 | 1 | 13 | 371 |
| **Net book value at December 31, 2008** | **993** | **483** | **13** | **1,489** |

*Rostelecom*

The recoverable amount of the Rostelecom unit to which indefinite lived intangible assets from CJSC Zebra Telecom and goodwill from CJSC RTComm.RU acquisitions are allocated were higher than its carrying amount, thus no impairment loss was recognized in the consolidated statements of income for the year ended December 31, 2008. The pre-tax discount rate applied to the cash flow projections is 18.17% and the annual growth rate in the periods beyond 5 years is 2%.

*MTs NTT*

The recoverable amount of cash generating unit CJSC MTs NTT was higher than its carrying amount, thus no impairment loss was recognized in the consolidated statements of income for the year ended December 31, 2008. The pre-tax discount rate applied to the cash flow projections is 20.60% and the annual growth rate in the period beyond 5 years is 3%

The calculations of value in use for all cash generating units are most sensitive to the gross margin, discount rate and market share assumptions. Gross margin is based on historical actual results. The discount rate is the weighted average cost of capital of the Group adjusted for risks specific to the units. Market share assumptions are important because management assesses how the unit's position, relative to its competitors, might change over the budget period.

## 8. SUBSIDIARIES

These consolidated financial statements include the assets, liabilities and results of operations of Rostelecom and its subsidiaries, all registered in the Russian Federation, as follows:

| Subsidiary | Main activity | Effective share of the Group as of December 31, 2008 | 2007 | 2006 |
|---|---|---|---|---|
| CJSC MTs NTT | Fixed line telecommunication services | 100% | 100% | 100% |
| CJSC Westelcom | Leasing of telecommunication equipment | 100% | 100% | 100% |
| CJSC Zebra Telecom (see Note 5) | Local telecommunication services and Internet services | 100% | 100% | 100% |
| OJSC RTComm.RU (see Note 5) | Internet services | 99.5% | 31% | 31% |
| CJSC RTComm-Sibir (see Note 5) | Internet services | 99.5% | 31% | 31% |
| LLC Bashrtcomm (see Note 5) | Internet services | 51% | 16% | 16% |
| LLC RTComm-Yug (see Note 5) | Internet services | 99.5% | 31% | 31% |
| CJSC Globus-Telecom (see Note 5) | Local telecommunication services | 94.9% | 94.9% | 94.9% |
| CJSC GlobalTel | Satellite telecommunications | 51% | 51% | 51% |
| CJSC SK Kostars | Insurance services | 86.7% | 86.7% | 86.7% |
| CJSC Incom | Local telecommunication services | 100% | 84.8% | 54.4% |
| DP Pansionat Malakhit | Recreational services | 100% | 100% | 100% |
| OJSC InfoTeKS Taganrog Telecom | Local telecommunication services | 100% | 100% | 74% |

In December 2008, the Group acquired an additional interest of 15.2% in CJSC Incom from Ericsson Enterprise AB, a non-related party, for the cash payment of 0.5.

In March 2007, the Group acquired the outstanding minority interest of 26% in OJSC InfoTeKS Taganrog Telecom, which is the subsidiary of CJSC Westelcom, for the cash payment of 25. As of December 31, 2006, CJSC Westelcom's interest in OJSC InfoTeKS Taganrog Telecom was 74%. In 2006, the latter had negative net assets, and the minority interest in accumulated loss was allocated against the Group's interest. The results of operations and financial position of OJSC InfoTeKS Taganrog Telecom were consolidated by the Group in the accompanying financial statements for the years ended December 31, 2008, 2007 and 2006.

## 9. INVESTMENTS IN ASSOCIATES

Investments in associates as of December 31, 2008, 2007 and 2006 were as follows:

| Associate | Main activity | Voting share capital, % | 2008 Carrying amount | 2007 Carrying amount | 2006 Carrying amount |
|---|---|---|---|---|---|
| OJSC RTComm.RU (refer to Note 5) | Internet services | - | - | 317 | 217 |
| OJSC MMTS-9 | Telecommunication services | 49 | 130 | 114 | 76 |
| OJSC Svyazintek | Implementation of integrated billing systems | 19 | 47 | 60 | 36 |
| Other | Various | - | 1 | 3 | 1 |
| **Total investments in associates** | | | 178 | 494 | 330 |

The Group's share in OJSC Svyazintek is 19%. However, the Group has the right to nominate two of eleven directors to the Board of OJSC Svyazintek while each of the other shareholders has only one director. This right gives an opportunity to the Group to have significant influence over the decision-making process of OJSC Svyazintek. The Group accounts for its interest in OJSC Svyazintek through equity method.

Summarized financial information as of December 31, 2008, 2007 and 2006 and for the years then ended of the associates disclosed above is presented below:

| Aggregate amounts | 2008 | 2007 | 2006 |
|---|---|---|---|
| Assets | 1,068 | 3,624 | 3,778 |
| Liabilities | 615 | 2,037 | 2,679 |
| Revenue | 4,266 | 8,539 | 5,729 |
| Net income | (275) | 444 | 255 |

All associates are registered in the Russian Federation.

In March 2007, the Group acquired 53.72% of the preferred shares of OJSC MMTS-9 for a cash payment of 17. This acquisition resulted in effective ownership of 50.29%, however, these shares do not have voting rights. Therefore, the acquisition did not result in obtaining control over OJSC MMTS-9.

As of December 31, 2007 and 2006, Rostelecom had significant influence over OJSC RTComm.RU through ownership of 31.1% of the voting shares of OJSC RTComm.RU. On July 01, 2008, the Group obtained control over OJSC RTComm.RU by acquiring an additional 68.4% equity interest. For more details refer to Note 5.

## 10. LONG-TERM INVESTMENTS

Long-term investments are available-for-sale investments and loans and receivables, which are stated at amortized cost using the effective interest method. As of December 31, 2008, 2007 and 2006 long-term investments comprised of the following:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Investment in Golden Telecom | - | 10,945 | 4,963 |
| Investment in OJSC Sberbank of Russia | 173 | 826 | 724 |
| Other long-term investments | 121 | 76 | 41 |
| **Total long-term investments** | **294** | **11,847** | **5,728** |

The investment in OJSC Sberbank of Russia is stated at fair value determined based on the Russian Trade System (RTS) closing bid price at the last trading day of the year ended December 31, 2008.

In February 2008, the Group accepted an offer by Lilian Acquisition, Inc., a subsidiary of Vimpelcom, to purchase the Group's shares of Golden Telecom, Inc. The consideration from the Group's sale of 4,417,055 shares of Golden Telecom, Inc. amounted to USD 464 million (11,385) paid in cash. Profit from this transaction before tax and related deferred tax effect amounted to 8,666 and 2,230, respectively, and are recognized as gain on sale of investments and tax charge in the accompanying consolidated statements of income for the year ended December 31, 2008. The net effect of 6,436, which was previously recorded in unrealized gain on available-for-sale investments as a result of fair value revaluations, was deducted from equity in the accompanying consolidated balance sheets as of December 31, 2008.

As of December 31, 2007 and 2006, the investment in Golden Telecom was recorded at its fair value determined based on NASDAQ closing bid price on the last trading day.

Included within other long-term investment is the deposit of 160 with Capital Credit Bank, which was impaired as the Bank is under insolvency procedure. Impairment loss of 86 is included in other non-operating expenses. The Group has collateral on deposit in term of property.

## 11. ACCOUNTS RECEIVABLE

Accounts receivable as of December 31, 2008, 2007 and 2006 comprised of the following:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Local operators | 1,963 | 1,067 | 1,679 |
| Subscribers | 4,510 | 5,056 | 4,519 |
| Foreign operators | 1,452 | 1,033 | 696 |
| Other | 2,490 | 1,751 | 1,284 |
| Less: allowance for doubtful trade accounts receivable | (1,716) | (1,994) | (1,132) |
| Trade accounts receivable, net | 8,699 | 6,913 | 7,046 |
| Prepayments | 389 | 503 | 418 |
| Prepaid taxes other than on income | 872 | 791 | 1,092 |
| Other accounts receivable | 420 | 349 | 721 |
| Less: allowance for doubtful other accounts receivable | (247) | (127) | (456) |
| Other accounts receivable, net | 1,434 | 1,516 | 1,775 |
| **Total accounts receivable** | **10,133** | **8,429** | **8,821** |

The net accounts receivable balance is not past due.

The following table summarizes accounts receivables denominated in foreign currencies as of December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| USD | 1,060 | 716 | 517 |
| EUR | 319 | 45 | 39 |
| SDR (special drawing right) | 73 | 269 | 140 |
| Other currencies | - | 3 | - |
| **Accounts receivable denominated in foreign currencies, gross** | **1,452** | **1,033** | **696** |
| Less: allowance for doubtful accounts receivable | (422) | (339) | (293) |
| **Accounts receivable denominated in foreign currencies, net** | **1,030** | **694** | **403** |

As of December 31, 2008, 2007 and 2006, the carrying value of trade accounts receivable approximated their fair value.

The following table summarizes the changes in the allowance for doubtful accounts receivable for the years ended December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Balance, beginning of year | 2,187 | 1,594 | 1,371 |
| Provision/(recovery) for doubtful accounts receivable | (32) | 815 | 389 |
| Accounts receivable written-off | (113) | (222) | (166) |
| **Balance, end of year** | **2,042** | **2,187** | **1,594** |

As of December 31, 2008, the balance of the allowance for doubtful accounts receivable decreased long-term accounts receivable and short-term accounts receivable by 79 and 1,963, respectively. As of December 31, 2007, the balance of the allowance for doubtful accounts receivable decreased long-term accounts receivable and short-term accounts receivable by 66 and 2,121, respectively. As of December 31, 2006, the balance of the allowance for doubtful accounts receivable decreased long-term accounts receivable and short-term accounts receivable by 6 and 1,588, respectively. Long-term accounts receivable are included in other non-current assets in the consolidated balance sheets.

## 12. SHORT-TERM INVESTMENTS

Short-term investments include Ruble denominated investments available-for-sale, which are stated at fair value, and loans and receivables which are stated at amortized cost using the effective interest method. Short-term investments comprised of the following as of December 31, 2008, 2007 and 2006:

| | **2008** | **2007** | **2006** |
|---|---|---|---|
| Bills of exchange | 3,449 | 343 | 542 |
| Short-term deposits and deposit certificates | 5,300 | 6,547 | 7,916 |
| Other | 13 | 30 | 38 |
| **Total short-term investments** | **8,762** | **6,920** | **8,496** |

As of December 31, 2008, 2007 and 2006 short-term investments, which are denominated in US dollars, include amounts totalling 1,552, 1,294 and 2,182, respectively,.

Bills of exchange and short-term deposits and deposit certificates are classified as loans and receivables.

The bills of exchange bear interest in the range from 7% to 14% and are denominated in Rubles, as well as in foreign currencies. As of December 31, 2008, approximately 0% (2007: 0%, 2006: 26%) of the Group's total bills of exchange are denominated in foreign currencies, represented by US dollars.

## 13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2008, 2007 and 2006 included cash on hand, at bank accounts and short-term deposits and bills of exchange with original maturities of less than three months as follows:

| | **2008** | **2007** | **2006** |
|---|---|---|---|
| Cash at bank – Rubles | 9,111 | 3,106 | 1,147 |
| Cash at bank – Foreign currencies | 591 | 105 | 93 |
| Short term deposits – Rubles | 1,327 | 67 | 6 |
| Short-term bills of exchange | 957 | - | 1,101 |
| Other | 6 | 6 | 6 |
| **Total cash and cash equivalents** | **11,992** | **3,284** | **2,353** |

## 14. EQUITY

### *Share capital*

The authorized share capital of the Company as of December 31, 2008, 2007 and 2006 comprised of 1,634,026,541 ordinary shares and 242,832,000 non-redeemable preferred shares. The par value of both ordinary and preferred shares amounted to Rbl 0.0025 per share.

As of December 31, 2008, 2007 and 2006, the issued and outstanding share capital was as follows:

| | **Number of shares** | **Nominal value** | **Carrying amount** |
|---|---|---|---|
| Ordinary Shares, Rbl 0.0025 par value | 728,696,320 | 1.822 | 75 |
| Preferred Shares, Rbl 0.0025 par value | 242,831,469 | 0.607 | 25 |
| **Total** | **971,527,789** | **2.429** | **100** |

There were no transactions with the Company's own shares during 2008, 2007 and 2006.

The Board of Directors of Rostelecom is authorized under its Charter to issue additional ordinary shares up to the total of the authorized share capital without further approval of shareholders.

The nominal share capital of the Company recorded on its incorporation has been indexed, to account for the effects of hyperinflation from that date through December 31, 2002. The share capital in the Russian statutory accounts at December 31, 2008, 2007 and 2006 amounted to 2,428,819 nominal (uninflated) Rubles.

Ordinary shares carry voting rights with no guarantee of dividends.

Preferred shares have priority over ordinary shares in the event of liquidation but carry no voting rights except on resolutions regarding liquidation or reorganization of the Company, 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 or conversion.

Preferred shares carry dividends amounting to the higher of 10% of the net income after taxation of the Company as reported in the Russian statutory accounts divided by the number of preferred shares and the dividends paid on one ordinary share. If the holders of preferred shares receive dividends of less than 10% of the net income after taxation as reported in the Russian statutory accounts, no dividends to the holders of ordinary shares are declared. Owners of preferred shares have the right to participate in and vote on all issues within the competence of shareholders' general meetings following the annual shareholders' general meeting at which a decision not to pay (or to pay partly) dividends on preferred shares has been taken.

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

Accordingly, the Company's preferred shares are considered participating equity instruments for the purpose of earnings per share calculations (refer to Note 24).

Distributable earnings of all entities included in the Group are limited to their respective retained earnings, as mandated by statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2008, 2007 and 2006 amounted to 49,708, 43,645 and 35,171, respectively.

### *Reserve capital*

In accordance with the Company's Charter, Rostelecom has to maintain a reserve fund through a mandatory annual transfer of at least 5% of its statutory net profits up to the maximum amount of 15% of its statutory share capital. As of December 31, 2008, 2007 and 2006 the statutory reserve fund amounted to 364,323 nominal (uninflated) Rubles. These amounts are prohibited for distribution by current Russian legislation except in some limited cases.

### *Dividends*

Dividends declared to holders of preferred and ordinary shares for the years ending December 31, 2007, 2006 and 2005 were accrued in the following years:

| | **2008** | **2007** | **2006** |
|---|---|---|---|
| Dividend – preferred shares | 942 | 718 | 903 |
| Dividend – ordinary shares | 1,414 | 1,078 | 1,138 |
| **Total dividends** | **2,356** | **1,796** | **2,041** |

| | **Rbl** | **Rbl** | **Rbl** |
|---|---|---|---|
| Dividend per preferred share | 3.88 | 2.96 | 3.72 |
| Dividend per ordinary share | 1.94 | 1.48 | 1.56 |

## 15. ACCOUNTS PAYABLE, PROVISIONS AND ACCRUED EXPENSES

Accounts payable, provisions and accrued expenses consisted of the following as of December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Trade accounts payable | 7,006 | 3,743 | 5,235 |
| Advances received | 1,033 | 858 | 865 |
| Short-term portion of pension obligations (refer to Note 23) | 56 | 55 | 63 |
| Short-term portion of site restoration provisions | 49 | 41 | 26 |
| Compensation related accruals | 937 | 1,324 | 741 |
| Other accrued expenses | 326 | 1,349 | 375 |
| Dividends payable | 88 | 75 | 67 |
| **Current accounts payable, provisions and accrued expenses** | **9,495** | **7,445** | **7,372** |
| Long-term portion of pension obligations (refer to Note 23) | 90 | 98 | 112 |
| Long-term portion of site restoration provisions | 48 | 57 | 78 |
| Long-term advances received | 72 | 59 | 69 |
| Other long-term accounts payable | 33 | 55 | 67 |
| **Non-current accounts payable, provisions and accrued expenses** | **243** | **269** | **326** |
| **Total accounts payable, provisions and accrued expenses** | **9,738** | **7,714** | **7,698** |

The following table summarizes trade accounts payable denominated in foreign currencies as of December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| USD | 1,440 | 463 | 932 |
| SDR | 255 | 181 | 314 |
| EUR | 149 | 221 | 124 |
| Other currencies | 2 | 20 | 53 |
| **Accounts payable denominated in foreign currencies** | **1,846** | **885** | **1,423** |

Site restoration provisions represent the present value of the expenditures the Company expects to incur in connection with phasing out of analog trunk lines during 2007-2010 in accordance with the formalized plan of the Company. The discount rate, which represents risk-free government bonds rate, was 10.11%.

## 16. FINANCE LEASE PAYABLE

Leased assets as of December 31, 2008, 2007 and 2006, where the Group is a lessee of IRU, plant and machinery under finance lease agreements, are comprised of the following:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Cost – capitalized finance leases | 917 | 572 | 523 |
| Impairment loss and accumulated depreciation | (217) | (160) | (108) |
| **Net book value** | **700** | **412** | **415** |

In April 2005, the Group entered into an IRU finance lease agreement for use of a portion of the network capacity of terrestrial optical fiber cables. The lease agreement is non-cancellable for the period of 15 years, which approximates the remaining useful life of the optical fibers. Effective interest rate of the lease is 7.21% p.a. Lease payments are denominated in US Dollars.

Also, the Group is involved in a finance lease agreement for use of a digital telecommunication station over its estimated remaining useful life of 7 years. Effective interest rate of the lease is 11.7% p.a. Lease payments are denominated in Russian Rubles.

In 2007, the Group entered into a number of minor finance lease agreements for purchase of telecommunication equipment and vehicles for an average period of 3 years. Effective interest rate of these leases is 10.3% p.a.

Future minimum lease payments together with the present value of the net minimum lease payments as of December 31, 2008, 2007 and 2006 are as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Finance lease liabilities – minimum lease payments | | | |
| Current portion of finance lease liability | 144 | 135 | 111 |
| Between one to two years | 81 | 106 | 83 |
| Between two to three years | 63 | 54 | 93 |
| Between three to four years | 61 | 43 | 43 |
| Between four to five years | 61 | 43 | 43 |
| Over five years | 377 | 307 | 349 |
| **Total minimum lease payments** | **787** | **688** | **722** |
| Less interest | (223) | (184) | (217) |
| **Present value of minimum lease payments** | **564** | **504** | **505** |

| **Present value of minimum lease payments** | | | |
|---|---|---|---|
| Not later than 1 year | 103 | 108 | 78 |
| Later than 1 year and not later than 5 years | 157 | 157 | 163 |
| Later than 5 years | 304 | 239 | 264 |
| Total non-current lease payable | 461 | 396 | 427 |
| **Total lease payable** | **564** | **504** | **505** |

Depreciation of property, plant and equipment under the finance lease contracts for 2008 amounted to 74 (2007: 52; 2006: 54). Finance charges for the year ended December 31, 2008 amounted to 44 (2007: 82; 2006: 44) and are included in interest expense in the consolidated statements of income.

## 17. VENDOR FINANCING PAYABLE

Vendor financing payable includes the following as of December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Globalstar L.P. | 1,608 | 1,246 | 1,249 |
| Peter Service | - | 391 | 391 |
| Vendor financing payable – current portion | 1,608 | 1,637 | 1,640 |
| | | | |
| Peter Service | - | - | 362 |
| Vendor financing payable – non-current portion | - | - | 362 |
| **Total vendor financing payable** | **1,608** | **1,637** | **2,002** |

As of December 31, 2008, the Group had the following outstanding vendor financing payable:

1,608 (USD 55 million) payable by CJSC GlobalTel to Globalstar L.P., which is the minority shareholder of CJSC GlobalTel, for the purchase of three gateways and associated equipment and services (refer to Note 6). Globalstar L.P. has a lien over this equipment until the liability is fully paid. CJSC GlobalTel is in default in respect of payments in 2004, 2005, 2006, 2007 and 2008 and has not obtained a waiver from Globalstar L.P. As a result, the whole balance of 1,207 (2007: 1,008, 2006: 1,082) (USD 41 million) is classified as current in these consolidated balance sheets as of December 31, 2008, 2007 and 2006. Penalty interest in amount of 401, 238 and 167, accrued for each day of delay at the rate of 10% p.a., is included in vendor financing payable in these balance sheets as of December 31, 2008, 2007 and 2006, respectively. In 2006, Loral, which is the legal successor of Globalstar L.P., brought an action against CJSC GlobalTel claiming immediate repayment of full amount of vendor financing payable. Management believes repayment of the defaulted vendor financing and loans would not have a material adverse effect on the Group's results of operations, financial position and operating plans.

## 18. LONG-TERM BORROWINGS

Long-term borrowings as of December 31, 2008, 2007 and 2006 were as follows:

| Maturity | 2008 | 2007 | 2006 |
|---|---|---|---|
| Current portion of interest bearing loans | 2,522 | 2,585 | 3,005 |
| Between one to two years | 117 | 136 | 198 |
| Between two to three years | - | 36 | 63 |
| Between three to four years | - | - | 37 |
| Between four to five years | - | - | - |
| Over five years | - | - | - |
| Non-current portion of interest bearing loans | 117 | 172 | 298 |
| **Total interest bearing loans** | **2,639** | **2,757** | **3,303** |

As of December 31, 2008, 2007 and 2006, interest bearing loans, which are mostly denominated in foreign currencies, were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| USD | 2,342 | 2,397 | 3,055 |
| Japanese Yen (JPY) | - | - | 32 |
| EUR | 30 | 77 | 123 |
| **Foreign currency denominated loans** | **2,372** | **2,474** | **3,210** |
| Russian Ruble denominated loans | 267 | 283 | 93 |
| **Total interest bearing loans** | **2,639** | **2,757** | **3,303** |

As of December 31, 2008, the Group has loan agreements with 8 banks and other financial institutions. The loans denominated in US Dollars are made at fixed rate of 6.29% and floating rates of LIBOR + 0.5 – 3.25%. The Russian Ruble denominated loans are made at fixed rates of 10-17% p.a. Effective interest rates of interest bearing loans approximate their nominal rates.

Included in long-term loans is the amount of 1,959 on a credit agreement between Rostelecom and Vnesheconombank (VEB) entered into in December 2005. The loan is repayable annually up to the end of 2012. Under the existing credit agreement with Vnesheconombank and CSFB, the Group is required to meet at the end of each quarter various financial covenants applied to the statutory financial statements of the Company, including maintaining certain levels of debt to equity and debt to income ratios. As of December 31, 2008 the Group was not in compliance with some of the covenants, so the whole amount of the loan is included in current portion of interest bearing loans as of December 31, 2008. At the date these financial statements were authorized for issue no waiver had been obtained by the Group from the bank. As of December 31, 2007 and December 31, 2006 the Group was not in compliance with some of the covenants, stipulated in the loan agreement and no waiver had been obtained from the banks. The Group received waivers from the bank only after the reporting dates (in June 2008 and June 2007, respectively), hence the whole amount of the loan is included in current portion of long-term loans in the consolidated balance sheets as of December 31, 2007 and 2006.

In connection with the $100 million loan from Vnesheconombank and CSFB, on June 28, 2006, the Group entered into an interest rate swap agreement with CSFB. In accordance with the interest rate swap agreement, each year on June 28 and December 28, commencing on December 28, 2006 and ending on December 28, 2012, the Group undertakes an obligation to CSFB calculated at a fixed interest rate and CSFB undertakes an obligation to the Group in the amount calculated at floating rate payable by the Group on its loan. The Group did not designate the above interest rate swap derivative as hedging instrument. Therefore, this financial instrument was classified as financial liability at fair value through profit and loss amounted to 176 (2007: 73, 2006: 15). Fair value of the derivative is calculated by discounting future cash flows determined by condition and payments schedule of the agreement using forward rates of similar instruments at the reporting date. The net loss of 103 related to the change in the fair value of the interest rate swap contract was included in the non-operating loss in the consolidated statements of income for the year ended December 31, 2008 (2007: 58, 2006: 15).

There is 298 outstanding on a credit agreement between CJSC GlobalTel and Loral Space and Communications Corporation (“Loral”) as of December 31, 2008. CJSC GlobalTel is in default in respect of this loan. A penalty in the amount of 94 is included in the outstanding balance. As no waiver has been obtained from Loral, these loans are classified as current in the consolidated balance sheets as of December 31, 2008. The loan does not provide for any collateral. In 2006, Loral brought an action against CJSC GlobalTel claiming immediate repayment of full amount of debt. In 2009, the Supreme Court of Arbitration committed CJSC GlobalTel to repay the loan and penalty to Loral.

## 19. INCOME TAXES

The components of net deferred tax assets and liabilities at December 31, 2008, 2007 and 2006, and the respective movements during 2008, 2007 and 2006, were as follows:

| | December 31, 2007 | Acquisition through business combination | Movement during 2008 recognized in Equity | Movement during 2008 recognized in Profit for the year | December 31, 2008 |
|---|---|---|---|---|---|
| *Tax effects of future tax deductible items* | | | | | |
| Accounts receivable | 304 | - | - | (197) | 107 |
| Accounts payable, provisions and accrued expenses | 131 | 58 | - | (100) | 89 |
| Investments | | - | - | 65 | 65 |
| Other | 112 | 20 | - | (51) | 81 |
| **Gross deferred tax asset** | **547** | **78** | **-** | **(283)** | **342** |
| *Tax effects of future taxable items:* | | | | | |
| Equity investments | 2,392 | - | (2,256) | (136) | - |
| Property, plant and equipment | 2,159 | 45 | - | (550) | 1, 654 |
| Other intangible assets | 115 | 200 | - | (37) | 278 |
| **Gross deferred tax liability** | **4,666** | **245** | **(2,256)** | **(723)** | **1, 932** |
| **Net deferred tax liability** | **4,119** | **167** | **(2,256)** | **(440)** | **1,590** |

| | December 31, 2006 | Acquisition through business combination | Movement during 2007 recognized in Equity | Movement during 2007 recognized in Profit for the period | December 31, 2007 |
|---|---|---|---|---|---|
| *Tax effects of future tax deductible items* | | | | | |
| Accounts receivable | 100 | - | - | 204 | 304 |
| Accounts payable, provisions and accrued expenses | 246 | - | - | (115) | 131 |
| Other | 101 | - | - | 11 | 112 |
| **Gross deferred tax asset** | **447** | **-** | **-** | **100** | **547** |
| *Tax effects of future taxable items:* | | | | | |
| Equity investments | 1,026 | - | 1,335 | 31 | 2,392 |
| Property, plant and equipment | 2,716 | - | - | (557) | 2,159 |
| Other intangible assets | 149 | - | - | (34) | 115 |
| **Gross deferred tax liability** | **3,891** | **-** | **1,335** | **(560)** | **4,666** |
| **Net deferred tax liability** | **3,444** | **-** | **1,335** | **(660)** | **4,119** |

| | December 31, 2005 | Acquisition through business combination | Movement during 2006 recognized in Equity | Movement during 2006 recognized in Profit for the period | December 31, 2006 |
|---|---|---|---|---|---|
| *Tax effects of future tax deductible items* | | | | | |
| Property, plant and equipment | - | 2 | - | (2) | - |
| Accounts receivable | 171 | 5 | - | (76) | 100 |
| Accounts payable, provisions and accrued expenses | - | 10 | - | 236 | 246 |
| Other | 27 | 17 | - | 57 | 101 |
| **Gross deferred tax asset** | **198** | **34** | **-** | **215** | **447** |
| *Tax effects of future taxable items:* | | | | | |
| Investments valuation difference | 449 | - | 570 | 7 | 1,026 |
| Property, plant and equipment | 3,718 | - | - | (1,002) | 2,716 |
| Other intangible assets | - | 161 | - | (12) | 149 |
| Accounts payable, provisions and accrued expenses | 202 | - | - | (202) | - |
| **Gross deferred tax liability** | **4,369** | **161** | **570** | **(1,209)** | **3,891** |
| **Net deferred tax liability** | **4,171** | **127** | **570** | **(1,424)** | **3,444** |

Differences between IFRS and statutory taxation and reporting regulations give rise to temporary differences between the carrying value of certain assets and liabilities for financial reporting and income tax purposes.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and the deferred income tax assets and deferred income tax liabilities relate to the income taxes levied by the same fiscal authority on the same taxable entity.

Deductible temporary differences for which no deferred tax assets were recognized in the accompanying balance sheets as of December 31, 2008, 2007 and 2006 amounted to 2,174, 1,353 and 1,316, respectively, of which unused tax losses with expiry date from 2012 to 2018 amounted to 1,095, 574 and 545 for 2008, 2007 and 2006 respectively.

Temporary differences associated with investments in subsidiaries for which no deferred tax liabilities were recognized in the accompanying balances sheets as of December 31, 2008, 2007 and 2006 amounted to 1,236, 606 and 435, respectively. Deductible temporary differences associated with investments in subsidiaries for which no deferred tax assets were recognized in the accompanying balance sheets as of December 31, 2008, 2007 and 2006 amounted to 382, 321 and 13, respectively.

On November 20, 2008, the Russian Federation government enacted legislation reducing the statutory income tax rate from 24% to 20%. Since this reduction in the statutory income tax rate was enacted prior to December 31, 2008, the effect of the change reduced the net deferred tax liability by 319 million, which has been recognized in these consolidated financial statements.

The components of income tax expense for the years ended December 31, 2008, 2007 and 2006 were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Current tax charge | 4,331 | 1,854 | 2,411 |
| Deferred tax benefit | (121) | (660) | (1,424) |
| Effect of tax rate change | (319) | - | - |
| **Income tax expense** | **3,891** | **1,194** | **987** |

The reconciliation of the theoretical amount that would arise using the Russian statutory rate of 24% to the total actual income tax was as follows for the years ending December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Income tax expense at statutory rate (24%) | 3,858 | 960 | 586 |
| Change in assessment for current tax of prior periods | - | - | 2 |
| Effect of tax rate change | (319) | - | - |
| Change in unrecognized temporary differences and unused tax losses | 110 | 9 | (7) |
| Permanent differences | 242 | 225 | 406 |
| **Income tax expense** | **3,891** | **1,194** | **987** |

Permanent differences comprise of various costs that are non-deductible for Russian income tax purposes, including depreciation of certain property, plant and equipment, certain employee costs, promotional and sponsorship expenditures, travel expenditures in excess of certain statutory allowances and other expenses and value added tax accrued on free-of-charge services.

## 20. REVENUE

Revenue comprised of the following for the years ended December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Telephone traffic** | | | |
| Domestic long-distance traffic | 29,611 | 31,973 | 31,370 |
| Outgoing international long-distance traffic | 12,082 | 12,317 | 13,271 |
| Incoming and transit international long-distance traffic | 6,450 | 5,710 | 4,480 |
| | **48,143** | **50,000** | **49,121** |
| **Rent of channels** | **7,710** | **7,725** | **7,116** |
| **Other revenue** | | | |
| Television and radio transmission | 345 | 448 | 528 |
| Satellite services | 263 | 699 | 559 |
| Data transmission services | 5,437 | 1,292 | 328 |
| Intelligent network services (INS) | 1,251 | 1,133 | 761 |
| Interconnection services | 128 | 519 | 597 |
| Technical support services | 444 | 464 | 364 |
| Equipment maintenance services | 890 | 696 | 537 |
| Miscellaneous revenue | 2,018 | 1,626 | 1,648 |
| | **10,776** | **6,877** | **5,322** |
| **Total revenue** | **66,629** | **64,602** | **61,559** |

Revenue from data transmission services increased substantially as a result of the acquisition of OJSC RTComm.RU, whose main activity is internet services. After the acquisition date, revenue of OJSC RTComm.RU from data transmission services amounted 2,022.

## 21. SEGMENT INFORMATION

The Group operates in one industry segment, being the provision of domestic and international long-distance telecommunication services in the Russian Federation. The results of this segment and assets and liabilities as of December 31, 2008, 2007 and 2006 are presented in the consolidated statements of income and the consolidated balance sheets, respectively.

An analysis of revenue by service type is disclosed in Note 20. A geographical analysis of revenue by the country or region of the customer for the years ending December 31, 2008, 2007 and 2006 is as follows:

| | Russia | CIS | USA | Western Europe | Eastern Europe | Others | Total |
|---|---|---|---|---|---|---|---|
| **2008** | 59,218 | 2,407 | 1,031 | 2,491 | 462 | 1,020 | 66,629 |
| **2007** | 58,024 | 2,406 | 848 | 2,068 | 400 | 856 | 64,602 |
| **2006** | 56,360 | 2,227 | 475 | 1,515 | 241 | 741 | 61,559 |

Substantially all of the Group assets are located within the territory of the Russian Federation.

## 22. ADMINISTRATION AND OTHER COSTS

Administration and other costs consisted of the following for the years ended December 31, 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Administration costs | 1,157 | 998 | 1,061 |
| Advertising and similar costs | 1,367 | 1,403 | 748 |
| Office maintenance | 1,986 | 1,903 | 1,543 |
| Utilities and similar services | 725 | 700 | 655 |
| Consulting and similar services | 774 | 450 | 312 |
| Universal service fund | 563 | 585 | 587 |
| Insurance | 147 | 201 | 321 |
| Other | 229 | 430 | 326 |
| **Total administration and other costs** | **6,948** | **6,670** | **5,553** |

## 23. EMPLOYEE BENEFITS

The numbers of employees of the Group was equal to 22,372 as at December 31, 2008 (2007: 22,534, 2006: 23,233).

The Group makes payments to the Government pension fund for its employees. Such contributions are included in the unified social tax ("UST") calculated by the Group using regressive scale and are charged to expense when incurred during the employee's service period. Total contributions for UST amounted to 1,435 during the year ended December 31, 2008 (2007: 1,426, 2006: 1,272).

The Company participates in the private Joint Participation Program, which is a pension plan with defined contributions. To participate in the program, individuals should be full-time employees of the Company and should enter into non-state pension insurance agreement with NPF "Telecom-Soyuz", which is the successor of NPF Rostelecom-Garantiya. Total expenses of the Group under this program amounted to 6 during the year ended December 31, 2008 (2007: 9, 2006: 6) and are included in wages, salaries, other benefits and payroll taxes in the consolidated statements of income.

The Company also operates a defined benefit pension scheme covering a large number of its employees, which requires contributions to be made to NPF Telecom-Soyuz. Under the scheme, an annuity is acquired by the Company as of the termination date of an employee if the latter satisfies certain criteria, such as seniority of 15 years in telecommunication sector, including seniority of 5 years in the Company, and retirement on pension within one month after the date an employee is entitled to pension in accordance with Russian legislation. The liabilities under this scheme are unfunded.

The following table summarizes movements in the present value of the defined benefit obligation and amounts recognized in the consolidated balance sheets for the above plan (refer to Note 15):

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Opening defined benefit obligation | 239 | 277 | 290 |
| Interest cost on benefit obligation | 17 | 19 | 20 |
| Current service cost | 11 | 13 | 15 |
| Actuarial losses on obligation | 5 | 8 | 38 |
| Benefits paid | (56) | (78) | (86) |
| Closing defined benefit obligation | 216 | 239 | 277 |
| Unrecognized past service cost | (70) | (86) | (102) |
| **Liability recognized in balance sheet** | **146** | **153** | **175** |

Amounts recognized in wages, salaries, other benefits and payroll taxes in the consolidated statements of income in respect of the above defined benefit plan are as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Interest cost on benefit obligation | 17 | 19 | 20 |
| Current service cost | 11 | 13 | 15 |
| Amortization of past service cost | 16 | 16 | 16 |
| Actuarial losses on obligation | 5 | 8 | 38 |
| **Total net benefit expense** | **49** | **56** | **89** |

The principal assumptions used in determining pension benefit obligation for the Group's plan are shown below:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Discount rate | 10.4% | 7.9% | 7.9% |
| Employee turnover rate | 10.9% | 10.9% | 10.5% |
| Expected inflation rate | 10.4% | 6.9% | 7% |

The amounts of experience adjustments are as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Present value of defined benefit obligation | 216 | 239 | 277 |
| Experience adjustments on plan liabilities | (3) | 15 | 46 |

In accordance with the transitional provisions for the amendments to IAS 19 *Employee Benefits* in December 2004, the disclosures above are determined prospectively from the 2006 reporting period.

The expected amount of benefits to be paid in 2009 is 75.

## 24. EARNINGS PER SHARE

The calculation of basic and diluted earnings per preferred and ordinary share is presented below (earnings per share data is stated in Rubles):

| | 2008 | | 2007 | | 2006 | |
|---|---|---|---|---|---|---|
| **Net income attributable to equity holders of the parent** | **12,178** | | **2,805** | | **1,458** | |
| | **Ordinary shares** | **Preferred shares** | **Ordinary shares** | **Preferred shares** | **Ordinary shares** | **Preferred shares** |
| **Weighted average number of shares outstanding** | **728,696,320** | **242,831,469** | **728,696,320** | **242,831,469** | **728,696,320** | **242,831,469** |
| **Basic and diluted earnings per share, Russian Rubles** | **12.54** | **12.54** | **2.89** | **2.89** | **1.50** | **1.50** |

The calculation of earnings per share is based on net profit for the period divided by the weighted average number of preferred and ordinary shares outstanding during the year. Dividends are fully allocated to continuing operations.

There are no potentially dilutive instruments, therefore, diluted earnings per share equal basic earnings per share.

## 25. FINANCIAL INSTRUMENTS

The table below summarizes carrying amount by class of all of the Group's financial instruments:

| | | December 31, 2008 | December 31, 2007 | December 31, 2006 |
|---|---|---|---|---|
| **Classes** | **Categories** | **Carrying amount** | **Carrying amount** | **Carrying amount** |
| Long-term equity investments | | | | |
| - at fair value | Available-for-sale | 173 | 11,771 | 5,687 |
| - at cost | Available-for-sale | 9 | 10 | 9 |
| Long-term debt investments | | | | |
| - at amortized cost | Loans and receivables | 112 | 66 | 32 |
| Long-term receivables | Loans and receivables | 37 | 16 | 13 |
| **Total Non-current financial assets** | | **331** | **11,863** | **5,741** |
| Short-term equity investments | | | | |
| - at fair value | Available-for-sale | 13 | 30 | 21 |
| Short-term debt investments | | | | |
| - at amortized cost | Loans and receivables | 8,749 | 6,890 | 8,475 |
| Short-term trade receivables | Loans and receivables | 8,699 | 6,913 | 7,046 |
| Short-term other receivables | Loans and receivables | 173 | 222 | 265 |
| Cash and cash equivalents | Loans and receivables | 11,992 | 3,284 | 2,353 |
| **Total Short-term financial assets** | | **29,626** | **17,339** | **18,160** |
| Long-term bank loans | Liabilities at amortized cost | 117 | 172 | 205 |
| Long-term non-bank loans | Liabilities at amortized cost | - | - | 93 |
| Non-current finance lease and vendor financing | Liabilities at amortized cost | 461 | 396 | 789 |
| Non-current accounts payable | Liabilities at amortized cost | 33 | 55 | 67 |
| **Total Non-current financial liabilities** | | **611** | **623** | **1,154** |

| (continued) | | December 31, 2008 | December 31, 2007 | December 31, 2006 |
|---|---|---|---|---|
| **Classes** | **Categories** | **Carrying amount** | **Carrying amount** | **Carrying amount** |
| Short-term bank loans | Liabilities at amortized cost | 2,046 | 2,286 | 2,891 |
| Short-term non-bank loans | Liabilities at amortized cost | 489 | 326 | 289 |
| Short-term finance lease and vendor financing | Liabilities at amortized cost | 1,711 | 1,745 | 1,718 |
| Short-term accounts payable | Liabilities at amortized cost | 8,181 | 6,418 | 6,403 |
| Non-hedge derivative | Financial liabilities at fair value through profit and loss | 176 | 73 | 15 |
| **Total Short-term financial liabilities** | | **12,603** | **10,848** | **11,316** |

The fair value of cash and cash equivalents, current receivables, trade payables, other current financial assets and liabilities approximate their carrying amount largely due to the short-term maturity of these instruments.

The fair value of long-term debt investments, long-term accounts receivables and non-current accounts payable correspond to the present values of the payments related to the assets and liabilities, taking into account the current interest rate parameters that reflect market-based changes to terms and conditions and expectations.

Available for sale investments accounted for at cost include unquoted equity investments whose value cannot be measured reliably. Quoted prices are not available for these investments due to the absence of an active market. It is also impossible to derive fair value using the similar transaction method. Discounting cash flow method cannot be applied to such investments as there are no reliably determinable cash flows from holding them.

## 26. GAIN/(LOSS) FROM FINANCIAL INSTRUMENTS

Gain/(loss) from financial instruments for 2008, 2007, 2006 are as follows:

**2008**

| **Classes** | **Categories** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** |
|---|---|---|---|---|---|
| Long-term equity investments | | | | | |
| - at fair value | Available-for-sale | - | (398) | 8,666 | - |
| - at cost | Available-for-sale | 1 | - | 4 | - |
| Long-term debt investments | | | | | |
| - at amortized cost | Loans and receivables | (86) | - | - | - |
| Investments in associates | N/A | | | | |
| Long-term receivables | Loans and receivables | (13) | - | - | (9) |
| **Total Long-term financial assets** | | **(98)** | **(398)** | **8,670** | **(9)** |

| (continued) | | 2008 | | | |
|---|---|---|---|---|---|
| **Classes** | **Categories** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** |
| Short-term equity investments | | | | | |
| - at fair value | Available-for-sale | - | (16) | - | - |
| Short-term debt investments | | | | | |
| - at fair value | Available-for-sale | - | - | - | - |
| - at amortized cost | Loans and receivables | - | - | - | 245 |
| Short-term trade receivables | Loans and receivables | 278 | - | - | 545 |
| Short-term other receivables | Loans and receivables | (233) | - | - | 45 |
| Cash and cash equivalents | Loans and receivables | - | - | - | (96) |
| **Total Short-term financial assets** | | **45** | **(16)** | **-** | **739** |
| Long-term bank loans | Liabilities at amortized cost | - | - | - | (10) |
| Long-term accounts payable | Liabilities at amortized cost | - | - | - | - |
| **Total Long-term financial liabilities** | | **-** | **-** | **-** | **(10)** |
| Short-term bank loans | Liabilities at amortized cost | - | - | - | (431) |
| Short-term non-bank loans | Liabilities at amortized cost | - | - | - | (44) |
| Short-term finance lease and vendor financing | Liabilities at amortized cost | - | - | - | (181) |
| Short-term accounts payable | Liabilities at amortized cost | - | - | - | (852) |
| Non-hedge derivative | Financial liabilities at fair value through profit and loss | - | (103) | - | - |
| **Total Short-term financial liabilities** | | **-** | **(103)** | **-** | **(1,508)** |

| | | 2007 | | | | 2006 | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Classes** | **Categories** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** |
| Long-term equity investments | | | | | | | | | - |
| - at fair value | Available-for-sale | - | 5,562 | - | (1) | - | 2,372 | - | - |
| - at cost | Available-for-sale | - | - | - | - | (7) | - | 52 | - |
| Long-term debt investments | | | | | | | | | |
| - at amortized cost | Loans and receivables | 2 | - | - | (4) | - | - | - | - |
| Investments in associates | N/A | - | - | - | - | - | - | - | - |
| Long-term receivables | Loans and receivables | (60) | - | - | - | (6) | - | - | - |
| **Total Long-term financial assets** | | **(58)** | **5,562** | **-** | **(5)** | **(13)** | **2,372** | **52** | **-** |
| Short-term equity investments | | | | | | | | | |
| - at fair value | Available-for-sale | - | (1) | - | - | - | 4 | - | - |
| Short-term debt investments | | | | | | | | | |
| - at fair value | Available-for-sale | - | - | - | - | - | - | - | - |
| - at amortized cost | Loans and receivables | - | - | - | (145) | - | - | - | (212) |
| Short-term trade receivables | Loans and receivables | (863) | - | - | (103) | (408) | - | - | (186) |
| Short-term other receivables | Loans and receivables | 107 | - | - | (9) | 4 | - | - | (44) |
| Cash and cash equivalents | Loans and receivables | - | - | - | (9) | - | - | - | (8) |
| **Total Short-term financial assets** | | **(756)** | **(1)** | **-** | **(266)** | **(404)** | **4** | **-** | **(450)** |
| Long-term bank loans | Liabilities at amortized cost | - | - | - | (1) | - | - | - | 211 |
| Long-term accounts payable | Liabilities at amortized cost | - | - | - | (3) | - | - | - | - |
| **Total Long-term financial liabilities** | | **-** | **-** | **-** | **(4)** | **-** | **-** | **-** | **211** |

| | | 2007 | | | | 2006 | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Classes** | **Categories** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** | **Impairment loss and reversal of impairment loss** | **Fair Value revaluation gain/(loss)** | **Gain/(loss) from sale of financial instruments** | **Gain/(loss) from currency translation** |
| Short-term bank loans | Liabilities at amortized cost | - | - | - | 214 | - | - | - | 111 |
| Short-term non-bank loans | Liabilities at amortized cost | - | - | - | (10) | - | - | - | 4 |
| Short-term finance lease and vendor financing | Liabilities at amortized cost | - | - | - | (3) | - | - | - | 12 |
| Short-term accounts payable | Liabilities at amortized cost | - | - | - | 236 | - | - | - | 332 |
| Non-hedge derivative | Financial liabilities at fair value through profit and loss | - | (58) | - | - | - | (15) | - | - |
| **Total Short-term financial liabilities** | | **-** | **(58)** | **-** | **437** | **-** | **(15)** | **-** | **459** |

## 27. RELATED PARTY TRANSACTIONS

### (a) The Government and OJSC Svyazinvest as a shareholder

As indicated in Note 1, the main shareholder of the Company is OJSC Svyazinvest, which holds 50.67% of the voting capital of the Company, and its representatives comprise a majority of the Board of Directors. The Government of the Russian Federation, in turn, holds 75% less one share of the voting capital of OJSC Svyazinvest and, therefore, ultimately controls the Company. It is a matter of Government policy to retain a controlling stake in sectors of the economy, such as telecommunications, that it views as strategic.

### (b) Interest of the Government in the telecommunications sector in the Russian Federation and the protection of that interest

Effective telecommunications and data transmission are of great importance to Russia for various reasons, including economic, social, strategic and national security considerations. The Government has exercised and may be expected to exercise significant influence over the operations of the telecommunications sector and consequently, the Group. The Government, acting through the Federal Tariff Service and the Federal Telecommunications Agency, has the general authority to regulate certain tariffs, and does regulate such tariffs. Except for regulation of tariffs, the telecommunication legislation requires the Group and other operators to make certain revenue-based payments to the Universal service fund, which is controlled by the Federal Telecommunications Agency. Moreover, the Ministry of Telecom and Mass Communications of the Russian Federation has control over the licensing of providers of telecommunications services.

### (c) Transactions with the Svyazinvest Group

The Group uses the regional networks of the Svyazinvest Group to terminate telephone traffic. Tariffs for services between the Group and other Svyazinvest Group companies for traffic initiation and termination are materially affected by governmental regulation as disclosed in paragraph (b) of this note.

In addition, the Group contracted the Svyazinvest Group companies as the Group's regional agents for customer service, billing and collection services related to long-distance services provided by the Group. Moreover, while calculating the costs of services rendered, the Group uses appropriate resources of Svyazinvest Group companies, including billing and other information systems data.

The Group also receives services related to the construction of the network from certain companies of the Svyazinvest Group which are included in additions of property, plant and equipment in amount of 58 (2007: 21, 2006: 36).

The Group makes certain contributions to non-for-profit organizations, which are companies of the Svyazinvest Group.

The Group makes contributions to the non-state pension fund, which provides the Company's employees with a number of post-employment benefits (refer to Note 23). OJSC Svyazinvest executes significant influence over the operations of the fund.

The amounts of revenue and expenses relating to the transactions with the Svyazinvest Group were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Revenue | 2,668 | 2,308 | 1,460 |
| Charges by network operators – national | (15,576) | (21,162) | (22,598) |
| Administration and other costs | (172) | (105) | (71) |
| Contributions in pension fund included in wages, salaries, other benefit and payroll taxes | (62) | (86) | (92) |
| Bad debt recovery | (27) | (83) | (46) |

In addition, OJSC Svyazinvest participates in the dividends declared by the Company, commensurate with its shareholding.

The amounts of receivables and payables due from and to the Svyazinvest Group were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Accounts receivable | 690 | 670 | 781 |
| Allowance for doubtful receivables | (153) | (129) | (46) |
| Accounts payable | (848) | (731) | (1,677) |

**(d) Transactions with the Government**

Other state bodies ("Budget Organizations"), such as the Ministry of Defence and entities funded by the Government, mainly use the Group's network to carry communications traffic and to broadcast across the country. The Group also consumes some services having both production and miscellaneous nature.

The amounts of revenue and expenses relating to the transactions with the Government were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Revenue | 6,206 | 5,486 | 4,385 |
| Charges by network operators – national | (404) | (385) | (351) |
| Administration and other costs | (916) | (722) | (821) |
| Contributions to Fund of Telecommunication History (included in administration and other costs) | (18) | (51) | (16) |
| Bad debt (expense)/ recovery | 79 | (51) | - |

The amounts of receivables and payables due from and to such organizations were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Accounts receivable | 636 | 526 | 530 |
| Allowance for doubtful receivables | (26) | (106) | (63) |
| Accounts payable | (372) | (171) | (219) |

The Group is also involved in providing telecommunication services to a significant number of commercial entities, which are directly or indirectly controlled by the Government or subsidiaries of governmentally controlled entities. The following table summarizes the effect of transactions with the above entities on the consolidated financial statements of the Group:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Share of total revenue | 1.3% | 1.2% | 1.2% |
| Share of charges by network operators – national | 3.6% | 4.6% | 5.1% |
| Share of accounts receivable | 2.4% | 2.5% | 2.8% |
| Share of allowance for doubtful receivables | 2.4% | 0.8% | 0.8% |
| Share in intangible assets | 6.7% | 8.0% | - |
| Share of other non-current assets | - | - | 79.3% |
| Share of trade accounts payable | 1.0% | 1.5% | 3.8% |

The Company deposits available cash with OJSC Sberbank of Russia in which Government of the Russian Federation controls 57.6%. As of December 31, 2008, 2007 and 2006 cash held in OJSC Sberbank of Russia amounted to 360, 250 and 641, respectively.

### (e) Transactions with associates

The Group is also involved in various telecommunication services with entities in which it has investments, including associates over which it exerts significant influence. A summary of these transactions is as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Revenue | 158 | 575 | 556 |
| Charges by network operators – national | (110) | (118) | (102) |
| Bad debt (expense)/ recovery | 33 | (10) | 22 |

The Group also receives services related to the construction of the network from OJSC Svyazintek which are included in additions of property, plant and equipment in amount of nil (2007: 9, 2006: 442).

Amounts included in the consolidated balance sheets relating to the operations with these entities were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Accounts receivable | 8 | 103 | 67 |
| Allowance for doubtful receivables | (5) | (38) | (28) |
| Accounts payable and accrued expenses | (17) | (23) | (18) |

### (f) Directors' remuneration

In 2008, the total remuneration of the directors and management board members, represented by short-term benefits, amounted to 198 (2007: 191, 2006: 149). As of December 31, 2008, 13 employees of the Company were members of the management board (2007: 12, 2006: 11).

### (g) Other related party transactions

The amounts of revenue and expenses relating to the transactions with other related parties were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Revenue | 10 | 23 | 1,087 |
| Administration and other costs | (2) | (8) | (129) |
| Bad debt (expense)/ recovery | (8) | 84 | (7) |

The amounts of receivables and payables due from and to such companies were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Accounts receivable | 42 | 4 | 239 |
| Allowance for doubtful receivables | (8) | - | (84) |
| Accounts payable and accrued expenses | - | - | (90) |

As of December 31, 2008 the Group holds promissory notes of 925 issued by OJSC Kit-Finans Investitsionniy Bank, which has significant influence over the Group. Interest income accrued on those notes during 2008 amounted to 48.

In 2006 the Group acquired promissory notes of OAO Svyazbank for 4,700, which were fully settled in the same year with net income from sale of promissory notes amounting to nil. As of December 31, 2006 cash held in OAO Svyazbank amounted to 319. Certain directors and managers of the Group and OAO Svyazinvest were directors of OAO Svyazbank till June 2006.

## 28. COMMITMENTS AND CONTINGENCIES

### (a) Legal proceedings

The Group is subject to a number of proceedings arising in the course of the normal conduct of its business (refer to (b) below). Management believes that the ultimate resolution of these matters will not have a material adverse effect on the results of operations or the financial position of the Company or the Group.

As mentioned in Note 18, Loral won a lawsuit against CJSC GlobalTel with a claim to repay the principal amount of the loan, interest and related expenses. In addition, Loral filed a lawsuit in the Superior Court of California, County of Santa Clara, USA, to recognize its claim against GlobalTel and to obtain the right to claim the property of CJSC GlobalTel. As of the balance sheet date, the Court has not considered the case.

### (b) Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes occurring frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group entities may be assessed additional taxes, penalties and interest, which can be significant. The Group entities' tax returns are open for review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year in which the decision on the conduct of the tax audit was adopted. Under certain circumstances, reviews may cover longer periods.

As of December 31, 2008, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained upon examination. Management of the Group believes that it has adequately provided for tax liabilities in the consolidated balance sheets as of December 31, 2008. However, the general risk remains that relevant authorities could take different position with regard to interpretative issues and the effect could be significant.

In December 2007, the Federal Tax Service of the Russian Federation completed the comprehensive tax inspection for the period of 2004-2006 and, as a result, issued a claim in the amount of 1,812 of additional taxes, fines and penalties. More than 90% of the amount relates to assessments calculated on the basis of the tax authorities' interpretation of telecommunication industry legislation in general and that of interaction between telecommunication operators in particular. The Group appealed the decision to a higher taxing authority and to the Arbitration Court of Moscow. In November 2008, the Arbitration Court of Moscow declared the claim of the tax authorities in the amount of 1,803 invalid and ordered the Group to pay 9. In February 2009, the Court of Appeals confirmed the decision of the Arbitration Court of Moscow. Subsequently, the Federal Tax Service of the Russian Federation filed an appeal to the Court of Cassation, which, in May 2009, upheld the ruling of the Arbitration Court of Moscow.

Management believes that, overall, taxes for 2004-2006 have been properly calculated by the Group and fairly stated in its financial statements based on the Group's analysis of the sustainability of liability. However, certain transactions revealed during the tax inspection management assessed as unlikely to be successfully defended in higher courts. As a result, the Group has accrued additional tax liabilities of 140 as of December 31, 2008 (2007:144, 2006:0).

In April 2008, the Russian Federal Tax Service completed a comprehensive tax inspection of CJSC GlobalTel for the period 2005-2006 and, as a result, issued a claim in the amount of 91 of additional taxes which was subsequently reduced to 45. CJSC GlobalTel disputed the claim in the Arbitration Court of Moscow. In April 2009, the court declared the claim of the tax authority of 43 to be invalid. Tax authorities may appeal the decision in the Court of Appeal.

## (c) Licenses

Substantially all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years up to 2013.

The Company has renewed all other licenses on a regular basis in the past, and believes that it will be able to renew licenses without additional cost in the normal course of business. Suspension or termination of the Company's main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Group.

## (d) Capital Commitments

As of December 31, 2008, contractual commitments of the Group for the acquisition of property, plant and equipment amounted to 3,134 (2007: 3,298, 2006: 2,915).

As of December 31, 2008, all lease contracts are legally cancellable. However, the Group was involved in a number of operating lease agreements for land, on which the Group constructed certain leasehold improvements. Thus, it is reasonably certain that these leases would not be cancelled. Future minimum lease payments under these operating leases as of December 31, 2008, were as follows:

| | |
|---|---|
| Current portion | 74 |
| Between one to two years | 65 |
| Between two to three years | 62 |
| Between three to four years | 52 |
| Between four to five years | 48 |
| Over five years | 1,623 |
| **Total minimum rental payables** | **1,924** |

In connection with the finance lease agreement referred to in Note 16, the Group, as lessor, also entered into operating IRU lease agreements for the rent of its network capacity of terrestrial fiber-optic cables for the period of 13 years starting at various dates between 2006 and 2008.

Future minimum rentals receivable related to these cancellable operating leases, which are unlikely to be cancelled as of December 31, 2008, 2007 and 2006, were as follows:

| | **2008** | **2007** | **2006** |
|---|---|---|---|
| Current portion | 39 | 83 | 70 |
| Between one to two years | 98 | 81 | 90 |
| Between two to three years | 92 | 80 | 88 |
| Between three to four years | 92 | 78 | 87 |
| Between four to five years | 92 | 78 | 86 |
| Over five years | 316 | 347 | 467 |
| **Total minimum rental receivables** | **729** | **747** | **888** |

## 29. CREDIT RISK MANAGEMENT

Each class of financial assets represented in the Group's balance sheet to some extent is exposed to credit risk. Management develops and implements policies and procedures aiming to minimize the exposure and impact on the Group's financial position in case of risk realization.

Financial instruments that could expose the Group to concentrations of credit risk are mainly trade and other receivables. The credit risk associated with these assets is limited due to the Group's large customer base and ongoing procedures to monitor the credit worthiness of customers and other debtors.

The Group's accounts receivable are represented by receivables from the Government and other public organizations, businesses and individuals each of them bearing different credit risk. Collection of receivables from the Government and other public organizations is mainly influenced by political and economic factors and not always under full control of the Group. However, management undertakes all possible efforts to minimize the exposure to risk of receivable from this category of subscribers. In particular, credit worthiness of such subscribers is assessed based on financing limits set by the Government. Management believes there were no significant unprovided losses relating to these or other receivables as at December 31, 2008.

To reduce risk of exposure on receivables from businesses and individuals the Group implements a range of procedures. Credit risk is determined based on a summary of probabilities of occurrences and possible impact of events negatively influencing the customer's ability to discharge its obligation. A credit rating is attributed to a customer on initial stage of cooperation and, then, reassessed periodically based on credit history. As a part of its credit risk management policy, the Group arranges preventive procedures which are represented by but not limited to advance payments, request for collaterals and banks and third parties party guarantees. For collection of receivables, which are past due, the Group takes a variety of actions from suspension of rendering of services to taking legal action.

The Group deposits excess cash available with several Russian banks and makes investments into promissory notes, both of which expose the Group to credit risk since there is no deposit insurance for banks operating in Russia. To manage the credit risk related to deposit of cash available with banks, management of the Group implements procedures to periodically assess the credit worthiness of the banks. To facilitate this assessment, deposits are mainly placed with the bank where the Group has already had current settlement account and can easily monitor activity of the bank. Before making an investment into promissory notes, management of the Group performs an analysis of financial position of the issuer and monitors its credit worthiness over periods up to maturity. Credit quality of the promissory notes is enhanced, whenever possible, by collaterals.

To secure the obligation of a debtor to pay on promissory notes and deposits, the Group holds collaterals amounting to 588 representing equipment in lease and property. The Group is entitled to take possession of the pledged equipment in lease and property only in case of either non-performance or undue performance of obligations by the debtor. The settlement date under promissory notes and deposits secured by collaterals will expire in 2009.

Maximum exposures to credit risk are limited to the net carrying amounts of respective financial assets. Such exposure is mitigated by collaterals held by the Group.

The Group had no individual customers, other than the Government of the Russian Federation and its related parties (refer to Note 27), that accounted for greater than 10% of its revenue during the years ended December 31, 2008, 2007 and 2006.

## 30. LIQUIDITY RISK MANAGEMENT

The Group monitors its risk to a shortage of funds by preparing and monitoring compliance with a cash budget/forecast. This tool considers the maturity of both cash inflow and outflow from the Group's operations. Based on projected cash flow the decision is taken on either investment of free cash or attracting financing required. Realization of liquidity risk management policy provides the Group with sufficient cash to discharge its obligation on a timely basis.

Maturity analysis as of December 31, 2008, 2007 and 2006 represented below shows undiscounted cash flows.

| Financial instrument | Less than one year | Between one to two years | Between two to three years | Between three to four years | Between four to five years | Over five years |
|---|---|---|---|---|---|---|
| Bank loans | 2,776 | 128 | - | - | - | - |
| Financial lease and vendor financing payable | 1,752 | 81 | 63 | 61 | 61 | 377 |
| Accounts payable | 9,521 | 88 | 30 | 22 | 24 | 173 |
| **As of December 31, 2008** | **14,049** | **297** | **93** | **83** | **85** | **550** |

| Financial instrument | Less than one year | Between one to two years | Between two to three years | Between three to four years | Between four to five years | Over five years |
|---|---|---|---|---|---|---|
| Bank loans | 2,841 | 147 | 37 | - | - | - |
| Financial lease and vendor financing payable | 1,791 | 106 | 54 | 43 | 43 | 307 |
| Accounts payable | 7,471 | 111 | 29 | 28 | 24 | 144 |
| **As of December 31, 2007** | **12,103** | **364** | **120** | **71** | **67** | **451** |

| Financial instrument | Less than one year | Between one to two years | Between two to three years | Between three to four years | Between four to five years | Over five years |
|---|---|---|---|---|---|---|
| Bank loans | 3,461 | 222 | 68 | 40 | - | - |
| Financial lease and vendor financing payable | 1,770 | 493 | 93 | 43 | 43 | 349 |
| Accounts payable | 7,416 | 83 | 85 | 29 | 32 | 171 |
| **As of December 31, 2006** | **12,647** | **798** | **246** | **112** | **75** | **520** |

In 2008, the Russian financial market was influenced by the World economic crisis. The Group deals mainly with short-term financial instruments denominated in Russian Rubles and management does not believe the crisis has or will significantly influence the Group's operations.

In accordance with Russian legislation, joint stock companies must maintain a level of equity (net assets) that is greater than the charter capital. In the event that a company's net assets, as determined under Russian accounting legislation, fall below certain minimum levels, specifically below zero, the company can be forced to liquidate. CJSC Zebra Telecom and CJSC GlobalTel have had, and continue to have, negative equity as reported in their Russian statutory financial statements. Management believes that the risk of the initiation of statutory liquidation procedures or other material adverse actions is remote.

## 31. MARKET RISK

Our significant market risk exposures are interest rate risk, exchange rate risk and other price risk. Exposure to other price risk arises from available for sale investments quoted on active markets.

### Interest rate risk

Interest rate risk mainly relates to floating rate debt denominated primarily in U.S. dollars and euros. To manage this risk, the Group entered into interest rate swaps to hedge significant amounts of its floating rate debt. Other borrowings do not materially influence the exposure to interest risk.

The table below demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax.

| | Increase/decrease in percentage point | Effect on profit before tax |
|---|---|---|
| **2008** | | |
| EUR | + 5.0% | (1) |
| EUR | - 5.0% | 1 |
| USD | + 5.0% | (255) |
| USD | - 5.0% | 255 |

| | Increase/decrease in percentage point | Effect on profit before tax |
|---|---|---|
| **2007** | | |
| EUR | + 1.0% | (1) |
| EUR | - 1.0% | 1 |
| USD | + 1.0% | (63) |
| USD | - 1.0% | 63 |
| **2006** | | |
| EUR | + 1.0% | (2) |
| EUR | - 1.0% | 2 |
| USD | + 1.0% | (94) |
| USD | - 1.0% | 94 |

Taking into account changes in the current situation on financial markets, management believes that 5% is the most probable range of fluctuation in interest rates.

### Foreign exchange risk

The main business of the Group is maintained with Russian counterparties based on agreements in Russian Rubles. The Group's foreign currency receivables and payables arise mainly on contracts with foreign operators because of international industry practice to make settlements in US dollars, Euro or SDR. Hence, the Group will be exposed to foreign exchange risk as long as it continues to make settlements with foreign currencies.

In 2008, approximately 11.1% (2007: 10.2%, 2006: 8%) of the Group's revenues and 17% (2007: 15%, 2006: 14%) of the Group's expenses were denominated in currencies other than the Russian Ruble. Revenues generated in foreign currency represent income received from foreign operators, and foreign currency denominated expenses consist primarily of payments to foreign operators for international long-distance traffic termination. Accounts receivable from foreign operators and accounts payable to foreign operators which are denominated in foreign currencies amounted to approximately 9% (2007: 8.2%, 2006: 5%) of the Group's total accounts receivable and 19% (2007: 11.5%, 2006: 18%) of the Group's total accounts payable as of December 31, 2008, 2007 and 2006, respectively. Borrowings denominated in foreign currencies and outstanding as of December 31, 2008, 2007 and 2006 amounted to 89.5%, 88.9% and 94% of the Group's total borrowings as of December 31, 2008, 2007 and 2006, respectively.

The Group does not have formal arrangements to mitigate foreign exchange risks of the Group's operations.

The table below demonstrates the sensitivity to a reasonably possible change in exchange rates, with all other variables held constant, of the Group's profit before tax:

| | **Increase/decrease in percentage point** | **Effect on profit before tax** |
|---|---|---|
| **2008** | | |
| EUR | + 20% | 35 |
| EUR | - 20% | (35) |
| USD | + 20% | (520) |
| USD | - 20% | 520 |
| SDR | + 20% | (36) |
| SDR | - 20% | 36 |
| **2007** | | |
| EUR | + 3.5% | (8) |
| EUR | - 6.0% | 13 |
| USD | + 4.0% | (104) |
| USD | - 5.5% | 143 |
| SDR | + 4.0% | 4 |
| SDR | - 5.5% | (5) |
| **2006** | | |
| EUR | + 3.5% | (6) |
| EUR | - 6.0% | 11 |
| USD | + 4.0% | (138) |
| USD | - 5.5% | 189 |
| SDR | + 4.0% | (7) |
| SDR | - 5.5% | 10 |

Taking into account that the Ruble depreciated against the USD by 20% and depreciated against Euro by 15% in 2008, and assessing the current situation on financial markets, management believes that 20% is the most probable range of the Ruble exchange rate fluctuation against the foreign currencies. The analysis was applied to monetary items denominated in relevant currencies at the balance sheet date.

## Other price risk

As of December 31, 2008, the Group's assets include investments in quoted securities subject to other price risk. To mitigate this risk, the Group regularly analyzes market securities trends and makes a decision to sell a security, when necessary.

## 32. CAPITAL MANAGEMENT

The table below demonstrates the sensitivity to a reasonably possible change in market indexes for securities, with all other variables held constant, of the Group in terms of the result of fair value revaluation recognized in equity.

| | **Increase/decrease in percentage point** | **Effect on revaluation result recognized in equity** |
|---|---|---|
| **2008** | | |
| MICEX | + 50.0% | 87 |
| MICEX | - 50.0% | (87) |
| **2007** | | |
| MICEX | + 30.0% | 3,532 |
| MICEX | - 30.0% | (3,532) |
| **2006** | | |
| MICEX | + 30.0% | 1,706 |
| MICEX | - 30.0% | (1,706) |

Taking into account changes in current situation in financial markets management believes that 50% is the most probable range of fluctuation in market indexes for securities.

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize the return to shareholders. The Board of directors reviews the Group's performance and establishes a variety of key performance indicators which are based on Russian statutory accounts. In addition, the Group is subject to externally imposed capital requirements (VEB loan covenants), which are used for capital monitoring. There were no changes in the objectives, policies and processes during 2008.

Capital includes equity attributable to the equity holders of the Company. Revaluation surplus, which is included in capital, is not subject to capital management because of its nature. The Company manages its capital structure and makes adjustments to it by issuance of new shares, dividend payments to shareholders and purchase of treasury shares. The Company monitors compliance of the amount of legal reserve with the statutory requirements. In addition, the Company monitors distributable profits on a regular basis and determines the amount and timing of dividend payments.

## 33. SUBSEQUENT EVENTS

In January 2009, OJSC Rostelecom in partnership with mobile operator OJSC Megafon won a tender for sponsorship of XXII Winter Olympic Games and XI Winter Paralympic Games 2014 in Sochi in the category of Telecommunication. According to the agreement, the sponsorship contribution amounted to USD 260 million and should be charged to each sponsor in the amount of USD 130 million. Half of this amount shall be paid by cash and other half shall be contributed in free services. In return, each partner will obtain exclusive rights to use Olympic logo in its advertising and other activity.

In May 2009, the Group's shareholders authorized dividends for the year ended December 31, 2008 in the amount of 2,121.6.

| | **Dividends** | **Dividends per share, Rbl** |
|---|---|---|
| Ordinary Shares, Rbl 0.0025 par value | 1,414.4 | 1.9410 |
| Preferred Shares, Rbl 0.0025 par value | 707.2 | 2.9124 |
| **Total** | **2,121.6** | |

The withholding tax on dividends amounts to 191.