OJSC TATTELECOM

International Financial Reporting Standards
Consolidated Financial Statements and
Independent Auditor's Report

31 December 2011

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Independent Auditor's Report

To the Shareholders and Board of Directors of OJSC Tattelecom:

1 We have audited the accompanying consolidated financial statements of OJSC Tattelecom and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6 In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

29 May 2012
Moscow, Russian Federation

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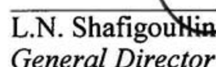
OJSC TATTELECOM
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in thousands of Russian roubles)

	Note	31 December 2011	31 December 2010
ASSETS			
Non-current assets			
Property, plant and equipment	9	10,517,726	10,305,120
Intangible assets	10	182,317	143,746
Financial investments	11	121,399	149,349
Other non-current assets	12	209,744	141,259
Total non-current assets		**11,031,186**	**10,739,474**
Current assets			
Inventory	13	195,807	138,933
Accounts receivable	14	782,061	634,940
Advances paid and prepaid expenses	15	110,591	191,932
Prepaid income tax		25,752	58
Prepaid taxes, other than income tax		27,264	30,170
Financial investments	11	28,142	19,313
Cash and cash equivalents	16	37,351	369,057
Total current assets		**1,206,968**	**1,384,403**
TOTAL ASSETS		**12,238,154**	**12,123,877**
EQUITY			
Ordinary shares	17	2,104,799	2,104,799
Treasury shares	17	(89,930)	(81,892)
Revaluation reserve for available for sale investments	11	(1,711)	(1,895)
Additional paid in capital	17	232,275	232,275
Retained earnings		5,117,766	4,472,056
TOTAL EQUITY		**7,363,199**	**6,725,343**
LIABILITIES			
Non-current liabilities			
Long-term borrowings	18	1,614,458	1,905,732
Non-current finance lease liabilities		1,265	220
Deferred income tax liabilities	19	564,642	509,362
Deferred revenue	20	62,123	215,599
Post-retirement benefit obligations	21	190,969	192,298
Other non-current liabilities		7,708	63,930
Total non-current liabilities		**2,441,165**	**2,887,141**
Current liabilities			
Current portion of long-term borrowings	18	988,619	859,252
Current finance lease liabilities		4,000	7,175
Accounts payable and accrued liabilities	22	1,023,741	1,127,689
Taxes payable other than on income	23	230,116	170,355
Deferred revenue, current portion	20	187,314	346,922
Total current liabilities		**2,433,790**	**2,511,393**
TOTAL LIABILITIES		**4,874,955**	**5,398,534**
TOTAL EQUITY AND LIABILITIES		**12,238,154**	**12,123,877**

Approved for issue and signed on behalf of the Board of Directors on 29 May 2012



L.N. Shafigoullin
General Director

L.R. Safina
Head of IFRS department

The accompanying notes on pages 5 to 30 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(in thousands of Russian roubles)

	Note	For the year ended 31 December 2011	2010
Revenue	24	6,712,122	5,939,421
Operating expenses	25	(5,452,172)	(4,775,256)
Operating profit		**1,259,950**	**1,164,165**
Finance income		14,029	93,229
Finance costs	26	(210,431)	(287,624)
Foreign exchange (loss)/gain		(10,018)	37,814
Profit before income tax		**1,053,530**	**1,007,584**
Income tax expense	19	(227,777)	(220,231)
Profit for the year attributable to the owners of the Company		**825,753**	**787,353**
Other comprehensive income:			
Actuarial gain, net of deferred tax charge of 3,269 (2010: 1,550)	21, 19	13,076	6,199
Gain on revaluation of available-for-sale investments, net of deferred tax charge of 37 (2010: 843)	11, 19	184	3,372
Total comprehensive income for the year attributable to the owners of the Company		**839,013**	**796,924**
Weighted average number of outstanding ordinary shares	17	20,386,378,080	20,419,338,080
Earnings per ordinary share, basic and diluted, in roubles per share		0.041	0.039

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(in thousands of Russian roubles)

	Note	Ordinary shares	Additional aid in capital	Revaluation reserve for available-for-sale investments	Treasury shares	Retained earnings	Total
Balance at 31 December 2009		**2,104,799**	**232,275**	**(5,267)**	**(81,892)**	**3,792,124**	**6,042,039**
Total comprehensive income for the year		–	–	3,372	–	793,552	796,924
Dividends declared	17	–	–	–	–	(113,620)	(113,620)
Balance at 31 December 2010		**2,104,799**	**232,275**	**(1,895)**	**(81,892)**	**4,472,056**	**6,725,343**
Total comprehensive income for the year		–	–	184	–	838,829	839,013
Dividends declared	17	–	–	–	–	(193,119)	(193,119)
Purchase of treasury shares		–	–	–	(8,038)	–	(8,038)
Balance at 31 December 2011		**2,104,799**	**232,275**	**(1,711)**	**(89,930)**	**5,117,766**	**7,363,199**

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands of Russian roubles)

	Note	For the year ended 31 December 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		**1,053,530**	**1,007,584**
Adjustments for:			
Depreciation of property, plant and equipment	9	1,183,301	1,104,765
Amortisation of intangible assets	10	92,776	68,411
Loss on disposal of property plant and equipment	25	69,564	99,077
Finance income		(14,029)	(93,229)
Finance costs	26	210,431	287,624
Loss on impairment of accounts receivable	14	41,679	36,399
Foreign exchange loss/(gain)		10,018	(37,814)
Other non-cash operating costs		(24,898)	(3,917)
Operating cash flows before changes in working capital		**2,622,372**	**2,468,900**
(Increase)/decrease in accounts receivable		(162,515)	102,598
(Increase)/decrease in inventory		(42,767)	5,349
Decrease in advances paid and prepaid expenses		74,085	159,832
Decrease/(increase) in prepaid taxes, other than income tax		2,906	(6,347)
(Decrease)/increase in accounts payable and accrued liabilities		(17,531)	279,635
Increase/(decrease) in taxes payable, other than income tax		59,761	(31,348)
Decrease in deferred revenue		(253,785)	(68,600)
Changes in working capital		**2,282,526**	**2,910,019**
Income tax paid		(201,497)	(102,088)
Interest paid		(233,875)	(327,310)
Net cash from operating activities		**1,847,154**	**2,480,621**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property, plant and equipment		(1,677,790)	(1,353,017)
Purchases of intangible assets		(68,247)	(105,666)
Proceeds from sale of property, plant and equipment		46,829	106,768
Interest received		20,224	34,865
Purchases of investments		(24,277)	(22,182)
Acquisition of subsidiaries, net of cash acquired		(98,326)	–
Disposal of subsidiaries, net of cash disposed		7,000	–
Proceeds from repayment of investments		2,639	330,000
Net cash used in investment activities		**(1,791,948)**	**(1,009,232)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Purchase of treasury shares		(8,038)	–
Repayment of bonds		–	(1,330,665)
Proceeds from borrowings		3,825,602	3,202,010
Repayment of borrowings		(3,994,337)	(2,772,045)
Finance lease payments		(17,481)	(36,142)
Dividends paid		(192,658)	(247,191)
Net cash used in financing activities		**(386,912)**	**(1,184,033)**
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(331,706)	287,356
CASH AND CASH EQUIVALENTS, beginning of the year		**369,057**	**81,701**
CASH AND CASH EQUIVALENTS, end of the year		**37,351**	**369,057**

The accompanying notes on pages 5 to 30 are an integral part of these consolidated financial statements.

1. OJSC TATTELECOM AND ITS OPERATIONS

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") for the year ended 31 December 2011 for OJSC Tattelecom ("Tattelecom" or "the Company") and its subsidiaries (together referred to as “the Group”).

The Company was incorporated on 22 July 2003 as an open joint stock company and is domiciled in the Russian Federation.

The Company is the largest telecommunications operator in the Republic of Tatarstan. The Company operates through seven regional branches: Almetyevsky, Arsky, Buinsky, Nizhnekamsky, Chistopolsky, Kazansky and Naberezhno-Chelninsky zonal telecommunication nodes.

The Company's registered address and place of business is N. Ershova street, 57, 420061, Kazan, Republic of Tatarstan.

As of 31 December 2011 and 2010 the Company’s majority shareholders were as follows:

	% of ownership
OAO Svyazinvestneftehim	87.2%
Other	12.8%
Total	**100.0%**

The Company’s ultimate parent and controlling party is the Republic of Tatarstan.

The Group consists of the Company and the following subsidiaries. All Group companies are incorporated under Russian law.

	% of ownership as of 31 December		
Subsidiary	**2011**	**2010**	**Immediate parent**
LLC Kamatel K	100%	100%	OJSC Tattelecom
LLC Elemte Invest	100%	100%	OJSC Tattelecom
LLC StroiRemKompania	100%	100%	LLC Elemte Invest
LLC Volna	95%	−	LLC Elemte Invest
LLC Kamatel	100%	−	OJSC Tattelecom
LLC Kamatel-Yantel	100%	−	OJSC Tattelecom
LLC Kamatel-K *	−	100%	OJSC Tattelecom
LLC LiNet **	12%	100%	OJSC Tattelecom

* The subsidiary has been liquidiated
** The Company has sold the controlling interst in the subsidiary

2. OPERATING ENVIRONMENT OF THE GROUP

The Russian economy displays certain characteristics of an emerging market. Russian tax, currency and customs legislation is subject to varying interpretations and contribute to challenges faced by the entities operating in the Russian Federation (Note 28).

The international sovereign debt crisis, stock market volatility and other risks could have a negative effect on the Russian financial and corporate sectors. The future economic development of the Russian Federation is dependent upon external factors and internal measures undertaken by the government to sustain growth, and to change the tax, legal and regulatory environment.

Management believes it is taking all measures necessary to support sustainability and development of the Group’s business in the current business and economic environment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The accompanying consolidated financial statements have been prepared under the historical cost convention as modified by the initial recognition at the fair value of financial instruments and the carrying amounts of equity items in existence at 31 December 2002, which include the adjustment for the effects of hyperinflation, calculated using conversion factors derived from the Russian Federation Consumer Price Index published by the Russian Statistics Agency.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Tattelecom and its subsidiaries maintain their accounts and prepare financial statements for regulatory purposes in accordance with Russian accounting legislation. The accompanying consolidated financial statements are based on statutory accounting records, which are maintained under historical cost convention. At each reporting date, the Company makes appropriate adjustments and reclassifications to its stand-alone statutory financial statements and those of its subsidiaries for the purpose of fair presentation in accordance with IFRS.

Functional and presentation currency

The Company's financial statements are measured in the currency prevailing in the economic environment in which the Company operates (functional currency). The functional and presentation currency of the Company is Russian rouble. All amounts in these consolidated financial statements are presented in thousands of Russian roubles unless otherwise stated.

Transactions denominated in foreign currencies are translated into the functional currency using the official exchange rates of the Central Bank of the Russian Federation ("CBRF") prevailing at the date of transactions. Exchange rate differences arising from such transactions and from translation of monetary assets and liabilities denominated in foreign currency at the closing exchange rate are recorded in the respective caption of the consolidated statement of comprehensive income.

The exchange rates of Russian rouble to US dollar ("USD") as of 31 December 2011 and 2010 were RUB 32.1961 and RUB 30.4769 to USD 1, respectively. The exchange rates of Russian rouble to Euro ("EUR") as of 31 December 2011 and 2010 were RUB 41.6714 and RUB 40.3331 to EUR 1, respectively.

Consolidated financial statements

Subsidiaries are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or obtainable from presently convertible instruments are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Consolidated financial statements (continued)

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in profit or loss. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any minority interest. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated.

Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required. If a unit of property, plant and equipment consists of several elements with different useful lives they are treated as separate fixed assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

At each reporting date management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of the asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

Depreciation

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate the cost less the residual values over their estimated useful lives, as follows:

	Useful life in years
Land	Not depreciated
Buildings	40
Telecommunications equipment	10
Transmission devices	15
Vehicles	7
Office equipment and other	3-5

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets under construction are not depreciated. Depreciation of these assets will begin when the related assets are ready to be placed in service.

Lease

The Company accounts for the leased property in accordance with the requirements of IAS 17, *Leases*. A lease is classified as a finance lease if the terms of the lease transfer substantially all risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

For finance leases, the assets leased are capitalized in property, plant and equipment at the lower of the fair value of the leased asset and the present value of future minimum lease payments, at the inception of the lease in the lessee's statement of financial position. Amounts due within one year after the reporting date are classified as current liabilities and the remaining balance – as non-current liabilities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Lease (continued)

Leased assets are depreciated over their useful lives as determined in accordance with the accounting policy or over the term of the finance lease, if shorter. Where there is reasonable certainty that the lessee will obtain ownership by the end of the finance lease term, the asset is depreciated over its useful life. Where it is possible that the assets received under finance lease agreements will be returned upon the end of the lease term, such assets are depreciated over their useful lives or the lease term, whichever is shorter.

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Intangible assets

Intangible assets primarily represent licenses, software and subscribers' base. Intangible assets are amortised using the straight-line method over their useful lives:

	Useful lives in years
Licenses	1-7
Software	1-10
Subscribers' base	5

If impaired, the carrying amount of intangible assets is written down to the higher of their value in use and fair value less cost to sell.

Financial instruments – key measurement terms

Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Group may use mid-market prices as a basis for establishing fair values for the offsetting risk positions, and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are included in the carrying values of related items in the consolidated statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Initial recognition of financial assets

Financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial assets are initially recorded at fair value plus transaction costs. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. The Group uses discounted cash flow valuation techniques to determine the fair value of financial instruments that are not traded in an active market.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Derecognition of financial assets

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Classification of financial assets

The Group classifies its financial assets into the following measurement categories: available-for-sale investments and loans and receivables.

Available-for-sale investments

Available-for-sale investments are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year as finance income. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year as finance income when the Group's right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired at which time the cumulative gain or loss is reclassified from other comprehensive income to finance income in profit or loss for the year.

Classification of financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. The Group classifies its financial liabilities as other financial liabilities. Other financial liabilities are carried at amortised cost.

Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, deposits and highly liquid financial investments with initial maturities of three months or less, with low risks of a decrease in value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of financial assets carried at amortised cost

Impairment losses are recognized in profit or loss when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and reliability of related collateral, if any.

If the terms of an impaired financial asset held at amortized cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset’s carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor’s credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss.

Inventories

Inventories comprise cables, spare parts, telephones, modems, IPTV set top boxes and are stated at the lower of cost or net realizable value. Cost of inventory is determined based on actual cost of each inventory item. Net realizable value represents the estimated selling price determined under the ordinary business terms less marketing costs.

Advances paid and prepaid expenses ("Prepayments")

Advances paid and prepaid expenses (hereinafter – “prepayments”) are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

Pension plans and post-employment benefits

The Group operates a defined benefit pension plan. The plan is funded through payments to a non-governmental pension fund, NPF Volga-Capital, determined by periodic actuarial calculations. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the consolidated statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period, together with adjustments for unrecognized past-service costs.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pension plans and post-employment benefits (continued)

The defined benefit obligation is calculated using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise. Past service costs are recognized immediately in profit or loss.

Pension assets do not meet the definition of plan assets of IAS 19, *Employee Benefits*, as the Group has an unconditional right to redeem the value of these assets from the fund to the extent of the Group's contributions plus 80% of return on these assets less benefits paid. Pension assets are classified as non-current available-for-sale-investments under the caption "investment in pension fund" and are measured at fair value.

Value added tax

Output value added tax ("VAT") related to sales is payable to tax authorities on the earlier of (a) collection of receivables from customers or (b) delivery of services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

Income taxes

Income taxes have been provided for in these consolidated financial statements in accordance with Russian legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the tax authorities in respect of taxable profits or losses for the current and prior periods.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised.The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

Revenue is recognized when the amount of the revenue can be reliably measured, and when it is probable that future economic benefits will flow to the Group. Revenue is measured at the fair value of consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of any discounts and value added tax.

The Group earns service revenues from usage of its local exchange networks and facilities. The principal services rendered by the Group are as follows:

- Local telecommunications services;
- Internet access services;
- Intrazonal telephone communications services;
- Installation and connection services;
- Interconnection and traffic transmission services;
- Lease of cable capacity;
- IP telephony, IPTV and cable TV services;
- Lease of telephone canalisation channels;
- Other revenues.

Local telecommunications services
Local telecommunications services include provision of local voice services to subscribers (urban and rural telephony). The services rendered relate to use by customers (e.g. call minutes), availability over time (e.g. monthly service charges) or other agreed calling plans. Revenue from local telecommunications services is recognised in the period in which services are used by subscribers.

Internet access services
Revenue from internet access services is recognised in the period in which the services are rendered.

Intrazonal telecommunications services
Intrazonal telecommunication services include the following:

- Telephone connections between subscribers of fixed line telephone network within the territory of the Republic of Tatarstan;

Telephone connections between subscribers of fixed line telephone network and subscribers of mobile communication network where subscriber numbers of the calling party and destination party are included in the numbering capacity within, respectively, geographically identifiable and geographically unidentifiable numbering areas assigned to the same constituent entity. The services rendered relate to use by customers (e.g. call minutes). The Group recognises revenues from intrazonal telecommunications services in the period when the services are used by the customers.

Installation and connection services
Fees received for installation and connection to the Group's telecommunication network are deferred and recognized as revenue over the estimated average period of a subscriber retention.

Interconnection and traffic transmission services
Revenue from interconnection and traffic transmission services is recognized at the time of interconnect traffic's transit across the Group's network.

Lease of cable capacity
The Group recognizes revenue from the lease of local and intrazonal cable capacity in the period in which the service is rendered.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition (continued)

IP telephony, IPTV and cable TV services;
The Group recognises revenue from IP telephony, IPTV and cable TV services in the period in which the services are rendered.

Lease of telephone canalisation channels
The Group recognises revenue from the lease of telephone canalisation channels in the period in which the service is rendered.

Other revenues
Other revenues primarily consist of revenues from telegraph services, services under agency agreements, maintenance services and sales of goods and are recognized when services are rendered/goods are delivered.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets. Capitalization of borrowing costs continues up to the date when the assets are substantially ready for their use. The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised. All other borrowing costs are recorded in the finance costs of the consolidated statement of comprehensive income in the period in which they are incurred.

Dividends

Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the consolidated financial statements are authorised for issue are disclosed in Note 30.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Treasury shares

Where the Company or its subsidiaries purchase the Company's equity instruments, the consideration paid, including any directly attributable incremental costs, net of income taxes, is deducted from equity attributable to the Company's owners until the equity instruments are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's owners.

Earnings per share

Basic earnings per share are determined by dividing the profit attributable to the Group's shareholders by the weighted average number of ordinary shares outstanding during the reporting period. For the purpose of calculating diluted earnings per share, profit or loss attributable to the shareholders of the Group, and the weighted average number of ordinary shares outstanding are adjusted for the effects of an assumed conversion of all potentially dilutive ordinary shares into ordinary shares.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Transactions with related parties

For the purposes of these consolidated financial statements, parties are considered to be related if the parties are under common control or one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24, *Related Party Disclosures*. In considering related party relationships, attention is directed to the substance of the relationship, not merely the legal form.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's past experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Useful lives of property, plant and equipment

The estimation of the useful lives of property, plant and equipment is a matter of judgement based on the experience with similar assets. The future economic benefits embodied in the assets will be consumed principally through use. However, other factors, such as technical or commercial obsolescence and wear and tear, often result in the diminution of the economic benefits embodied in the assets. Management assesses the remaining useful lives in accordance with the current technical conditions of the assets and estimated period during which the assets are expected to earn benefits for the Group.

The following primary factors are considered: (a) expected usage of the assets; (b) expected physical wear and tear, which depends on operational factors and maintenance programme; and (c) technical or commercial obsolescence arising from changes in market conditions. Had the estimated useful lives been 10% higher (lower) than management's estimates, the depreciation expenses would have decreased (increased) by 108,113 (2010: 101,988).

Impairment of accounts receivable

Provision for impairment of accounts receivable is based on the historical data related to collectability of accounts receivable and solvency analysis of the most significant debtors. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected.

Installation and connection fees

Installation and connection fees are non-refundable fees received at the time of the subscribers' connection to the Group's telecommunications network. Installation and connection services are not separable from other telecommunications services provided to the subscribers. Revenue from installation and connection services is deferred upon receipt of the fees and amortized to profit or loss over the estimated average fixed line subscription period. Management's estimate of an average subscription period is based on the historical data and is six years for residential subscribers and five years for commercial organizations (2010: eight and five years, respectively). Had the estimated subscription period increased (decreased) by one year, for both types of subscribers, the Group's revenue from installation and connection fees would have decreased (increased) by 67,267 (2010: 68,225).

5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The following new standards and interpretations became effective for the Group from 1 January 2011:

Improvements to International Financial Reporting Standards (issued in May 2010 and effective from 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on the acquiree's share-based payment arrangements that were not replaced, or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date, and not the amount obtained during the reporting period; IAS 1 was amended to clarify the requirements for the presentation and content of the statement of changes in equity (this amendment was adopted previously by the Group in its prior year's financial statements); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits. The above amendments resulted in additional or revised disclosures, but had no material impact on measurement or recognition of transactions and balances reported in these consolidated financial statements.

Other revised standards and interpretations effective for the current period. IFRIC 19 "Extinguishing financial liabilities with equity instruments", amendments to IAS 32 on classification of rights issues, clarifications in IFRIC 14 "IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction" relating to prepayments of minimum funding requirements and amendments to IFRS 1 "First-time adoption of IFRS", did not have any impact on these consolidated financial statements.

6. NEW ACOUNTING PRONOUNCEMENTS

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012 or later, and which the Group has not early adopted.

Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its consolidated financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other

comprehensive income. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.***Disclosures - Offsetting Financial Assets and Financial Liabilities –***

6. NEW ACOUNTING PRONOUNCEMENTS (CONTINUED)

Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Group's consolidated financial statements.

7. SEGMENT INFORMATION

The Group has identified seven operating segments which are the Group's regional branches. The discrete financial information for the identified operating segments (i.e. revenue, net financial result) is available and regularly reviewed by the Group's corporate management team ("chief operating decision maker" or "CODM"). This financial information is derived from the Group's statutory accounting records.

All identified operating segments meet the aggregation criteria under IFRS 8, *Operating Segments*, as these segments share similar economic characteristics and also are similar in respect of the nature of provided services, types of customer and the methods used to provide the services. On these grounds, the Company's management considers the Group to be a single reportable segment.

Management believes that the disclosure of the segments' financial information reviewed by CODM and the reconciliation of this information with these consolidated financial statements are not required as it would not affect the decision making process of the users of these consolidated financial statements, nor would it contribute to a better evaluation of the nature and the financial results of the Group's operations. The Group makes entity-wide disclosures as required by IFRS 8. The information required for disclosure can be found in the respective notes below.

8. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

During 2011, the Group has entered in the following significant transactions with the parties controlled by the Company's ultimate parent:

	Note	2011	2010
Revenue	24	660,665	591,408
Operating expenses		274,300	312,114
Purchases of property, plant and equipment		−	100,629
Loans received		−	230,000

The Group had the following significant balances due to/from related parties:

	Note	2011	2010
Accounts receivable		83,029	126,552
Accounts payable		58,418	109,233
Borrowings	18	258,668	239,114
Advances from customers		−	99,481

In 2011 remuneration of the members of the Board of Directors and key management personnel amounted to 42,701 (2010: 38,111).

9. PROPERTY, PLANT, AND EQUIPMENT

	Note	Land and buildings	Telecom-munication equipment	Trans-mission devices	Vehicles	Office equipment and other	Construc-tion in progress	Total
Cost as of 31 December 2009		**1,530,708**	**5,292,550**	**5,852,877**	**200,623**	**248,405**	**412,331**	**13,537,494**
Accumulated depreciation as of 31 December 2009		**(138,699)**	**(1,290,252)**	**(1,434,587)**	**(89,276)**	**(169,227)**	**–**	**(3,122,041)**
Carrying amount as of 31 December 2009		**1,392,009**	**4,002,298**	**4,418,290**	**111,347**	**79,178**	**412,331**	**10,415,453**
Additions		–	43,202	–	–	–	1,157,075	**1,200,277**
Transfers		12,122	567,773	360,324	4,232	17,590	(962,041)	**–**
Reclassification of initial cost		(1,234)	4,717	(430)	(3,030)	(23)	–	**–**
Reclassification of accumulated depreciation		1	(1,726)	47	1,590	88	–	**–**
Disposals		(58,181)	(227,980)	(49,278)	(8,206)	(24,087)	(6,463)	**(374,195)**
Depreciation on disposals		4,188	139,212	18,170	4,095	2,685	–	**168,350**
Depreciation charge	25	(38,683)	(591,421)	(422,944)	(27,392)	(24,325)	–	**(1,104,765)**
Cost as of 31 December 2010		**1,483,415**	**5,680,262**	**6,163,493**	**193,619**	**241,885**	**600,902**	**14,363,576**
Accumulated depreciation as of 31 December 2010		**(173,193)**	**(1,744,187)**	**(1,839,314)**	**(110,983)**	**(190,779)**	**–**	**(4,058,456)**
Carrying amount as of 31 December 2010		**1,310,222**	**3,936,075**	**4,324,179**	**82,636**	**51,106**	**600,902**	**10,305,120**
Additions		–	27,006	–	–	–	1,447,472	**1,474,478**
Acquisitions through business combinations		3,083	2,266	32,375	–	98	–	**37,822**
Transfers		38,197	741,766	700,973	20,720	1,641	(1,503,297)	–
Reclassification of initial cost		(25)	8,752	(10,474)	1,875	(128)	–	–
Reclassification of accumulated depreciation		3	(3,490)	4,328	(973)	132	–	–
Disposals		(16,145)	(65,759)	(120,465)	(6,061)	(4,150)	(5,983)	**(218,563)**
Depreciation on disposals		3,029	27,929	61,839	4,011	5,362	–	**102,170**
Depreciation charge	25	(32,371)	(651,454)	(454,966)	(25,679)	(18,831)	–	**(1,183,301)**
Cost as of 31 December 2011		**1,508,525**	**6,394,293**	**6,765,902**	**210,153**	**239,346**	**539,094**	**15,657,313**
Accumulated depreciation as of 31 December 2011		**(202,532)**	**(2,371,202)**	**(2,228,113)**	**(133,624)**	**(204,116)**	**–**	**(5,139,587)**
Carrying amount as of 31 December 2011		**1,305,993**	**4,023,091**	**4,537,789**	**76,529**	**35,230**	**539,094**	**10,517,726**

Property, plant and equipment with total carrying amount of 378,874 (2010: 1,048,029) has been pledged as collateral for borrowings.

Carrying amount of the property, plant and equipment held under finance leases amounted to 145,604 (2010: 174,195) including telecommunication equipment of 73,531 (2010: 92,616); vehicles of 61,100 (2010: 65,119) and office equipment of 10,973 (2010: 16,460). Additions included capitalised borrowing costs of 27,006 (2010: 43,202). The capitalisation rate was 7.7% (2010: 8%).

10. INTANGIBLE ASSETS

	Note	Licenses	Software	Subscribers' base	Total
Cost as of 31 December 2009		**13,825**	**113,189**	**45,055**	**172,069**
Accumulated amortisation as of 31 December 2009		**(7,764)**	**(22,469)**	**(3,691)**	**(33,924)**
Carrying amount as of 31 December 2009		**6,061**	**90,720**	**41,364**	**138,145**
Additions		44,465	29,547	–	74,012
Disposals		(12,918)	(38,815)	–	(51,733)
Amortisation on disposals		12,918	38,815	–	51,733
Amortisation expense	25	(21,298)	(38,102)	(9,011)	(68,411)
Cost as of 31 December 2010		**45,372**	**103,921**	**45,055**	**194,348**
Accumulated amortisation as of 31 December 2010		**(16,144)**	**(21,756)**	**(12,702)**	**(50,602)**
Carrying amount as of 31 December 2010		**29,228**	**82,165**	**32,353**	**143,746**
Additions		30,635	43,505	–	74,140
Acquisitions through business combinations		–	–	57,207	57,207
Disposals		(26,256)	(24,768)	–	(51,024)
Amortisation on disposals		26,256	24,768	–	51,024
Amortisation expense	25	(31,599)	(43,585)	(17,592)	(92,776)
Cost as of 31 December 2011		**49,751**	**122,658**	**102,262**	**274,671**
Accumulated amortisation as of 31 December 2011		**(21,487)**	**(40,573)**	**(30,294)**	**(92,354)**
Carrying amount as of 31 December 2011		**28,264**	**82,085**	**71,968**	**182,317**

11. FINANCIAL INVESTMENTS

	2011	2010
Available-for-sale investments, including non-current portion of 106,321 (2010: 97,718)	117,302	106,849
Loans to employees, including non-current portion of 15,078 (2010: 16,996)	25,389	27,178
Other loans, including non-current portion of nil (2010: 34,635)	6,850	34,635
Total	**149,541**	**168,662**
Less non-current portion	(121,399)	(149,349)
Total current portion	**28,142**	**19,313**

Available-for-sale investments include the following:

	2011	2010

Investment in pension fund - unlisted equity securities	104,242	95,638
Listed equity securities	10,111	9,131
Other unlisted equity securities	2,949	2,080
Total	**117,302**	**106,849**

11. FINANCIAL INVESTMENTS (CONTINUED)

The changes in the fair value of the investment in pension fund were as follows:

	Note	2011	2010
Balance at beginning of year		**95,638**	**96,623**
The Company's contributions to the fund		18,302	14,641
Amounts paid by the fund to settle pension obligations	21	(9,919)	(19,841)
Gain on revaluation of available-for-sale investments		221	4,215
Balance at end of year		**104,242**	**95,638**

12. OTHER NON-CURRENT ASSETS

	2011	2010
Advances for the acquisition of non-current assets	218,504	150,019
Impairment provision	(8,760)	(8,760)
Total	**209,744**	**141,259**

13. INVENTORY

	2011	2010
Cables and spare parts for telecommunications equipment	90,502	102,399
Goods for sale	68,850	6,827
Other inventories	36,455	29,707
Total	**195,807**	**138,933**

14. ACCOUNTS RECEIVABLE

	Note	2011	2010
Accounts receivable		930,848	791,617
Impairment provision	25	(148,787)	(156,677)
Total		**782,061**	**634,940**

By group of customer:	2011	2010
Commercial organisations, net of impairment provision of 76,320 (2010: 106,246)	383,974	335,170
Residential subscribers, net of impairment provision of 67,725 (2010: 45,416)	367,447	263,507
State organisations, net of impairment provision of 4,742 (2010: 5,015)	30,640	36,263
Total	**782,061**	**634,940**

Movements in the provision for impairment of accounts receivable were as follows:

	Note	2011	2010
Balance at beginning of year		**156,677**	**139,218**
Amounts written off during the year		(49,569)	(18,940)
Accrual of the impairment provision	25	41,679	36,399
Balance at end of year		**148,787**	**156,677**

14. ACCOUNTS RECEIVABLE (CONTINUED)

Analysis by credit quality of accounts receivable was as follows:

	2011	2010
Neither past due nor impaired − exposure to:		
- Commercial organisations	320,976	268,214
- Residential subscribers	284,357	206,698
- State organisations	17,710	26,092
Total neither past due nor impaired	**623,043**	**501,004**
Past due, not impaired:		
- Less than 30 days overdue	73,154	65,754
- From 30 to 60 days overdue	28,621	22,162
- From 60 to 90 days overdue	18,140	16,391
- From 90 to 120 days overdue	9,861	11,172
- From 120 to 180 days overdue	18,215	18,457
- More than 180 days overdue	11,027	–
Total past due, not impaired	**159,018**	**133,936**
Past due and impaired:		
- Less than 30 days overdue	–	–
- From 30 to 60 days overdue	–	–
- From 60 to 90 days overdue	–	–
- From 90 to 120 days overdue	–	–
- From 120 to 180 days overdue	–	–
- More than 180 days overdue	148,787	156,677
Total past due and impaired	**148,787**	**156,677**
Less impairment provision	(148,787)	(156,677)
Total	**782,061**	**634,940**

The individually impaired receivables mainly relate to debtors which are in unexpectedly difficult economic situations. The Group has no significant concentrations of credit risk as the Group’s customer base is highly diversified and management is monitoring customers' ability to settle their debts on a regular basis.

15. ADVANCES PAID AND PREPAID EXPENSES

	2011	2010
Advances paid	105,978	113,298
Prepaid expenses	4,613	78,634
Total	**110,591**	**191,932**

16. CASH AND CASH EQUIVALENTS

	2011	2010
Bank balances payable on demand	31,523	366,392
Cash on hand	5,828	2,665
Total	**37,351**	**369,057**

16. CASH AND CASH EQUIVALENTS (CONTINUED)

Based on Fitch's national rating, the credit quality of the banks in which the Group held its cash and cash equivalents balances was as follows:

	2011	2010
AAA rated	1,721	1,607
AA- to AA+ rated	29,630	364,471
Unrated	172	314
Total	**31,523**	**366,392**

17. SHARE CAPITAL

	Number of shares, in thousands
At 31 December 2010 and 2009	**20,419,338**
Treasury shares purchased	(32,960)
At 31 December 2011	**20,386,378**

The total authorized number of ordinary shares was 20,885,140 thousand (2010: 20,885,140 thousand) with par value of RUB 0.1 per share. The difference of 20,401 between the nominal and carrying values of the shares reflects the effect of hyperinflation using the conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat").

Additional paid in capital of 232,275 represents contributions in the form of property, plant and equipment received by the Company from its ultimate parent.

In 2011, the Company declared dividends of RUB 0.00944 per share (2010: RUB 0.0055 per share), totalling 196,767 (2010: 115,767), including the dividends on treasury shares of 3,648 (2010: 2,147), for the year ended 31 December 2010.

18. BORROWINGS

	2011	2010
Bank borrowings, including non-current portion of 1,614,458 (2010: 1,800,188).	2,496,125	2,658,056
Corporate bonds, including non-current portion of nil (2010: 105,544)	106,952	106,928
Total	**2,603,077**	**2,764,984**
Less non-current portion	(1,614,458)	(1,905,732)
Total current portion	**988,619**	**859,252**

	Note	Loan currency	2011	2010
UniCredit Bank		Russian roubles	700,452	700,486
AB Devon Credit		Russian roubles	484,481	–
Alfa Bank		Russian roubles	476,295	400,391
Absolut Bank		Russian roubles	401,726	–
AK BARS Bank	8	Russian roubles	258,668	239,114
ING Bank (Eurasia)		Euro	101,002	283,601
ROSBANK		Russian roubles	73,418	749,082
Bank of Moscow		Russian roubles	–	285,382
Other borrowings		Russian roubles	83	–
Total			**2,496,125**	**2,658,056**

18. BORROWINGS (CONTINUED)

	Maturity	2011 contractual interest rate % p.a.	2010 contractual interest rate % p.a.
ING Bank (Eurasia)	2012	LIBOR+1.7	LIBOR+3.5 and LIBOR+1.7
Alfa Bank	2013	7.5	8.93
AB Devon Credit	2014	7.5	–
Absolut Bank	2014	7.5	–
UniCredit Bank	2013	7.85	8.45
AK BARS Bank	2013	3.2-8.25	3.1-8.25
ROSBANK	2013	8.46	MosPrime+2.75 and 8.46

The loans totalling 101,002 (2010: 131,781) were collaterised by the Group's property, plant and equipment (refer to Note 9).

Corporate bonds
In November 2007, the Company issued 1.5 million non-convertible bearer bonds maturing in 2012. The nominal value of each bond was RUB 1. The coupon rate is 8.25% per annum until the bonds' maturity date.

19. INCOME TAXES

The Group's income tax expense comprised the following:

	2011	2010
Current income tax expense	175,803	173,227
Deferred income tax expense	51,974	47,004
Total	**227,777**	**220,231**

Reconciliation of the theoretical to the actual income tax expense is as follows:

	2011	2010
Profit before income tax	**1,053,530**	**1,007,584**
Theoretical income tax at statutory income tax rate of 20% (2010: 20%)	210,706	201,517
Adjustments for:		
Non-taxable income	(32,256)	(43,440)
Non deductible expenses	44,293	79,585
Other	5,034	(17,431)
Income tax expense	**227,777**	**220,231**

19. INCOME TAXES (CONTINUED)

Differences between IFRS and statutory taxation regulations in the Russian Federation give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary deductible/(taxable) differences is detailed below and is recorded at the rate of 20% (2010: 20%):

	Balance at 31 December 2010	(Charged)/ credited to profit or loss	Charged to other comprehensive income	Balance at 31 December 2011
Property, plant and equipment	(679,683)	31,408	–	(648,275)
Accounts payable and accrued liabilities	59,681	13,122	–	72,803
Deferred revenue	109,974	(80,015)	–	29,959
Financial investments	(11,979)	(10,433)	(37)	(22,449)
Defined benefit pension obligations	38,460	3,003	(3,269)	38,194
Accounts receivable	(29,686)	4,211	–	(25,475)
Other	3,871	(13,270)	–	(9,399)
Net deferred tax liability	**(509,362)**	**(51,974)**	**(3,306)**	**(564,642)**

	Balance at 31 December 2009	(Charged)/ credited to profit or loss	Charged to other comprehensive income	Balance at 31 December 2010
Property, plant and equipment	(671,061)	(8,622)	–	(679,683)
Accounts payable and accrued liabilities	36,902	22,779	–	59,681
Deferred revenue	117,354	(7,380)	–	109,974
Tax loss carried forward	24,161	(24,161)	–	–
Financial investments	(19,324)	8,188	(843)	(11,979)
Defined benefit pension obligations	40,491	(481)	(1,550)	38,460
Accounts receivable	(18,571)	(11,115)	–	(29,686)
Other	30,083	(26,212)	–	3,871
Net deferred tax liability	**(459,965)**	**(47,004)**	**(2,393)**	**(509,362)**

20. DEFERRED REVENUE

	2011	2010
Deferred revenue from installation and connection fees, including non-current portion of 62 123 (2010: 215,599)	177,041	486,249
Subscriber advances	72,396	76,272
Total	**249,437**	**562,521**
Less non-current portion	(62,123)	(215,599)
Total current portion	**187,314**	**346,922**

21. POST-RETIREMENT BENEFIT OBLIGATIONS

The Company operates defined benefit pension plan which is based on the employees' remuneration, age, length of service and the position in the Company. The plan is funded by the Company and the employees.

The amount of pension obligations reflected in the Group's consolidated statement of financial position was as follows:

	2011	2010
Present value of pension obligations	190,969	192,298

The movements in the defined benefit obligations were as follows:

	Note	2011	2010
Balance at beginning of year		**192,298**	**199,068**
Current service cost		9,551	8,803
Interest cost		15,384	17,916
Amounts paid by the fund to settle pension obligations	11	(9,919)	(19,841)
Actuarial gain		(16,345)	(7,749)
Other		–	(5,899)
Balance at end of year		**190,969**	**192,298**

The amounts recognised in profit or loss were as follows:

	2011	2010
Current service cost	9,551	8,803
Interest cost	15,384	17,916
Other	–	(5,899)
Defined benefit plan expenses	**24,935**	**20,820**

Defined benefit plan expense is included in the other operating expenses.

The principal assumptions used were as follows:

	2011	2010
Discount rate	8%	8%
Future salary increase	8.5%	8.5%
Future benefits increase	8.5%	8.5%
Staff turnover	3%	3%
Average life expectancy of the plan participants from date of retirement	16 years	16 years

Best estimate of contributions expected to be paid to the plan during the annual period beginning after 31 December 2011 equals to 18,302.

22. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2011	2010
Payable for non-current assets	364,065	457,452
Payable to employees	229,994	207,253
Payable for interconnection and traffic transmission services	216,161	244,298
Payable for construction services	93,844	120,242
Accrued liabilities	87,355	71,954
Dividends payable	8,902	8,441
Other payables	23,420	18,049
Total	**1,023,741**	**1,127,689**

23. TAXES PAYABLE OTHER THAN INCOME TAX

	2011	2010
VAT payable	138,788	112,776
Property tax payable	41,629	42,483
Insurance contributions payable	33,775	4,245
Other taxes payable	15,924	10,851
Total	**230,116**	**170,355**

24. REVENUE

	2011	2010
Local telecommunication services	2,190,525	2,061,122
Internet access services	1,812,110	1,384,592
Intrazonal telecommunications services	868,725	965,243
Interconnection and traffic transmission services	506,664	510,332
Installation and connection services	270,419	220,982
Lease of cable capacity	195,040	192,676
IPTV and IP telephony services	134,767	87,640
Lease of telephone canalisation channels	114,110	94,880
Cable television services	21,401	124
Other revenues	598,361	421,830
Total	**6,712,122**	**5,939,421**

By group of customer:	2011	2010
Residential subscribers	3,705,611	3,210,143
Commercial organisations	2,295,765	2,137,870
State organisations	710,746	591,408
Total	**6,712,122**	**5,939,421**

In 2011, the Group’s management revisited the estimate of the average fixed line subscription period for residential subscribers. This estimate is used in the calculation of the revenue recognized for the installation and connection services. The revised estimate is 6 years (2010: 8 years). The change in the accounting estimate was accounted for prospectively and resulted in an increase of the Group’s 2011 revenue and profit before tax of 110,089.

25. OPERATING EXPENSES

	Note	2011	2010
Payroll expenses, including applicable taxes		1,791,464	1,601,400
Depreciation of property, plant and equipment	9	1,183,301	1,104,765
Interconnection and traffic transmission charges		551,333	573,005
Materials, repairs and maintenance		364,208	328,417
Utilities		267,235	236,374
Subscribers' connection costs		228,480	109,755
Taxes, other than income tax		177,487	181,256
Rent expense		101,158	74,425
Invoice delivery and acceptance of payments		96,127	84,951
Amortisation of intangible assets	10	92,776	68,411
Loss on disposal of property plant and equipment		69,564	99,077
Loss on impairment of receivables	14	41,679	36,399
Advertising expenses		47,890	38,898
Reimbursement from the Universal Service Fund, net of the respective contributions		(78,278)	(113,089)
Other expenses		517,748	351,212
Total		**5,452,172**	**4,775,256**

25. OPERATING EXPENSES (CONTINUED)

In 2011 the Group incurred expenses totalling 142,989 (2010: 172,646) related to provision of universal telecom services. These expenses were included in relevant operating expenses categories. The Group received reimbursement of the above expenses from the Federal Telecommunications Agency which is reported in the reimbursement from the Universal Service Fund caption of the operating expenses above. The Group's contributions to the Universal Service Fund totalled 64,711 (2010: 59,557).

26. FINANCE COSTS

	2011	2010
Interest payable on loans and vendor financing less capitalised interest	207,733	280,400
Interest expense on finance leases	2,698	7,224
Total	**210,431**	**287,624**

27. RISK MANAGEMENT

The risk management function within the Group is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

Credit risk
Credit risk is the risk that counterparty may fail to fulfil its obligations to the Group on a timely basis, which will cause the Group to incur losses. Availability of a diversified client base allows the Group to be independent from specific customers (the Group's receivables are distributed among a significant number of residential subscribers, commercial and state organisations).

The Group's maximum exposure to credit risk by class of assets is reflected in the carrying amounts of financial assets in the consolidated financial statements and amounts to 968,953 (2010: 1,172,659).

Liquidity risk
Liquidity risk is the risk that the Group will not be able to settle all obligations as they become due. The Group has established a detailed budgeting and cash forecasting process to ensure that it has adequate cash available to meet its payment obligations. The maturity analysis of the Group's financial liabilities (based on undiscounted contractual cash outflows) as at 31 December 2011 was as follows:

	Note	Less than one year	From one year to five years	Total
Bank loans	18	881,667	1,614,458	**2,496,125**
Corporate bonds	18	106,952	–	**106,952**
Other long-term liabilities		–	12,127	**12,127**
Finance lease liabilities		4,776	1,516	**6,292**
Accounts payable and accrued liabilities	22	1,023,741	–	**1,023,741**
Financial liabilities, total		**2,017,136**	**1,628,101**	**3,645,237**

27. RISK MANAGEMENT (CONTINUED)

The maturity analysis of the Group's financial liabilities (based on undiscounted contractual cash outflows) as at 31 December 2010 was as follows:

	Note	Less than one year	From one year to five years	Total
Bank loans	18	857,868	1,800,188	**2,658,056**
Corporate bonds	18	1,384	105,544	**106,928**
Other long-term liabilities		–	91,946	**91,946**
Finance lease liabilities		8,523	251	**8,774**
Accounts payable and accrued liabilities	22	1,127,689	–	**1,127,689**
Financial liabilities, total		**1,995,464**	**1,997,929**	**3,993,393**

The Group manages its liquidity on a corporate-wide basis to ensure the funding is sufficient to meet Group's operational needs in liquidity.*Currency risk*
In respect of currency risk, management sets limits on the level of exposure by currency and in total. The positions are monitored on a regular basis. The Group's financial assets of 968,953 (2010: 1,172,659) are denominated in Russian roubles and therefore do not bear currency risk. The table below summarises the exposure of the Group's financial liabilities to foreign currency exchange rate risk:

		2011			2010		
	Note	US Dollar	Euro	Total	US Dollar	Euro	Total
Bank loans	18	–	101,002	**101,002**	–	283,601	**283,601**
Accounts payable and accrued liabilities		154,769	117,551	**272,320**	309,467	–	**309,467**
Financial liabilities denominated in foreign currencies		**154,769**	**218,553**	**373,322**	**309,467**	**283,601**	**593,068**

The following table presents sensitivities of equity and net profit to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency of the Group, with all other variables held constant:

	2011	2010
US Dollar strengthening by 10% (2010: 10%)	(15,477)	(30,947)
US Dollar weakening by 10% (2010: 10%)	15,477	30,947
Euro strengthening by 10% (2010: 10%)	(21,855)	(28,360)
Euro weakening by 10% (2010: 10%)	21,855	28,360

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Group.

Interest rate risk
Interest rate risk is the risk that changes in market interest rates on financial instruments used by the Group may negatively impact the Group's financial results and cash flows.

The Group has an exposure to changes in interest rates primarily through its debt by changing their fair value (fixed rate debt) or their cash flows (variable rate debt). The Group does not have a formal procedure in place for management of interest risk and does not use any derivative financial instruments to manage the interest rate risk. The Group limits its interest rate risk exposure by maintaining an appropriate mix between fixed and floating rate borrowings. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favourable interest rate terms.

27. RISK MANAGEMENT (CONTINUED)

Interest rate risk (continued)
Management assessed the Group's sensitivity to increase or decrease in the floating interest rate. An increase (decrease) of 1% would result in the Group's net profit decrease (increase) of 1,403 (2010: 4,171). Such sensitivity assessment is used for the Group's management reporting with respect to the interest rate risk and reflects the management's assessment of reasonably possible fluctuations of interest rates. The analysis was applied to loans and borrowings (financial liabilities) on the basis of the assumption that the debt outstanding as at the end of reporting period remains outstanding during the year.*Capital risk management*
The Group manages its capital to ensure that it is able to continue as a going concern while maximising the return to the shareholders through the optimisation of the debt and equity balance. In order to achieve this goal, the Group undertakes actions aimed at minimisation of risks and costs associated with the future financing. The Group has different types of borrowings available for use in order to meet its needs in capital, such as bonds' issuance, long-term and short-term borrowings.

Though the Group does not establish any formal policies with respect to debt and equity ratio, the Group reviews its capital structure on a regular basis to determine the necessary measures in order to maintain a balanced structure of its capital. In such reviews the management considers the cost of capital and risks related to each category of capital. The Group's targeted net debt to equity ratio should not exceed 50%.

The Group's debt to equity ratio was calculated as follows:

	Note	2011	2010
Borrowings	18	2,603,077	2,764,984
Less cash and cash equivalents	16	37,351	369,057
Net debt		**2,565,726**	**2,395,927**
Equity		7,363,199	6,725,343
Net debt to equity ratio, %		**35**	**36**

There were no changes to the Group's approach to capital management during the year.

The Group has a stated dividend policy that stipulates the distribution of at least 30% of the Company's statutory non-consolidated net profit. However, the dividend for a specific year is determined after taking into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the Company's shareholders.

28. COMMITMENTS AND CONTINGENCIES

Operating lease commitments
The Group's future minimum lease payments under non-cancellable operating leases as of 31 December 2011 and 2010 were as follows:

	2011	2010
Within one year	32,767	28,844
Between one and five years	19,671	5,828
After 5 years	40,751	41,789
Total	**93,189**	**76,461**

28. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Litigation
The Group has been and continues to be the subject of legal proceedings and adjudications from time to time, none of which has had, individually or in the aggregate, a material adverse impact on the financial position and financial performance of the Group.

Tax contingencies
Russian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities.

The Russian tax authorities may be taking a more assertive and sophisticated approach in their interpretation of the legislation and tax examinations. This includes the following guidance from the Supreme Arbitration Court for anti-avoidance claims based on reviewing the substance and business purpose of transactions. Combined with a possible increase in tax collection efforts to respond to budget pressures, the above may lead to an increase in the level and frequency of scrutiny by the tax authorities. In particular, it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Russian transfer pricing legislation enacted during the current period is effective prospectively to new transactions from 1 January 2012. It introduces significant reporting and documentation requirements. The transfer pricing legislation that is applicable to transactions on or prior to 31 December 2011, also provides the possibility for tax authorities to make transfer pricing adjustments and to impose additional tax liabilities in respect of all controllable transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions with interdependent parties, as determined under the Russian Tax Code, all cross-border transactions (irrespective whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. Significant difficulties exist in interpreting and applying transfer pricing legislation in practice. Any existing court decisions may provide guidance, but is not legally binding for decisions by other, or higher level, courts in the future.

The tax consequence of transactions for Russian taxation purposes is frequently determined by the form in which transactions are documented and the underlying accounting treatment prescribed by Russian Accounting Rules. Also, Russian legislation sets rigorous documentation requirements and even minor errors normally lead to disallowance of related expenses. Management has assessed, based on their interpretation of the relevant tax legislation, that the Group may be exposed to possible tax risks amounting to 209,635 (2010: 193,042). No provision has been recorded for these tax risks.

Capital construction obligations
As of 31 December 2011, the Group had contractual commitments in respect of construction of property, plant and equipment for a total of 128,266 (2010: 2,475). The Group has already allocated the necessary resources to cover these commitments. The Group believes that future net income and funding will be sufficient to cover these and any similar commitments.

29. BUSINESS COMBINATIONS

Acquisition of LLC Kamatel

In March 2011, the Company acquired 100% interest in the capital of LLC Kamatel for consideration of 63,737 which was settled in cash. The impact of the acquired subsidiary on the Group's consolidated statement of comprehensive income is not material, nor would it have been if the subsidiary had been consolidated from 1 January 2011. Fair value of subsidiary's net assets (excluding identifiable intangible assets) as of the date of acquisition amounted to 19,998 and included property, plant and equipment of 24,172, cash and cash equivalents of 708, other assets of 2,539 and assumed liabilities of 7,421. The amount of 43,739 being the excess of the consideration paid over the fair value of these net assets has been attributed to an identifiable intangible asset – acquired subscribers' base.

Acquisition of LLC Volna

In March 2011, the Group acquired 95% interest in the capital of LLC Volna for consideration of 30,428 which was settled in cash. The impact of the acquired subsidiary on the Group's consolidated statement of comprehensive income is not material, nor would it have been if the subsidiary had been consolidated from 1 January 2011. Combined fair value of subsidiary's net assets (excluding identifiable intangible assets) as of the date of acquisition amounted to 16,002 and included property, plant and equipment of 11,384, cash and cash equivalents of 645, other assets of 5,240 and assumed liabilities of 1,267. The amount of 14,426 being the excess of the consideration paid over the fair value of these net assets has been attributed to an identifiable intangible asset – acquired subscribers' base.

Acquisition of LLC Kamatel-Yantel

In 2011, the Group acquired 100% interest in LLC Kamatel-Yantel for total purchase consideration of 4,096. The fair value of the acquired net assets, the goodwill arising on these transactions, the revenue and the net result contributed by this entity to the Group from the date of acquisition to 31 December 2011 were not material for the purpose of these consolidated financial statements.

The disclosure of IFRS carrying value of net assets of the acquired subsidiaries, immediately before the business combination, is impracticable as the subsidiaries have not prepared IFRS financial statements.

30. SUBSEQUENT EVENTS

In March 2012, the Company signed a three year non-revolving credit line agreement with Avers bank for an amount of 400,000 with interest rate of 9%.

In April 2012, the Group declared dividends of 0.01016 roubles per share, totalling 211,775.