JSFC SISTEMA AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
As of December 31, 2006 and 2005 and
For the Years Then Ended

JSFC SISTEMA AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSFC Sistema:

We have audited the accompanying consolidated balance sheets of JSFC Sistema and subsidiaries ("the Group") as of December 31, 2006 and 2005 and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion such financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

June 11, 2007

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2006	2005
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	5	$ 598,381	$ 482,647
Short-term investments	6	943,989	594,196
Loans to customers and banks, net	7	1,289,832	451,395
Insurance-related receivables	8	233,400	149,589
Accounts receivable, net	9	1,069,706	442,643
Prepaid expenses, other receivables and other current assets, net	10	1,009,834	567,544
VAT receivable		450,703	495,191
Inventories and spare parts	11	661,568	482,909
Deferred tax assets, current portion	24	195,672	123,681
Total current assets		6,453,085	3,789,795
NON-CURRENT ASSETS:			
Property, plant and equipment, net	12	7,453,054	5,876,124
Advance payments for non-current assets		305,846	233,761
Goodwill	2	514,460	330,932
Licenses, net	13	452,372	615,042
Other intangible assets, net	14	1,229,721	886,272
Investments in affiliates	15	1,108,647	914,203
Investments in shares of Svyazinvest	3	1,390,302	-
Other investments	16	122,500	150,000
Loans to customers and banks, net of current portion	7	464,490	117,107
Debt issuance costs, net		80,220	82,662
Deferred tax assets, net of current portion	24	73,623	33,472
Other non-current assets	17	483,164	61,479
Total non-current assets		13,678,399	9,301,054
TOTAL ASSETS		$ 20,131,484	$ 13,090,850

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (continued)
AS OF DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2006	2005
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable		$ 868,378	$ 594,816
Bank deposits and notes issued, current portion	18	920,369	459,629
Insurance-related liabilities	19	721,192	412,328
Taxes payable		150,894	125,474
Deferred tax liabilities, current portion	24	52,714	28,149
Subscriber prepayments, current portion	23	552,997	472,673
Derivative financial instruments	32	184,316	-
Accrued expenses and other current liabilities	20	1,021,875	517,451
Short-term loans payable	21	1,297,168	637,769
Current portion of long-term debt	22	280,427	523,530
Total current liabilities		6,050,330	3,771,819
LONG-TERM LIABILITIES:			
Long-term debt, net of current portion	22	5,296,017	3,209,311
Subscriber prepayments, net of current portion	23	136,861	163,897
Bank deposits and notes issued, net of current portion	18	65,200	37,200
Deferred tax liabilities, net of current portion	24	290,115	237,916
Postretirement benefits obligation	25	16,391	16,217
Deferred revenue	26	129,120	125,700
Total long-term liabilities		5,933,704	3,790,241
TOTAL LIABILITIES		11,984,034	7,562,060
Minority interests in equity of subsidiaries		3,546,740	2,295,147
Commitments and contingencies	33	-	-
Puttable shares of SITRONICS	27	80,000	-
SHAREHOLDERS' EQUITY:			
Share capital (9,365,757 and 9,650,000 shares issued and outstanding as of December 31, 2006 and 2005, respectively, with par value of 90 Russian Rubles)	28	30,057	30,057
Treasury stock (284,243 shares with par value of 90 Russian Rubles as of December 31, 2006)	28	(347,068)	-
Additional paid-in capital	3,4	2,196,475	1,479,743
Retained earnings		2,499,302	1,696,276
Accumulated other comprehensive income		141,944	27,567
TOTAL SHAREHOLDERS' EQUITY		4,520,710	3,233,643
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		$ 20,131,484	$ 13,090,850

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2006	2005
Sales		$ 10,054,552	$ 7,143,386
Revenues from financial services		808,230	450,163
TOTAL REVENUES		10,862,782	7,593,549
Cost of sales, exclusive of depreciation and amortization shown separately below		(4,510,874)	(2,877,169)
Financial services related costs, exclusive of depreciation and amortization shown separately below		(563,230)	(342,018)
TOTAL COST OF SALES		(5,074,104)	(3,219,187)
Selling, general and administrative expenses		(2,016,227)	(1,414,313)
Depreciation and amortization		(1,290,266)	(1,024,592)
Other operating expenses, net		(171,544)	(71,392)
Equity in net income of investees		92,196	54,446
Gain on disposal of interests in subsidiaries and affiliates		330,412	15,326
OPERATING INCOME		2,733,249	1,933,837
Interest income		65,439	66,132
Change in fair value of derivative instruments	32	(60,000)	-
Interest expense, net of amounts capitalized		(355,326)	(225,684)
Currency exchange and translation gain/(loss)		67,300	(13,913)
Bitel liability and investments write-off	16	(320,000)	-
Income before income tax, equity in net income of energy companies in the Republic of Bashkortostan, minority interests and extraordinary gain		2,130,662	1,760,372
Income tax expense	24	(803,429)	(512,993)
Equity in net income of energy companies in the Republic of Bashkortostan		139,794	23,587
Income before minority interests and extraordinary gain		$ 1,467,027	$ 1,270,966

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (continued)
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2006	2005
Minority interests		$ (654,023)	$ (740,514)
Income before extraordinary gain		813,004	530,452
Extraordinary gain	3	-	3,956
NET INCOME		$ 813,004	$ 534,408
Other comprehensive income/(loss):			
Unrealized gain on securities available for sale, net of income tax effect of $442 and $512, respectively		1,402	1,622
Change in fair value of interest rate swaps, net of income tax effect of ($337) and $537, respectively		(1,067)	1,703
Translation adjustment, net of minority interests of $79,570 and ($26,757), respectively, and income tax effect of nil	2	114,042	(23,368)
Comprehensive income		$ 927,381	$ 514,365
Weighted average number of common shares outstanding		9,570,050	9,475,980
Earnings per share, basic and diluted:			
Income before extraordinary gain		$ 85.0	$ 56.0
Extraordinary gain		-	0.4
Net income		85.0	56.4

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 813,004	$ 534,408
Adjustments to reconcile net income to net cash provided by operations:		
Extraordinary gain	-	(3,956)
Depreciation and amortization	1,290,266	1,024,592
(Gain)/loss on disposals of property, plant and equipment	(16,917)	15,638
Bitel liability and investments write-off	320,000	-
Non-cash compensation to employees	90,778	-
Profit recognized by the percentage-of-completion method on real estate developed for sale	(96,919)	(2,195)
Gain on disposal of interests in subsidiaries and affiliates	(330,412)	(15,326)
Minority interests	654,023	740,514
Equity in net income of investees	(231,990)	(78,033)
Deferred income tax benefit	(108,140)	(105,920)
Debt issuance cost amortization	27,035	16,341
Change in fair value of derivative financial instruments	60,000	-
Amortization of connection fees	(91,094)	(75,955)
Provision for doubtful accounts receivable	122,827	59,564
Allowance for loan losses	35,363	62,054
Inventory obsolescence expense	3,748	10,875
Changes in operating assets and liabilities, net of effects from purchase of businesses:		
Trading securities	(147,034)	(306,567)
Loans to banks	(422,031)	86,254
Insurance-related receivables	(75,089)	(47,837)
Accounts receivable	(388,246)	(181,033)
Prepaid expenses, other receivables and other current assets	(277,111)	(338,073)
VAT receivable	45,720	(149,192)
Inventories and spare parts	57,022	(198,249)
Accounts payable	80,402	311,936
Insurance-related liabilities	261,553	127,255
Taxes payable	14,738	6,566
Subscriber prepayments	109,984	164,412
Accrued expenses and other liabilities	314,306	130,053
Postretirement benefits obligation	174	4,704
Net cash provided by operations	2,115,960	1,792,830
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(1,766,148)	(2,087,101)
Purchases of intangible assets	(599,390)	(372,552)
Purchases of businesses, net of cash acquired	(631,401)	(540,404)
Proceeds from disposals of interests in subsidiaries and affiliates, net of cash disposed	235,174	12,862
Purchase of shares of Svyazinvest	(1,300,000)	-
Purchases of long-term investments	(399,048)	(796,990)
Proceeds from sale of long-term investments	20,000	13,053
Purchases of other non-current assets	(138,827)	(8,134)
Purchases of short-term investments	(568,179)	(839,516)
Proceeds from sale of short-term investments	449,039	662,847
Proceeds from sale of property, plant and equipment	32,302	4,179
Cash deposited for acquisition of Intracom Telecom	(46,100)	-
Increase in other restricted cash	(22,624)	(5,269)
Net increase in loans to customers	(581,631)	(319,174)
Net cash used in investing activities	(5,316,833)	(4,276,199)

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars)

		2006		2005
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from short-term borrowings, net		523,930		408,707
Net increase in deposits from customers		341,677		112,663
Net (decrease)/increase in bank promissory notes issued		(24,905)		50,511
Proceeds from grants		-		3,360
Proceeds from long-term borrowings, net of debt issuance costs		2,260,070		1,346,640
Principal payments on long-term borrowings		(636,983)		(526,852)
Principal payments on capital lease obligations		(5,197)		(4,468)
Payments to shareholders of subsidiaries		(262,419)		(198,333)
Dividends paid		(9,978)		(8,752)
Purchase of treasury stock		(347,068)		-
Proceeds from issuance of common stock, net of issuance costs		-		1,284,649
Proceeds from capital transactions of subsidiaries		1,450,256		-
Net cash provided by financing activities	$	3,289,383	$	2,468,125
Effects of foreign currency translation on cash and cash equivalents	$	27,224	$	(5,856)
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	$	115,734	$	(21,100)
CASH AND CASH EQUIVALENTS, beginning of the year		482,647		503,747
CASH AND CASH EQUIVALENTS, end of the year	$	598,381	$	482,647
CASH PAID DURING THE YEAR FOR:				
Interest	$	(448,062)	$	(204,171)
Income taxes		(908,209)		(708,505)
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Property, plant and equipment contributed free of charge	$	5,387	$	6,259
Equipment acquired through vendor financing		4,287		2,533
Equipment acquired under capital leases		11,151		7,738

In addition, non-cash investing activities for the years ended December 31, 2006 and 2005 included acquisitions and dispositions of subsidiaries and affiliates, as described in Notes 3 and 4.

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(Amounts in thousands of U.S. dollars)

	Share capital	Treasury stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total
Balances at January 1, 2005	**$ 25,090**	**-**	**$ 198,882**	**$ 1,170,620**	**$ 47,610**	**$ 1,442,202**
Issuance of common stock (Note 28)	4,967	-	1,279,682	-	-	1,284,649
Gain on disposal of a subsidiary, net of income tax effect of nil (Note 4)	-	-	1,179	-	-	1,179
Unrealized gain on securities available for sale, net of income tax effect of $512	-	-	-	-	1,622	1,622
Change in fair value of interest rate swaps, net of income tax effect of $537	-	-	-	-	1,703	1,703
Translation adjustment, net of minority interest of ($26,757) and income tax effect of nil (Note 2)	-	-	-	-	(23,368)	(23,368)
Dividends declared (Note 28)	-	-	-	(8,752)	-	(8,752)
Net income	-	-	-	534,408	-	534,408
Balances at December 31, 2005	**$ 30,057**	**-**	**$ 1,479,743**	**$ 1,696,276**	**$ 27,567**	**$ 3,233,643**
Capital transactions of subsidiaries (Note 4)	-	-	716,732	-	-	716,732
Repurchase of common stock (Note 28)	-	$ (347,068)	-	-	-	(347,068)
Unrealized gain on securities available for sale, net of income tax effect of $442	-	-	-	-	1,402	1,402
Early termination and change in fair value of interest rate swaps, net of income tax effect of ($337)	-	-	-	-	(1,067)	(1,067)
Translation adjustment, net of minority interest of $79,570 and income tax effect of nil (Note 2)	-	-	-	-	114,042	114,042
Dividends declared (Note 28)	-	-	-	(9,978)	-	(9,978)
Net income	-	-	-	813,004	-	813,004
Balances at December 31, 2006	**$ 30,057**	**$ (347,068)**	**$ 2,196,475**	**$ 2,499,302**	**$ 141,944**	**$ 4,520,710**

See notes to consolidated financial statements.

1. DESCRIPTION OF BUSINESS

The financial statements of JSFC Sistema and subsidiaries ("the Group") reflect the consolidation of separate financial statements of operating entities controlled by means of direct or indirect ownership of a majority voting interest by the Group's holding company, JSFC Sistema. Most of the consolidated entities and the parent company are incorporated in the Russian Federation ("RF").

The controlling shareholder of JSFC Sistema is Vladimir P. Evtushenkov. Minority holdings are held by certain top executives or former top executives of the Group. Commencing from February 2005, 19.6% of outstanding shares of the Group are traded on the London Stock Exchange in the form of GDRs (Note 28).

The principal activities of the significant entities of the Group are as follows:

Operating Entities	Short Name	Principal activity
JSFC Sistema	JSFC Sistema	Investing and financing activities
Telecommunications Segment:		
MTS and subsidiaries	MTS	Wireless telecommunication services
Comstar UTS and subsidiaries	Comstar UTS	Fixed line telecommunication services, data transmission and internet services
Technology Segment:		
SITRONICS and subsidiaries	SITRONICS	Production and marketing of integrated circuits, wafers, electronic devices and consumer electronics, research and development, IT and systems integration, computer hardware and software distribution
Insurance Segment:		
Rosno and subsidiaries	Rosno	Medical, property, casualty, life and personal insurance and reinsurance, administration of state medical insurance programs
Banking Segment:		
Moscow Bank for Reconstruction and Development and subsidiaries	MBRD	Banking activities, securities transactions and foreign currency transactions
East-West United Bank	EWUB	
Real Estate Segment:		
Sistema-Hals and subsidiaries	Sistema-Hals	Development and marketing of real estate projects
Mass Media Segment:		
Sistema Mass Media and subsidiaries	Sistema Mass Media	Cable television, advertising, production and distribution of periodicals, movie production
Retail Segment:		
Detsky Mir and subsidiaries	Detsky Mir	Retail and wholesale trading
Detsky Mir-Center and subsidiaries	DM-Center	
Other businesses:		
VAO Intourist and subsidiaries	Intourist	Sale of tour packages in the RF and abroad
Concern RTI Systems and subsidiaries	Concern RTI	Manufacturing of radiotechnical equipment, research and development
Binnofarm and subsidiaries	Binnofarm	Production and distribution of pharmaceuticals
Financial Fleurus Holdings S.A. and subsidiaries	Sistema International	Investing in real estate projects outside the CIS, financing activities

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records in local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

Principles of Consolidation – The consolidated financial statements include the accounts of JSFC Sistema, as well as entities where JSFC Sistema has operating and financial control through direct or indirect ownership of a majority voting interest. The consolidated financial statements also include accounts of variable interest entities where the Group is a primary beneficiary. All significant intercompany transactions, balances and unrealized gains/(losses) on transactions have been eliminated.

The beneficial ownership interest and voting interest of JSFC Sistema in the significant subsidiaries as of December 31, 2006 and 2005 are as follows:

Operating entities	**Ownership interest**		**Voting interest**	
	2006	**2005**	**2006**	**2005**
MTS	53%[(1)]	53%[(1)]	53%	53%
Comstar UTS	59%[(1)]	100%[(1)]	59%	100%
SITRONICS	85%	78%	85%	78%
Rosno	49%[(1)]	49%[(1)]	51%	51%
MBRD	95%[(1)]	95%[(1)]	99%	99%
EWUB	51%	affiliate	51%	affiliate
Sistema-Hals	80%[(1)]	100%[(1)]	80%	100%
Intourist	66%	72%	66%	72%
DM-Center	100%	100%	100%	100%
Detsky Mir	75%[(1)]	75%[(1)]	75%	75%
Concern RTI	100%	100%	100%	100%
Financial Fleurus	100%	100%	100%	100%
Binnofarm	100%	100%	100%	100%

[(1)] – Including indirect ownership

Accounts of newly-acquired subsidiaries have been consolidated in the Group's financial statements from the beginning of the year, in which the control was acquired, with pre-acquisition earnings of an interest purchased during the year included in minority interest in the consolidated statement of operations.

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

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

Concentration of Business Risk – The Group's principal business activities are within the Commonwealth of Independent States ("CIS"), primarily in the Russian Federation ("RF") and Ukraine. Laws and regulations affecting businesses operating in the RF and Ukraine are subject to rapid changes, which could impact the Group's assets and operations.

Foreign Currency Translation – The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("FAS") No. 52, "Foreign Currency Translation".

Management has determined that the functional currencies of the Group's significant subsidiaries for the years ended December 31, 2006 and 2005 are as follows:

MTS' macro-region South	Russian ruble ("RUB")
UMC	Ukrainian Hryvna ("UAH")
BCTI	Turkmenistan manat ("TMM")
MGTS	RUB
SITRONICS' Russian subsidiaries	RUB
SITRONICS Telecom Solutions Czech Republic(1)	Czech Krona ("CZK")
Intracom Telecom	Euro ("EUR")
Kvazar-Micro's subsidiaries(2)	Local currencies of the countries of domicile
Rosno	RUB
MBRD	RUB
Sistema Mass Media	RUB
Detsky Mir	RUB
DM-Center	RUB
Concern RTI	RUB
Other subsidiaries of the Group(3)	U.S. dollar ("USD")

(1) – Former STROM telecom.
(2) – Except for Kvazar-Micro International Ltd., a company incorporated in the United Kingdom, whose functional currency is the USD.
(3) – Due to the pervasive use of the USD in their operations.

The Group has selected the USD as its reporting currency and translated into USD financial statements of subsidiaries with functional currencies other than USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at average rates of exchange prevailing during the year. The resulting translation gain in the amount of $114.0 million for the year ended December 31, 2006 and translation loss in the amount of $23.4 million for the year ended December 31, 2005, net of minority interests of $79.6 million and ($26.8) million, respectively, were recorded as a separate component of other comprehensive income.

Transactions in foreign currencies are recorded at the exchange rate prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are expressed in the functional currency at the exchange rates in effect at the balance sheet date. Revenues, costs and expenses are recorded using average exchange rates prevailing during the reporting period.

Revenue Recognition – The Group's segments earn and record revenues as follows:

<u>Telecommunications Segment</u>

The Telecommunications Segment of the Group earns revenues from the provision of wireless and wireline telecommunication and data transmission services and usage of its exchange networks and facilities. Segment revenues consist of (i) usage charges, (ii) monthly subscription fees, (iii) service activation and connection fees, (iv) revenues from use of prepaid phone cards, (v) charges for value-added telecommunication services, (vi) roaming fees charged to other operators for guest roamers utilizing the segment's network and (vii) equipment sales. The segment records revenues over the periods they are earned as follows:

(i) Revenues derived from wireless and wireline telephone usage and data transmission are recognized as the services are provided.
(ii) Monthly telephone and network service fees are recognized in the month during which the telephone services are provided to customers.

(iii) Upfront fees received for installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the expected subscriber relationship period, as follows:

MTS' subscribers[1]	12-60 months
Comstar UTS' residential wireline voice phone subscribers	15 years
Comstar UTS' residential subscribers of broadband internet services	1 year[2]
Other categories of Comstar UTS' subscribers	3-5 years

[1] – MTS calculates an average expected term of the subscriber relationship for each region in which it operates and amortizes regional connection fees accordingly.
[2] – 3 years prior to July 1, 2005.

(iv) The Telecommunications segment recognizes revenues from prepaid phone cards in the period when the customer uses time under the phone card. Unused time on sold cards is not recognized as revenues until the related services have been provided to the customer or the card has expired. Revenues under prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to segment's wireless network and a predetermined allotment of wireless phone calls and/or other services offered by the segment, are allocated between connection fees and service fees based on their relative fair values.

(v) Revenues derived from value-added telecommunication services are recognized in the period when the services are provided to customers.

(vi) The segment charges roaming per-minute fees to other wireless operators for their subscribers utilizing segment's networks. Revenues derived from roaming services are recognized as services are provided.

(vii) The segment sells handsets and accessories to customers who enter into contracts for service and as separate distinct transactions. Revenues from the handsets and accessories are recognized when title passes to the customer. Estimated returns are recorded as a direct reduction of sales at the time the related sales are recorded. UMC also from time to time sells handsets at prices below cost. These subsidies are recognized in the cost of equipment when the sale is recorded.

Regulated tariff services, consisting of local telephone services and, starting from January 1, 2006, services rendered to other operators, such as traffic charges, connection fees and line rental services, provided by Comstar UTS, totaled approximately 5.6% and 4.2% of the consolidated revenues for the years ended December 31, 2006 and 2005, respectively. Changes in rate structure are subject to the Federal Tariff's Service approval.

Technology Segment

The Technology Segment recognizes revenues only when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured.

Revenues under arrangements specific to respective divisions of the Technology Segment are recognized as follows:

Telecommunication Solutions division:

The division's arrangements for sale of software products are multiple-element arrangements, involving provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

If the services element of the arrangement is deemed essential to the functionality of the software arrangement, the accounting for performance of construction-type contracts is applied, provided that the following conditions are met: (a) contracts executed by the parties normally include provisions that clearly specify the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement; (b) the buyer can be expected to satisfy its obligations under the contract; (c) the division can be expected to perform its contractual obligations. The measurement of progress towards completion is based on efforts

devoted to a contract at the particular stages. At SITRONICS Telecom Solutions Czech Republic ("SITRONICS TS CR") the extent of progress is measured by the ratio of hours performed to date to estimated total hours at completion.

Intracom Telecom calculates the extent of progress based on the ratio of costs incurred to total estimated costs. A contract is considered as substantially completed when (a) the product is delivered, and (b) the product is accepted by the customer.

If the services element of the arrangement is not deemed essential to the functionality of the software, the service revenues are accounted for separately from the software revenues. In such multiple-element arrangements, the software component is accounted for using the residual method.

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

Information Technologies Solutions division:

Because of frequent sales price reductions and rapid technology obsolescence, revenues from the division's computer hardware sales to dealers under agreements allowing price protection are deferred until the dealers sell the merchandise.

The division's arrangements regarding systems integration services typically include multiple elements, such as equipment and software, installation services and post-contract support. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: i) the delivered items have value to the customer on a standalone basis; ii) there is objective and reliable evidence of the fair value of the undelivered items; iii) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

If evidence of the fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract support are recognized as revenue on a pro rata basis over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Revenue and cost of sales from contracts involving solutions achieved through modification of complex telecommunications equipment and software are recognized by reference to the stage of completion of the contract activity at the balance sheet date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred that it is probable will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

Microelectronic Solutions, Consumer Electronics and Electronics Manufacturing Services divisions:

The products of these divisions are generally sold with a limited warranty of product quality. The product return reserves, warranty and other post-contract support obligations are accrued at the time of sale. The divisions accrue for known warranty if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified issues based on historical activity.

The Electronics Manufacturing Services division enters into arrangements with certain manufacturers and distributors of consumer electronics products to assemble such products at its facilities. In those cases where the division's responsibility to the customer is limited solely to assembly services or where the division buys components from and subsequently sells the assembled devices to the same counterparty, the division records only the net amount retained as its revenues.

Real Estate Segment

The Real Estate Segment of the Group earns revenues from i) real estate development, ii) project and construction management, iii) real estate asset management and iv) facility management. The segment records revenues as follows:

(i) Revenues from real estate development activities are recognized in accordance with the provisions of FAS No. 66, "Accounting for Sales of Real Estate" and AICPA Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP No. 81-1").

When the segment undertakes real estate development projects at its own risk, it recognizes revenues from sales of real estate when a) a sale is consummated; b) the buyer's initial and continuing investments are adequate to demonstrate a commitment to pay; c) the segment's receivable is not subject to future subordination; d) the segment has transferred to the buyer the usual risks and rewards of ownership and does not have a substantial continuing involvement with the project. A sale is not considered consummated until (a) the parties are bound by the terms of a contract; (b) all consideration has been exchanged; (c) any permanent financing for which the segment is responsible has been arranged; and (d) all conditions precedent to closing have been performed. Revenues from development of office and residential buildings are recognized prior to consummation of sale by the percentage-of-completion method if (a) construction is beyond a preliminary stage; (b) the buyer is committed to the extent of being unable to require a refund except for non-delivery of the property; (c) sales prices are collectible; (d) aggregate sales proceeds and costs can be reasonably estimated.

Investments in real estate developed for sale where the sale is not consummated are accounted for under the deposit method in accordance with FAS No. 66, except for those investments in development of office buildings, apartments, condominiums, shopping centers and similar structures, where criteria for revenue recognition have been met as of the balance sheet date. Such investments are accounted for by the percentage-of-completion method.

In those instances, when the segment acts as a contractor under construction contracts with third parties, it applies the percentage-of-completion method to the respective contracts where and as soon as it is able to reliably estimate the stage of progress to completion of the project, costs to complete the project and contractual revenues. Progress towards completion is measured by the percentage of costs incurred to date to the estimated total costs at completion for each contract (the "cost-to-cost" method). On most of its contracts, the segment is not able to reliably estimate costs to complete the project and contractual revenues until the project is at least 30% complete. Until the 30% completion point, the segment carries the projects at cost. The segment does not recognize revenue on contracts until reasonably dependable estimates of costs to complete the project and contractual revenues can be made.

(ii) The segment provides project and construction management services to municipal governments on certain socially important infrastructure projects. The segment's remuneration under the majority of those arrangements was determined as a percentage of project costs incurred by third parties and approved by the municipal government. Based upon the guidance in Emerging Issues Task Force Consensus No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF 99-19"), management has concluded that the segment's services under such contracts do not transfer to the segment full risks and rewards associated with the projects. Therefore, the segment recognizes as revenues only its fees from project management services. Fees are recognized as the project costs are incurred and approved by the municipal government when the segment acts as a general contractor.

(iii) Revenues from real estate asset management include rental revenues, revenues from sale or assignment of rights to land plots and residential units. Rental revenues are recognized over the lease term on a straight-line basis. Revenues from sale or assignment of rights over real estate are recognized when substantially all the risks and rewards of ownership have been passed to the buyer.

(iv) Revenues from service contracts for facilities management are recognized on the accrual basis over the periods when services are provided.

Insurance Segment

Premiums on written non-life insurance of the Insurance Segment are recognized on a pro-rata basis over the term of the related policy coverage, normally not exceeding one year. The unearned premium provision represents that portion of premiums written relating to the unexpired term of the policy. Premiums from traditional life and annuity policies with life contingencies are recognized as revenue when due from the policyholder.

Banking Segment

Interest income of the Banking Segment is recognized on the accrual basis. Loans are placed on non-accrual status when interest or principal is delinquent for a period in excess of 90 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized where recovery is doubtful. Loans are written off against the allowance for loan losses in case of uncollectibility of loans and advances, including through repossession of collateral.

Other Segments

Concern RTI recognizes revenues from development and production of radiotechnical equipment in accordance with the provisions of SOP No. 81-1. It applies the percentage-of-completion method to the respective contracts where and as soon as it is able to reliably estimate the stage of progress to completion of the project, costs to complete the project and contractual revenues. Progress towards completion is measured by the percentage of costs incurred to date to the estimated total costs at completion for each contract (the “cost-to-cost” method).

The other Group’s segments recognize revenues when products are shipped or when services are rendered to customers.

In travel agency arrangements where the Group acts as an agent, only the net agency fee is recognized as revenue.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, amounts on deposit in banks, cash invested temporarily in various instruments with maturities of three months or less at the time of purchase and minimum reserve deposits with the Central Bank of the Russian Federation. Short-term interbank loans originated by MBRD with original maturities of three months or less are included in loans to customers and banks.

Financial Instruments – The Group’s financial instruments include cash, short-term and long-term investments, receivables, derivative financial instruments, payables and debt. Except as described below, the estimated fair value of such financial instruments as of December 31, 2006 approximated their carrying value as reflected in the consolidated balance sheets. The fair value of the Group’s publicly traded long-term notes as of December 31, 2006 ranged from 99.4% to 106.7% of the principal amount. The carrying and fair value of other fixed rate and variable rate debt were not significant as of December 31, 2006.

From time to time, in its acquisitions the Group uses derivative instruments, consisting of put and call options on all or part of the minority stakes of acquired companies, to defer payment of the purchase price and provide optimal acquisition structuring. In addition, the Group entered into several variable-to-fixed interest rate and cross currency interest rate swap agreements to manage its exposure to changes in fair value of future cash flows of its variable-rate long term debt, which is caused by interest rate and currency fluctuations (Note 22). The Group also entered into several short-term USD forward agreements to hedge the fair value of its investments in RUB-denominated financial instruments and accounts receivable. The Group does not use derivatives for trading purposes.

The Group accounts for derivative instruments in accordance with FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and FAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". All derivatives are measured at fair value and recognized as either assets or liabilities in the consolidated balance sheet. MTS' interest rate swap agreements are designated as a cash flow hedge and the hedging relationship qualifies for hedge accounting. The effective portion of the change in fair value of interest rate swap agreements is, accordingly, recorded in other comprehensive income and reclassified to interest expense in the same period that the related cash flows of the hedged transaction affect the interest expense. Changes in fair value of other derivative instruments are recognized in net income as those instruments were not designated as hedges.

At the inception of the hedge and on a quarterly basis, the Group performs an analysis to assess whether changes in cash flows of its interest rate swap agreements are deemed highly effective in offsetting changes in cash flows of the hedged debt. If at any time the correlation assessment will indicate that the interest rate swap agreements are no longer effective as a hedge, the Group will discontinue hedge accounting and all subsequent changes in fair value will be recorded in net income.

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

Loans to Customers and Banks – Loans to customers and banks arise out of operations of the Banking Segment. The determination of the allowance for losses in respect of loans provided by MBRD is based on an analysis of the loan portfolio and reflects the amount, which, in the judgment of management of the Group, is adequate to provide for losses inherent in the loan portfolio. A specific provision is made as a result of a detailed appraisal of risk assets. In addition, a general provision is carried to cover risks, which although not specifically identified, are present in any portfolio of banking assets.

Management's evaluation of the allowance is based on MBRD's past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions. It should be understood that estimates of loan losses involve an exercise of judgment. While it is possible that in particular periods, MBRD may sustain losses which are substantial relative to the allowance for loan losses, it is the judgment of management that the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio.

Insurance-Related Receivables – Insurance-related receivables include receivables arising from insurance operations and advances to health care providers under voluntary and obligatory medical insurance programs. Receivables arising from insurance operations consist of outstanding direct premiums due from policyholders, outstanding assumed premiums due from ceding companies and receivables due from claims ceded.

Policy Acquisition Costs – Policy acquisition costs represent costs of the acquisition or renewal of insurance policies by Rosno. They are deferred and amortized over the period for which costs are expected to be recoverable out of associated revenues. Deferred acquisition costs are included in other receivables and prepaid expenses, net of the unexpired risk provision, that is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year.

Subscriber Acquisition Costs – Subscriber acquisition costs represent the direct costs paid for each new subscriber. The Group expenses these costs as incurred.

Inventories and Spare Parts – Inventories, including spare parts, are stated at the lower of cost or market.

The cost of inventories of SITRONICS' entities is computed on a weighted average cost basis, except for its Information Technologies Solutions division, which accounts for its inventories using the first-in, first-out ("FIFO") cost method.

The cost of Comstar UTS' inventories (including mostly spare parts) is computed on a weighted average cost basis.

Prior to January 1, 2006, MTS computed cost of inventory using the FIFO method. Starting from January 1, 2006, MTS changed its method of accounting for inventory cost from FIFO to the weighted average cost method. The effect of change in accounting policy was not significant to the Group's consolidated financial position, results of operations and cash flows, and is not expected to be in future.

Other subsidiaries of the Group account for their inventories using the FIFO method.

The cost of raw materials includes cost of purchase, customs duties, transportation and handling costs. Work in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings. The entities of the Group periodically assess their inventories for obsolete or slow moving stock.

Vendor Programs – Funds received by SITRONICS from its vendors for price protection, vendor rebates, marketing, training, product returns and promotion programs are recorded when earned as adjustments to product costs, revenue, or selling, general and administrative expenses according to the nature of the program.

Value-Added Taxes – Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not reclaimable as of the balance sheet dates are recorded as VAT receivable in the accompanying financial statements.

Assets held for sale – In 2006, MTS decided to discontinue using certain telecommunication equipment in Russian regions with a net book value of approximately $63.2 million as of December 31, 2006, in accordance with MTS' network development strategy. MTS has negotiated with a third party to sell this equipment during the year ended December 31, 2007 at net book value. Accordingly, this equipment has been classified as a current asset in the Group's balance sheet as of December 31, 2006.

Property, Plant and Equipment – For subsidiaries acquired by the Group through business combinations accounted for by the purchase method, property, plant and equipment ("PP&E") were assigned their fair values at the acquisition date. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent additions to PP&E have been recorded at cost.

Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

Depreciation is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	17-31 years
Network and base station equipment	5-12 years
Other plant, machinery and equipment	3-15 years

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to

determine the implicit rate computed by the lessor and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

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

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

Asset Retirement Obligations – In accordance with FAS No. 143, "Accounting for Asset Retirement Obligations", the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under FAS No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2006, the estimated asset retirement obligations were not significant to the Group's consolidated financial position and results of operations.

License Costs – Costs of licenses for providing telecommunications services are capitalized as a result of (a) the purchase price allocated to licenses acquired in business combinations (Note 3) and (b) licenses purchased directly from government organizations, which require license payments.

Current operating licenses of the Group do not provide for automatic renewal upon expiration. As the Group and the telecommunications industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on the straight-line basis over the initial term of the license without consideration of possible future renewals commencing from the date such license area becomes commercially operational.

Goodwill and Other Intangible Assets – Goodwill represents the excess of the cost of a business acquired over the fair value of identifiable net assets at the date of acquisition. Goodwill is reviewed annually for impairment or whenever it is determined that the impairment indicators exist. The Group determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with FAS No. 142, "Goodwill and Other Intangible Assets", and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. Management believes that there was no impairment of goodwill for the years ended December 31, 2006 and 2005.

The carrying amount of goodwill attributable to each reportable operating segment with goodwill balances and changes therein, are as follows:

	Telecom-munications	Insurance	Mass Media	Corporate and Other	Total
Balance as of January 1, 2005	$ 172,365	$ 1,341	-	$ 635	$ 174,341
Purchase price allocation	156,591	-	-	-	156,591
Balance as of December 31, 2005	328,956	1,341	-	635	330,932
Purchase price allocation	48,782	8,953	$ 125,500	293	183,528
Balance as of December 31, 2006	**$ 377,738**	**$ 10,294**	**$ 125,500**	**$ 928**	**$ 514,460**

Other intangible assets represent acquired customer bases, trademarks, roaming contracts with other telecommunications operators, telephone numbering capacity and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment in accordance with the provisions of FAS No. 142.

Acquired customer bases are amortized over the estimated average subscriber life from 12 to 96 months. Deferred telephone numbering capacity costs with limited contractual life are being amortized over their contractual lives, which vary from 5 to 20 years. Software costs and other intangible assets are being amortized over 3 to 10 years. All finite-life intangible assets are being amortized using the straight-line method.

Investments – The Group's share in net assets and net income of certain entities, where the Group holds 20 to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated net assets and operating results using the equity method of accounting. The Group's share in net income of the affiliates where the Group has day-to-day involvement in business activities and which are integral to the Group's business is recorded within the operating income. In other cases, the Group's share in net income is shown after the income tax provision.

Investments in corporate shares where the Group owns more than 20% of voting shares, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition.

Trading securities held by the Group are stated at market value. Unrealized holding gains and losses for trading securities are included in earnings.

Investments in marketable securities classified as available-for-sale are stated at fair value based on market quotes. Unrealized gains/(losses), net of deferred taxes, are recorded as a component of other comprehensive income. For the years ended December 31, 2006 and 2005, unrealized gains/(losses) on marketable securities available-for-sale have not been significant.

The Group also purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible.

Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value. During the year ended December 31, 2006, the Group's investment in Bitel in the amount of $150.0 million was fully impaired and written off (Note 16). No other impairment of investments has occurred during the year ended December 31, 2006.

Debt Issuance Costs – Debt issuance costs are amortized using the effective interest method over the terms of the related loans. Debt issuance costs amounted to $80.2 million and $82.7 million, net of accumulated amortization of $55.6 million and $28.7 million as of December 31, 2006 and 2005, respectively.

Impairment of Long-lived Assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. Management is not aware of any indicators of impairment relating to the Group's investments in long-lived assets during the year ended December 31, 2006, except for impairment of the investment in Bitel.

Bank Deposits and Notes Issued – Bank deposits and notes issued arise out of operations of the Banking Segment and include deposits from banks and customers and promissory notes issued.

Insurance-Related Liabilities – Insurance-related liabilities arise out of the operations of the Insurance Segment and include the unearned premium provision, loss provision for outstanding claims, undisbursed funds of the Government Fund for Obligatory Medical Insurance ("GFOMI"),

accumulated under an obligatory medical insurance program, prepaid insurance and reinsurance premiums and liabilities under deposit type insurance contracts (policies in force under which the Group does not assume insurance risk).

Rosno provides for losses on outstanding claims on an individual case basis for the estimated cost of claims notified but not settled as at the balance sheet date. Provision is also made for the ultimate cost of claims, including claims incurred but not reported, or not fully reported. This provision is actuarially determined by line of business, and includes assumptions based on prior years claims experience. The loss provision for life insurance is actuarially determined based upon mortality, morbidity and interest rate assumptions applied to all life insurance policies in force as at year-end.

An unexpired risk provision is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year. The Group does not consider anticipated investment income in making a determination whether a premium deficiency exist.

GFOMI carries out an obligatory medical insurance program to provide RF citizens with free of charge medical services via certain appointed insurers, including Rosno, which has contracted with GFOMI to administer a portion of this program. Rosno receives advances from GFOMI and makes payments to medical centers in respect of services provided by them to policyholders. Any funds received from GFOMI by Rosno, which are not paid out for medical services, are retained and recorded as a liability. These funds may be spent by the Group only on the provision of the medical facilities and care, as presently defined under the program. Rosno does not assume any insurance risk under this program.

Deferred Revenue – Telecommunication equipment and transmission devices, installed at newly constructed properties in Moscow, have been historically transferred to MGTS free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously, deferred revenue is recorded in the same amount and is amortized as a reduction of the depreciation charge in the consolidated statement of operations over the contributed assets' life.

Deferred grant revenue represents funds contributed to the Group, which usage is restricted. Deferred grants are released to income when the conditions of the grant are substantially met.

Income Taxes – Income taxes of the Group's Russian entities have been computed in accordance with RF laws. Income tax rate in the RF equals 24%. The income tax rate on dividends paid within Russia is 9%. The foreign subsidiaries of the Group are paying income taxes in their jurisdictions. As of December 31, 2006, the income tax rate in Ukraine was 25%.

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

Treasury Stock – Shares of common stock of JSFC Sistema repurchased by the Group are recorded at cost as treasury stock and result in a reduction of shareholders' equity in the Group's consolidated financial statements.

Stock-based Compensation – Effective from January 1, 2006, the Group started accounting for stock-based compensation plans in accordance with provisions of FAS No. 123R "Share Based Payment". Under FAS No. 123R, companies must calculate and record the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services received in the statement of operations and comprehensive income. The cost of the equity instruments is measured based on the fair value of the instruments on the date they are granted and is recognized over the period during which the employees are required to provide services in exchange for the equity instruments.

MTS adopted the provisions of FAS No. 123R, using the modified prospective transition method. Under that transition method, compensation cost of $1.7 million recognized in 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2006, based on the grant date fair value estimated in accordance with the original provisions of requirements of FAS No. 123. The Group's consolidated financial statements for prior periods have not been restated.

Adoption of FAS No.123R did not have significant effect on the Group's net income for the year ended December 31, 2006.

MTS did not issue any new stock-option plans during the year ended December 31, 2006 (Note 31).

In September 2006, Comstar UTS approved a stock-based compensation plan (Note 31).

Retirement and Post-Retirement Benefits – Subsidiaries of the Group contribute to the local state pension funds and social funds, on behalf of all their employees.

In Russia, all social contributions, including contributions to the pension fund, are substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 20% to 2% depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine, the subsidiaries of the Group are required to contribute a specified percentage of each employee payroll up to a fixed limit to a pension fund, an unemployment fund and a social security fund. The contributions are expensed as incurred.

In addition, Intracom Telecom and MGTS have defined benefit plans to provide their employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service (Note 25). The Group accounts for pension plans following the requirements of FAS No. 87, "Employers' Accounting for Pensions", as amended by FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", FAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and FAS No. 132R, "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106".

Borrowing Costs – Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the years ended December 31, 2006 and 2005 amounted to $74.6 million and $56.2 million, respectively.

Advertising Costs – Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2006 and 2005 were $362.6 million and $270.0 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Research and Development Costs – Research and development ("R&D") costs are fully charged to the consolidated statements of operations when incurred and for the years ended December 31, 2006 and 2005, equaled $27.2 million and $23.6 million, respectively. Such costs were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Costs of producing software incurred between the date of start of the related projects and the date on which technological feasibility is established and when the related software product is available for general release to customers are capitalized.

Earnings per Share – Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the year ended December 31, 2006 and 2005.

Diluted EPS reflect the potential dilution related to MTS' and Comstar UTS' stock options granted to employees.

Distributions to Shareholders – Distributable retained earnings of the Group are based on amounts extracted from statutory accounts of JSFC Sistema and may significantly differ from amounts calculated on the basis of U.S. GAAP.

Comprehensive Income – Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources.

Recent Accounting Pronouncements – In February 2006, the FASB issued FAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment to FAS No. 133, 'Accounting for Derivative Instruments and Hedging activities' and FAS No. 140, 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". FAS No. 155 addresses application of FAS No. 133 to beneficial interests in securitized financial assets and permits to remeasure fair value for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, requires to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, amends FAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument, and clarifies certain other derivatives classification issues. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that starts after September 15, 2006, and is not expected to have a material impact on the Group's financial position and results of operations.

In March 2006, the FASB issued FAS No. 156, "Accounting for Servicing of Financial Assets". FAS No. 156 amends FAS No. 140 with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement clarified and amended the measurement methods and principles of recognition of mortgage and other servicing assets and liabilities. FAS No.156 is effective beginning the first fiscal year after September 15, 2006. The Group does not anticipate that this Statement will have a material impact on the Group's financial position and results of operations.

In June 2006, the Emerging Issues Task Force reached a consensus on EITF Issue No. 06-03 ("EITF No. 06-03"), "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)". EITF No. 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The provisions of EITF No. 06-03 become effective for fiscal years beginning after December 15, 2006. The adoption of EITF No. 06-03 is not expected to have a material effect on the Group's consolidated financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", of FAS No. 109, "Accounting for Income Taxes" ("FIN 48"). The Interpretation applies to all tax positions that are within the scope of FAS No. 109 and requires the two-step approach for recognizing and measuring tax benefits. The Interpretation establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognized in the financial statements. To meet this threshold, the enterprise must determine that upon examination by the taxing authority, the tax position is more likely to be sustained than not, based on the technical merits of the position. Once the recognition threshold has been met, enterprises are required to recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. In both steps, enterprises must presume that the taxing authority has full knowledge of all relevant information. FIN 48 also requires enterprises to make explicit disclosures at the end of each reporting period about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. FIN 48 is effective for fiscal years beginning after December 15, 2006, and should be applied to all tax positions upon initial adoption. The cumulative effect of applying the provisions of the Interpretation should be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Group is currently assessing the impact of the adoption of this Interpretation.

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements". FAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. FAS No. 157

is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Group is currently assessing the impact of the adoption of this Statement.

In September 2006, the FASB issued FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)". FAS No. 158 requires companies with publicly traded equity securities that sponsor a postretirement benefit plan to fully recognize, as an asset or liability, the overfunded or underfunded status of their benefit plan(s). The funded status is measured as the difference between the fair value of the plan's assets and its benefit obligation. FAS No. 158 also requires companies to measure their plan assets and benefit obligations as of year-end balance sheet date. FAS No. 158 is becoming effective for fiscal years ending after December 15, 2006; the provision to require measurement at the entity's year-end balance sheet date will be effective for fiscal years ending after December 15, 2008. The adoption of FAS No. 158 did not have a material impact on the Group's financial position or results of operations.

In February 2007, the FASB issued FAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" – including an amendment of FAS No. 115, which permits an entity to measure certain financial assets and financial liabilities at fair value. FAS No. 159 offers an irrevocable option to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded in earnings (the fair value option, or "FVO"). The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. FAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity (1) makes that choice in the first 120 days of that fiscal year, (2) has not yet issued financial statements, and (3) elects to apply the provisions of FAS No. 157, Fair Value Measurements. The Group is currently evaluating the provisions of FAS No. 159 to determine the potential impact its adoption will have on the Group's financial statements, if the Group decides to adopt FVO.

Reclassifications – Certain reclassifications of prior years' amounts have been made to conform to the presentation adopted for the year ended December 31, 2006.

3. ACQUISITIONS

Svyazinvest

In December 2006, the Group acquired a 25% stake plus one share in JSC Svyazinvest from Mustcom Limited for a total consideration of approximately $1,390.0 million, including cash of $1,300.0 million and the fair value of the call and put option of $90.0 million (Note 32). In a series of transactions, Comstar UTS and MGTS Finance S.A., a subsidiary of Comstar UTS, have acquired 4,879,584,306 ordinary shares of Svyazinvest, with Comstar UTS buying 3,378,173,750 shares, which represent 17.3% of total outstanding shares of Svyazinvest, and MGTS Finance S.A. buying 1,501,410,556 shares, representing 7.7% of total outstanding shares of Svyazinvest.

The Group continues its evaluation of whether the acquisition of 25% plus one share of Svyazinvest allows the Group to exercise significant influence over this entity, in which case the Group will account for its investment in Svyazinvest under the equity method. In the accompanying consolidated financial statements for the year ended December 31, 2006, the Group's investment in Svyazinvest is stated at cost of acquisition. The Group believes that application of the equity method to the Group's holding in Svyazinvest for the period from the date of acquisition to December 31, 2006 would not have a material impact on the Group's results of the operations for the year ended December 31, 2006, or on its financial position as of that date. Due to lack of consolidated financial statements of Svyazinvest prepared in accordance with US GAAP as of December 31, 2006 or earlier date, the Group is unable to present summarized information as to assets, liabilities and results of operations of Svyazinvest. As of the date of these financial statements, the Group had not performed any purchase price allocation in respect of this acquisition.

East-West United Bank ("EWUB")

In December 2006, MBRD purchased 2.0% share in East-West United Bank from VTB for a total cash consideration of $756.9 thousand (equivalent of EUR 573.4 thousand), increasing Group's ownership to 51.0%. Under the purchase agreement, the Group has an obligation to further purchase, and VTB has an obligation to sell, another 47.0% of voting shares, subject to fulfillment of certain conditions till December 31, 2007.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Loans to customers and banks	$	255,594
Short-term investments		81,028
Other current assets		17,916
Bank deposits and notes issued		(263,451)
Other current liabilities		(31,502)
Minority interest		(41,079)
Carrying value of the Group's investments in EWUB as of the date of acquisition		(17,749)
Purchase price	$	757

Intracom Telecom

In June 2006, SITRONICS acquired 51.0% of the common shares of Intracom Telecom for $150.6 million (equivalent of EUR 120.0 million as of the date of the transaction), of which $106.7 million was paid in cash in June 2006 and $46.1 million was recorded as a liability as of December 31, 2006 (Note 20). Intracom Telecom is a provider of telecommunications solutions and services, such as advanced technological products in the areas of fixed and wireless broadband access and transmission systems, as well as content delivery systems (IPTV, triple-play), primarily in Eastern Europe and
the Middle East.

SITRONICS also entered into a put option with the other shareholder of Intracom Telecom to acquire the remaining 49.0% of common shares of Intracom Telecom. The exercise period of the put option is 36 months following a 24 months period after the acquisition date. The agreement stipulates that the purchase price will be agreed by the parties, or will be equal to the fair value as determined by an independent appraiser.

This acquisition was accounted for using the purchase method. The purchase price allocation for the acquisition was as follows:

Current assets	$	522,208
Non-current assets		181,078
Customer base costs		7,096
Software costs		66,106
Deferred taxes		11,287
Current liabilities		(492,728)
Long-term liabilities		(7,463)
Minority interest		(137,020)
Purchase price	$	150,564

Cosmos Hotel

In March 2006, Intourist purchased 20.0% of the common shares of Cosmos Hotel for approximately $20.8 million. Upon completion of this transaction, Intourist became a controlling shareholder of Cosmos Hotel with the voting power of 64.1%.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Current assets	$	15,650
Non-current assets		52,554
Deferred taxes		(9,448)
Current liabilities		(9,373)
Minority interest		(7,019)
Carrying value of the Group's investments in Cosmos Hotel as of the date of acquisition		(21,614)
Purchase price	$	20,750

United Cable Network

In February 2006, Sistema Mass Media acquired 100.0% of the shares of JIR Broadcast and JIR Inc., holders of 100.0% stock in United Cable Networks ("UCN"), for a total cash consideration of $145.9 million, including the refinancing of the debt previously obtained by JIR Broadcast and JIR Inc. UCN is a pay TV and broadband service provider in Russia, operating in 17 metropolitan areas throughout Russian Federation with 724,000 subscribers (unaudited) as of the date of acquisition.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Current assets	$	9,133
Non-current assets		21,683
Customer base cost		26,000
Goodwill		104,499
Deferred taxes		(6,240)
Current liabilities		(4,104)
Non-current liabilities		(5,071)
Purchase price	$	145,900

The customer base is amortized over the average remaining subscriber's life of approximately 8 years. Goodwill is mainly attributable to the economic potential of the markets where UCN is operating.

Barash Communication Technologies Inc. ("BCTI")

In June 2005, MTS entered into an agreement to acquire 100.0% of the outstanding stock of BCTI, which is a leading cellular operator in Turkmenistan with a customer base of approximately 59,100 subscribers (unaudited). BCTI holds a license to provide GSM-900/1800 services for the whole territory of Turkmenistan and a license for provision of AMPS services. The agreement provided for the acquisition of a 51.0% stake and included a forward commitment to complete the acquisition of the remaining 49.0% stake within eight months of the date of the original agreement subject to certain conditions.

MTS acquired the 51.0% stake in BCTI for cash consideration of $28.2 million, including a finder's fee of $2.5 million. The Group accounted for the purchase of the remaining 49.0% stake in BCTI as a financing of the minority interest and, consequently, consolidated 100.0% of the subsidiary starting from June 30, 2005. In November 2005, MTS completed the acquisition of the remaining 49.0% stake in BCTI for a cash consideration of $18.5 million.

This acquisition was accounted for using the purchase method. The purchase price allocation for the acquisition was as follows:

Current assets	$	7,808
Non-current assets		3,804
License costs		50,503
Deferred taxes		(10,862)
Current liabilities		(4,566)
Purchase price	$	46,687

In accordance with certain provisions of the license agreement, the Group shares a certain percentage of net profit derived from the operations of the BCTI branch located in Turkmenistan with the Government of Turkmenistan. The amount of shared net profit is calculated based on the financial statements prepared in accordance with local GAAP, subject to certain adjustments. The Group shared 49% of net profit from the date of acquisition and until December 21, 2005, and 20% of net profit commencing December 21, 2005.

Energy companies in the Republic of Bashkortostan

In August 2005, the Group completed the acquisition of minority shareholdings in six energy companies in the Republic of Bashkortostan for a total cash consideration of $469.6 million. The acquired shareholdings included 19.9% of the shares of each of Novoil, Ufimsky NPZ, Ufaneftekhim, ANK Bashneft and Ufaorgsintez and 18.6% of Bashnefteproduct.

In October 2005, the Group increased its stakes in five of the companies, for a total cash consideration of $143.7 million. Sistema's shareholding in Novoil increased to 28.2%, in Ufimsky NPZ to 25.5%, in Ufaneftekhim to 22.4%, in ANK Bashneft to 25.0% and in Ufaorgsintez to 24.9%.

In September 2006, the Group increased its stakes in all companies, for a total cash consideration of $141.7 million. Sistema's shareholding in Novoil increased to 29.6%, in Ufimsky NPZ to 27.7%, in Ufaneftekhim to 28.5%, in ANK Bashneft to 25.8%, in Ufaorgsintez to 26.3% and in Bashnefteproduct to 27.45%.

Additional Interests in MTS, MGTS and ReCom

In December 2006, MTS Bermuda, one of MTS' subsidiaries, repurchased 2,232,200 of MTS' ADRs for a total cash consideration of $110.0 million. As a result of this transaction, the Group' ownership interest in MTS increased from 52.8%, as of December 31, 2005, to 53.1%. The transaction was accounted for using the purchase method. The allocation of purchase price increased the recorded trademark cost by $10.0 million, the customer base cost by $2.1 million, the license cost by $2.7 million and $35.7 million was recognized as goodwill. Goodwill is mainly attributable to the economic potential of the markets where MTS is operating.

In February, March and October 2006, Comstar UTS completed several transactions on acquisition of MGTS' common stock under unconditional purchase offers. As a result of these transactions, Comstar UTS purchased 11.3% of voting shares of MGTS (9.4% of MGTS' share capital) for an aggregate cash consideration of $181.4 million, increasing its voting interest in MGTS to 55.7%.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Current assets	$	(903)
Non-current assets		55,942
Customer base cost		6,080
Current liabilities		2,859
Non-current liabilities		123
Minority interest		117,257
Purchase price	$	181,358

The customer base is amortized over the average remaining subscriber's life of approximately 15 years for residential wireline voice phone subscribers and of approximately 5 years for other categories of subscribers.

In December 2005, the Group increased its ownership interest in VAST to 100.0% for a total cash consideration of $160.0 million. Prior to the acquisition VAST was a joint venture, where Sistema had 51% ownership interest and 50% voting power. VAST owns a 3% stake in MTS. In addition, in October-December 2005, the Group acquired on the open market 0.8% of the common shares of MTS for a total cash consideration of $115.5 million. As a result of these transactions, Sistema's voting power in MTS increased by 2.3% to 52.8%.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Trademark	$	81,556
Customer base cost		16,590
Numbering capacity		2,127
License cost		17,173
Goodwill		110,636
Deferred taxes		(28,187)
Minority interest		75,605
Purchase price	$	275,500

Goodwill is mainly attributable to the economic potential of the markets where MTS is operating. License cost is amortized over the remaining contractual terms of licenses of approximately 3 to 10 years and customer base cost is amortized over the average remaining subscriber's life of approximately 12 to 60 months.

In December 2005, MTS purchased 46.1% minority stake in ReCom for $110.0 million in cash. As a result of the transaction, MTS' ownership in the subsidiary increased to 100.0%. The acquisition was accounted for using the purchase method. The allocation of purchase price increased the recorded license cost by $43.9 million, the customer base cost by $15.0 million and resulted in recognition of goodwill in the amount of $16.2 million. Goodwill is mainly attributable to the economic potential of the market assuming low regional penetration level as of the date of acquisition. The license costs are amortized over the remaining contractual terms of the licenses of approximately 3 to 8 years, and the customer base is amortized over the average subscriber's life of approximately 60 months.

Other

Below are the lists of other acquisitions for the years ended December 31, 2006 and 2005:

For the year ended December 31, 2006

Acquiree	Principal activity	Date of acquisition	Ownership interest Before acquisition	Ownership interest After acquisition	Acquiring entity	Purchase price (in millions of USD)
Comstar UTS	Fixed-line operator	December 2006	59.1%	59.4%[1]	Comstar One	13.8
Riviera Holding	Tour operator in Saint-Petersburg	December 2006	0.0%	51.0%	VAO Intourist	7.0
Zeta Telecom	Consulting company	December 2006	49.0%	51.0%	Sistema	0.3
VZPP-Mikron	Producer of electronic power supply components for customers in RF	December 2006	51.0%	96.7%	SITRONICS	4.5
WaveCrest Group Enterprises Ltd. [2]	Fixed-line operator in Great Britain.	October 2006	0.0%	66.0%	Sistema	39.3
DG Tel and Technology Systems	Alternative fixed-line operators in Ukraine	October 2006	0.0%	100.0%	Comstar UTS	4.7
Callnet and Cornet	Fixed-line operators in the Republic of Armenia	October 2006	0.0%	75.0%	Comstar UTS	4.4
Nostro LLC	Owner of a building located in Moscow at Sadovnicheskaya st., 75	August 2006	0.0%	100.0%	Sistema-Hals	26.6
Stenson Corporation/ Skymax UK Ltd.	Owner of radio frequencies	August 2006	0.0%	100.0%	Sistema Mass Media	18.2
Cable television operators in various regions of RF	Cable television	July-September 2006	0.0%	55.5%-100.0%	Sistema Mass Media	10.7
Tatilya Turizm Seyahat Insaat	Turkish travel operator, working under the brand "Danuna"	July 2006	0.0%	51.0%	Intourist Overseas Ltd	0.3
Dagtelecom	Mobile operator in the Republic of Dagestan	July 2006	0.0%	75.0%	MTS	14.7
Pekin Hotel[3]	Hotel complex in Moscow	June 2006	0.0%	100.0%	VAO Intourist	62.8
Astelit	Alternative fixed-line operator	June 2006	0.0%	100.0%	Comstar UTS	7.8
Mir Otdykha/Skyway	Travel operator	June 2006	0.0%	51.0%	VAO Intourist	1.4
UralElektro	Producer of electronic equipment	March 2006	0.0%	50.0%+1 share	Concern RTI	2.1
UralElektro-K	Producer of electronic equipment	March 2006	0.0%	100.0%	Concern RTI	3.3
Tireks Development	Owner of 30.0% interest in Dom Igrushki, the Group's subsidiary	March 2006	0.0%	99.0%	Detsky Mir	2.4
SITRONICS[4]	Holding company of the Group's Technology segment	March 2006	78.0%	93.0%	Sistema	14.5
Medexpress	Provider of voluntary medical insurance in the north-west region of RF	February 2006	0.0%	51.0%	Rosno	6.6
GK Sendi and Informservice	Internet provider and a cable television operator in Nizhny Novgorod	January 2006	0.0%	100.0%	Sistema Mass Media	6.3

[1] – Represents increase in the Group's ownership interest in Comstar UTS after transactions described in Note 31.

[2] – The acquisition was performed for the purpose of resale to MTT, the Group's affiliate, to which it was subsequently sold with gain on sale recorded in the statement of operations for the year ended December 31, 2006 in an amount of $0.8 million.

[3] – In June 2006, VAO Intourist issued additional stock to the Group and to the Moscow Government. The Moscow Government contributed its 100.0% stake in Pekin Hotel with a fair value of $62.8 million. The transaction resulted in a decrease of the Group's additional paid-in capital by $2.5 million and a decrease in the Group's ownership in Intourist from 72.0% to 66.0%.

[4] – In March 2006, Sistema contributed $206.8 million to the share capital of SITRONICS. Minority share of this consideration amounted to $14.5 million. Upon completion of this transaction, Sistema's ownership interest in SITRONICS increased to 93.0%, which due to subsequent capital transactions of SITRONICS decreased to 84.5% (Notes 4 and 27).

For the year ended December 31, 2005

Acquiree	Principal activity	Date of acquisition	Ownership interest: Before acquisition	Ownership interest: After acquisition	Acquiring entity	Purchase price (in millions of USD)
Telesot Alania	Mobile operator in the Republic of North Osetia	December 2005	52.5%	100.0%	MTS	32.6
Sibintertelecom	Mobile operator in Chita	December 2005	93.5%	6.5%	MTS	2.8
MTS Tver	Mobile operator in Tver	December 2005	26.0%	100.0%	MTS	1.4
Conversia Svyaz and Overta	Alternative fixed-line operators in Saratov region	December 2005	0.0%	100.0%	Comstar UTS	10.0
CTK Contrast Telecom	Alternative fixed line operator in Moscow region	December 2005	0.0%	100.0%	Comstar UTS	5.5
Unitel	Alternative fixed line operator in Moscow region	December 2005	0.0%	100.0%	Comstar UTS	4.5
Upravlenie i Leasing	Provider of cable TV broadcasting services	December 2005	0.0%	75.0%	Sistema Mass Media	5.1
Eurodawn / Digital TV	Aerial, digital, multiprogram television broadcasting	November 2005	0.0%	74.0%	Mardenhead	7.0
Tyumenneftegas svyaz	Alternative fixed line operator	October 2005	0.0%	89.4%	Comstar UTS	9.0
Metrocom	Alternative fixed line operator in Saint-Petersburg	September 2005	0.0%	45.0%	Comstar UTS	22.5
Vyrastai-ka and S-Toys, Chudo-Ostrov Neva	A retail network, a children's toys wholesale company and children's goods retailer in Saint-Petersburg	August and September 2005	0.0%	100.0%	Detsky Mir	2.0
ESTA	Cable television operator	August 2005	0.0%	100.0%	Sistema Mass Media	8.6
SITRONICS TS CR[(1)]	Integrated solutions provider for wireless and fixed networks	July 2005	67.0%	100.0%	SITRONICS	19.8
Yaroslavl radio plant	Producer of commercial payload for satellites and professional communications facilities	June 2005	0.0%	51.0%	Concern RTI	6.1
Gorizont-RT	Mobile operator in the Republic of Sakha (Yakutia)	June 2005	76.0%	100.0%	MTS	13.5
MTU Saturn	Designer and producer of electric systems	May 2005	0.0%	54.0%	Concern RTI	1.5
Kvant	Personal computers and components manufacturer	April 2005	25.0%	78.0%	SITRONICS	6.0
Sweet-Com	Holder of 3.5GHz radio frequency allocation for Moscow region	February 2005	0.0%	74.9%	MTS	2.0
MTT	Nationwide transit network operator	February 2005	45.0%	50.0%	Hurdsfield	6.4
MTS-Komi	Mobile operator in Komi Republic	February 2005	0.0%	100.0%	MTS	1.2
MBRD	Banking	February 2005	82.0%	95.0%	Sistema	10.0
Telmos	Fixed line operator	February 2005	80.0%	100.0%	Sistema	8.5
Cosmos Hotel [(2)]	Hotel complex in Moscow	January 2005	0.0%	44.1%	VAO Intourist	21.6

[(1)] – The fair value of the acquired net assets as of the date of this transaction was determined to be in excess of the purchase price. The allocation of the purchase price decreased the cost of the manufacturing plant and inventories by $3.9 million and $3.6 million, respectively. The remaining excess of the fair value of net assets acquired over the purchase price comprised $4.0 million, and was recorded as an extraordinary gain in the consolidated statement of operations.

[(2)] – In January 2005, Intourist announced an issue of new stock to its existing shareholders. The Moscow Government purchased the first tranche in exchange for a 40.0% stake in Cosmos Hotel. Upon completion of this transaction, Sistema's ownership interest in Intourist decreased to 72.0%. During the year ended December 31, 2005, the Group purchased an additional 4.1% share of Cosmos Hotel on the open market for a total cash consideration of $0.9 million.

Controlling interest in Hellas On Line SA

In December 2006, Comstar UTS has entered into an agreement with Intracom Holdings to purchase a 51.0% stake in Hellas On Line SA, an Internet provider operating in Greece, for a cash consideration of $62.3 million (equivalent of Euro 47.9 million as of December 31, 2006). The acquisition will be executed to get access to the Greek market and enjoy synergies resulting from sharing the experience of implementation of ADSL technology. The Group believes that the closing of the transaction, which is subject to certain conditions precedent, including approval of Greek regulatory authorities, will take place in the first half of 2007. The management believes that the fair value of the contract as of December 31, 2006 is not material for the Group's consolidated financial statements.

Pro forma results of operations (unaudited)

The following pro forma financial data for the years ended December 31, 2006 and 2005, give effect to the acquisitions of Intracom Telecom, UCN, BCTI, Cosmos Hotel, Pekin Hotel and acquisitions of additional interests in EWUB, MGTS, MTS, ReCom, Sibintertelecom, Telesot Alania and Gorizont-RT as if they had occurred as of January 1, 2005:

		2006		2005
Revenues	$	10,862,782	$	8,026,138
Income before extraordinary gain		819,181		567,720
Net income		819,181		571,676
Earnings per share, basic and diluted:	$	85.6	$	60.3

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated at the beginning of the respective period, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions.

4. DISPOSITIONS AND CAPITAL TRANSACTIONS OF SUBSIDIARIES AND ASSOCIATES

In November 2006, Sistema-Hals completed its initial public offering ("IPO") of 1,738,650 newly issued shares, and in addition, the Group sold 112,171 ordinary shares, in the form of global depository receipts ("GDRs"), with 20 GDR representing 1 share of common stock. The gross proceeds from Sistema-Hals IPO and subsequent sale of shares amounted to approximately $432.1 million. The transaction resulted in an increase of the Group's additional paid-in capital of $301.4 million, and a gain from disposal of $19.2 million. As a result of the IPO, the Group's effective ownership in Sistema-Hals decreased from 100% to 80%.

In July 2006, the Group disposed of Glorerly, a subsidiary holding 35.0% interest in Sistema-Invest, the owner of the Group's energy companies in the Republic of Bashkortostan for a total cash consideration of $201.0 million. The transaction resulted in a gain from disposal of $175.1 million.

In March 2006, 5.0% of SITRONICS' common shares were sold to Sistema's CEO for a total cash consideration of $14.0 million with a deferral of payment for up to 4 years. The fair value of the shares amounted to approximately $105.0 million. The Group has recorded compensation costs of $91.0 million and a gain from disposal of an interest in a subsidiary of approximately the same amount. Following the transaction, the Group's effective ownership in SITRONICS decreased from 93.0% to 88.2%, which subsequently decreased to 84.5% (Note 27).

In February 2006, Comstar UTS completed its IPO of 139,000,000 newly issued shares, and in addition, the Group sold 7,500,000 ordinary shares, in the form of global depository receipts ("GDRs"), with each GDR representing 1 share of common stock. The gross proceeds from Comstar UTS' IPO and subsequent sale amounted to $1,060 million. The transaction resulted in an increase of the Group's additional paid-in capital of $418.1 million and a gain from disposal of interest in subsidiaries of $25.8 million. As a result of the IPO the Group's effective ownership in Comstar UTS decreased from 100.0% to 59.1%.

During the year ended December 31, 2006, the Group sold its interests in Literaturnaya Gazeta, TV Stolitsa and Gazeta Metro for the total cash consideration of $9.0 million. These transactions resulted in recognition of an aggregate gain from disposal of $6.4 million.

In December 2005, Rosno sold its interest in Leader, a subsidiary operating in insurance business, for the total cash consideration of approximately $6.0 million. The transaction resulted in recognition of a loss from disposal of $0.2 million.

In November 2005, the Group sold its interests in Kamov Holding for the total cash consideration of approximately $11.8 million. Kamov Holding held a 49.5% stake in Kamov, a helicopter producer. The transaction resulted in a gain from disposal of $10.0 million.

During the year ended December 31, 2005, the Group sold its interests in Nasha Pressa, Stolichnaya Pressa, Concern RadioCenter and certain other media subsidiaries for the total cash consideration of $4.1 million. These transactions resulted in recognition of an aggregate gain from disposal of $5.3 million, and an increase of additional paid-in capital of $1.2 million.

Other

In August 2006, the Group sold its 8.0% stake in Moscow Telecommunication Company ('Comcor') for the cash consideration of $20.0 million. The transaction resulted in gain on disposal of $14.5 million.

In May 2006, the Group sold its 50.0% interest in Regiony, an affiliate operating in the real estate business for the total cash consideration of $3.1 million. The transaction resulted in a gain on disposal of $3.1 million.

5. CASH AND CASH EQUIVALENTS

Cash equivalents amounting to $82.8 million and $154.2 million as of December 31, 2006 and 2005, respectively, are comprised primarily of term deposits with banks and bank promissory notes with original maturities of less than 90 days.

Also included in cash as of December 31, 2006 and 2005, are $56.0 million and $19.6 million, respectively, which represent the MBRD's minimum reserve deposit, required by the Central Bank of RF.

6. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Trading securities:		
RF Eurobonds	$ 7,392	$ 5,013
Corporate bonds	271,584	206,655
Government and municipal bonds	187,782	54,959
Corporate shares	58,981	16,414
Other trading securities	3,878	16,588
	529,617	299,629
Other short-term investments:		
Promissory notes and deposit certificates from third parties	155,997	135,099
Promissory notes from and loans to related parties	95,046	49,162
Bank deposits with original maturities exceeding 90 days	153,692	104,649
Other short-term investments	9,637	5,657
	414,372	294,567
Total	**$ 943,989**	**$ 594,196**

Corporate bonds consist of bonds, denominated mainly in RUB, with maturity dates from 2007 to 2009 and coupon rates of 7-20% per annum, issued by Russian companies, and of bonds, issued by European companies, maturing after 2008 and with coupon rates of 7-12% per annum.

Government and municipal bonds consist of bonds, denominated mainly in RUB, which have maturity dates from 2007 to 2036 and coupon rates of 0-14% per annum, issued by RF and its municipalities, and of bonds, issued by European countries, maturing after 2008 and with coupon rates of 3-11% per annum.

Corporate shares are publicly traded shares of Russian companies. They are reflected at period-end market value based on last trade prices obtained from Moscow Interbank Currency Exchange ("MICEX").

The weighted average interest rate on promissory notes from third parties was 8% as of December 31, 2006 and 2005. The promissory notes from related parties bear weighted average interest of 8% as of December 31, 2006, and were primarily interest free as of December 31, 2005.

The effective interest rates on bank deposits with original maturities exceeding 90 days as of December 31, 2006 were 6% for RUB-denominated deposits and 7% on deposits in USD and Euros. As of December 31, 2005, the effective interest rates on bank deposits with original maturities exceeding 90 days were 4% for RUB-denominated deposits and 7% on deposits in USD.

7. LOANS TO CUSTOMERS AND BANKS, NET

Loans to customers and banks, net of an allowance for loan losses, as of December 31, 2006 and 2005 consisted of the following:

		2006		2005
Loans to customers	$	1,388,673	$	589,521
Loans to banks		503,455		81,424
		1,892,128		670,945
Less: allowance for loan losses		(137,806)		(102,443)
Less: amounts maturing after one year		(464,490)		(117,107)
Loans to customers and banks, current portion	**$**	**1,289,832**	**$**	**451,395**

Loans to customers as of December 31, 2006 and 2005 included loans to affiliates and other related parties of $35.8 million and $47.8 million, respectively. Management anticipates no losses in respect of these amounts.

The following table presents effective average interest rates by categories of loans as of December 31, 2006 and 2005:

	2006			2005		
	RUB	USD	Other currencies	RUB	USD	Other currencies
Loans to customers						
- corporate customers	13.7%	13.2%	13.1%	11.7%	11.4%	9.9%
- individuals	18.0%	12.3%	19.3%	23.0%	11.3%	9.0%
Loans to banks	5.8%	5.8%	3.5%	7.7%	3.2%	2.3%

8. INSURANCE-RELATED RECEIVABLES

Insurance-related receivables as of December 31, 2006 and 2005 consisted of the following:

		2006		2005
Receivables from insurance operations	$	146,271	$	102,422
Advances to health care providers		87,129		47,167
Total	**$**	**233,400**	**$**	**149,589**

9. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Trade receivables	$ 1,156,756	$ 512,217
Less: provision for doubtful accounts	(87,050)	(69,574)
Total	**$ 1,069,706**	**$ 442,643**

Trade receivables as of December 31, 2006 and 2005 include receivables for services provided and goods shipped to the Group's affiliates and other related parties in the amounts of $48.4 million and $30.0 million, respectively. Management anticipates no losses in respect of receivables from related parties and accordingly no provision has been created in respect thereof.

10. PREPAID EXPENSES, OTHER RECEIVABLES AND OTHER CURRENT ASSETS, NET

Prepaid expenses, other receivables and other current assets, net of provision for doubtful accounts, as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Prepaid expenses and advances to suppliers	$ 547,952	$ 369,078
Dividends receivable from energy companies in the Republic of Bashkortostan	83,215	-
Receivables for sale of Glorerly shares	79,078	-
Deferred policy acquisition costs	76,407	31,122
Prepaid taxes	73,658	39,868
Assets held for sale	63,209	-
Security deposit under repurchase agreement	-	42,000
Uzdunrobita put-call option	-	5,956
Receivables for sale of Mikron shares	-	4,870
Receivables for sale of WaveCrest shares	40,674	-
Other	58,188	78,569
Less: provision for doubtful accounts	(12,547)	(3,919)
Total	**$ 1,009,834**	**$ 567,544**

The amortization charge for policy acquisition costs for the years ended December 31, 2006 and 2005 was $137.7 million and $81.9 million, respectively.

11. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Raw materials and spare parts	$ 329,118	$ 171,026
Work-in-progress	74,077	37,352
Costs and estimated earnings in excess of billings on uncompleted contracts	27,802	142,572
Finished goods and goods for resale	230,571	131,959
Total	**$ 661,568**	**$ 482,909**

12. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Land	$ 48,305	$ 16,792
Buildings and leasehold improvements	1,072,615	740,786
Switches, transmission devices, network and base station equipment	5,406,574	4,182,957
Other plant, machinery and equipment	1,015,012	689,884
Construction in-progress and equipment for installation	2,226,211	1,766,778
	9,768,717	7,397,197
Less: accumulated depreciation	(2,315,663)	(1,521,073)
Total	**$ 7,453,054**	**$ 5,876,124**

Depreciation expense for the years ended December 31, 2006 and 2005 amounted to $866.1 million and $630.1 million, respectively.

13. LICENSES, NET

Licenses, net of accumulated amortization, as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Operating licenses	$ 1,042,164	$ 1,000,390
Less: accumulated amortization	(589,792)	(385,348)
Total	**$ 452,372**	**$ 615,042**

Amortization expense for licenses for the years ended December 31, 2006 and 2005 amounted to $213.5 million and $194.3 million, respectively.

The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

Year ended December 31,	
2007	$ 137,539
2008	127,120
2009	80,034
2010	33,886
2011	29,972
Thereafter	43,821
	$ 452,372

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new licenses acquisitions, changes in useful lives and other relevant factors.

14. OTHER INTANGIBLE ASSETS, NET

Intangible assets, other than goodwill and licenses, net of accumulated amortization, as of December 31, 2006 and 2005 consisted of the following:

	2006			2005		
	Gross carrying value	Accumu-lated amorti-zation	Net carrying value	Gross carrying value	Accumu-lated amorti-zation	Net carrying value
Amortized intangible assets:						
Acquired customer base	$ 266,305	(164,969)	101,336	$ 200,931	(121,876)	79,055
Radio frequencies	163,963	(52,882)	111,081	130,839	(31,227)	99,612
Numbering capacity with finite contractual life, software and other	1,351,610	(509,987)	841,623	901,812	(339,463)	562,349
	1,781,878	(727,838)	1,054,040	1,233,582	(492,566)	741,016
Unamortized intangible assets:						
Trademarks	147,449	-	147,449	126,176	-	126,176
Numbering capacity with indefinite contractual life	28,232	-	28,232	19,080	-	19,080
Total intangible assets	**$ 1,957,559**	**(727,838)**	**1,229,721**	**$ 1,378,838**	**(492,566)**	**886,272**

Amortization expense recorded on other intangible assets for the years ended December 31, 2006 and 2005 amounted to $210.3 million and $203.8 million, respectively. The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

Year ended December 31,	
2007	$ 311,012
2008	257,440
2009	212,520
2010	136,317
2011	40,475
Thereafter	96,276
	$ 1,054,040

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

15. INVESTMENTS IN AFFILIATES

Investments in affiliates as of December 31, 2006 and 2005 consisted of the following:

	2006		2005	
	Voting power, %	Carrying value	Voting power, %	Carrying value
Shares of energy companies in the Republic of Bashkortostan	Various	$ 826,960	Various	$ 636,865
MTT	50%	108,851	50%	73,984
MTS Belarus	49%	119,802	49%	66,288
Metrocom (Note 34)	45%	15,635	45%	12,774
Cosmos Hotel (Note 3)	consolidated		43%	21,614
East-West United Bank	consolidated		49%	17,749
ZETA Telecom	consolidated		49%	6,338
SkyLink	50%	-	50%	3,200
Loans to MTS Belarus	-	21,341	-	41,341
Loans to SkyLink	-	5,354	-	16,809
Other investments and loans to investees	Various	10,704	Various	17,241
Total		**$ 1,108,647**		**$ 914,203**

Investments in affiliates as of December 31, 2006 and 2005 include $21.3 million and $41.3 million, respectively, in loans to MTS Belarus bearing interest at 3% to 11% per annum.

Investments in shares of energy companies in the Republic of Bashkortostan represent investments in several oil and oil-refining companies. As of December 31, 2006 and 2005, these investments included:

	Ownership interest	
	2006	**2005**
ANK Bashneft	25.8%	25.0%
Novoil	29.6%	28.2%
Ufimsky NPZ	27.7%	25.5%
Ufaneftekhim	28.5%	22.4%
Ufaorgsintez	26.3%	24.9%
Bashnefteproduct	27.4%	18.7%

The most recent financial information available for the energy companies in the Republic of Bashkortostan are as of September 30, 2006. The aggregate financial position and results of operations of these companies as of and for the year ended September 30, 2006 are as follows:

As of September 30, 2006 (unaudited)

Current assets	$	1,572,483
Non-current assets	$	3,198,922
Current liabilities	$	(466,761)
Non-current liabilities	$	(590,394)

For the year ended September 30, 2006 (unaudited)

Revenues	$	5,723,288
Operating income	$	1,084,852
Net income	$	543,362

The aggregate financial position and results of operations of MTT, MTS Belarus and SkyLink as of and for the year ended December, 2006 are as follows:

As of December 31, 2006 (unaudited)

Current assets	$	386,740
Non-current assets	$	1,056,344
Current liabilities	$	(543,138)
Non-current liabilities	$	(521,678)

For the year ended December 31, 2006 (unaudited)

Revenues	$	1,032,370
Operating income	$	227,094
Net income	$	151,496

Based on projected cash flows of MTS Belarus and SkyLink, the Group has concluded that no impairment of the Group’s investments in MTS Belarus and SkyLink has occurred as of December 31, 2006.

16. OTHER INVESTMENTS

In August 2006, the Group acquired 81% of voting shares of CJSC Sahles for US$122.5 million in cash. Sahles owns controlling stakes in the entities constituting the Perm Motors group ("PM"). PM is involved in aircraft engine manufacturing.

The corporate structure of PM was designed in a manner that prevented the Group from obtaining operational control over activities of PM during the year ended December 31, 2006. In particular, the Group was unable to obtain consolidated financial statements of PM as of December 31, 2006 and for the year then ended prepared in accordance with US GAAP or perform purchase price allocation in respect of this acquisition. Due to lack of control over PM, during the year ended December 31, 2006 the Group has accounted for its investments in PM at cost. The Group is currently determining its further strategy in respect of PM.

In December 2005, MTS acquired a 51.0% stake in Tarino Limited ("Tarino") for $150.0 million in cash from Nomihold Securities Inc ("Nomihold"). Tarino was at that time the indirect owner, through its wholly-owned subsidiaries, of Bitel LLC ("Bitel"), a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan.

Concurrently with the purchase of a 51.0% stake, MTS entered into a put and call option agreement with Nomihold to acquire the remaining 49.0% interest in Tarino. The call option was exercisable by MTS from November 22, 2005 to November 17, 2006, and the put option was exercisable by the seller from November 18, 2006 to December 8, 2006. The call and put option price was $170.0 million. The put and call option was recorded at fair value, which approximated nil at December 31, 2005. At December 31, 2006, a liability of $170.0 million was recorded.

After the decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. MTS could not re-gain operating control over Bitel's operations in 2005 and therefore accounted for its 51.0% investment in Bitel at cost as at December 31, 2005.

During 2006, MTS took steps to vindicate its ownership rights in Bitel although these efforts so far have not proven to be successful. The matter was brought to the Kyrgyz Prosecutor General for investigation. On January 15, 2007, the Prosecutor General informed MTS that it sees no grounds to become involved in the ownership dispute over Bitel and additionally stated that MTS had no basis to appeal the decision of the Kyrgyz courts in connection with the ownership of Bitel.

In addition, an appeal to overturn certain adverse Kyrgyz courts rulings connected with ownership rights to Bitel was also filed with the Kyrgyz Supreme Court on December 15, 2006, but the time period in which the appeal should have been heard has expired without any action by the court.

Consequently the decision was made by MTS to write off the costs associated with the purchase of 51.0% stake in Bitel. As of December 31, 2006 the investment was fully impaired. Furthermore, as noted above, with the impairment of the underlying asset, a liability of $170.0 million was recorded with an associated charge to non-operating expenses.

Simultaneously, MTS brought damage claims in the High Court of Justice in the Isle of Man seeking damages for the misappropriation and forced seizure of Bitel and its assets against a number of companies. It is not possible at this time to predict the outcome or resolution of any such disputes or litigation; however, MTS believes that its position is meritorious.

In January 2007, Nomihold brought the claim to the London Court of International Arbitration ("LCIA") seeking to exercise the put option by MTS.

Also, there is on-going arbitration in the United Kingdom related to Tarino's ownership in Bitel. Kyrgyzstan Mobitel Investment Company Limited ("KMIC") has initiated a separate arbitration proceeding against the three Isle of Man companies affiliated with the Group ("the KFG Companies") claiming that the KFG Companies breached a May 31, 2003 Transfer Agreement concerning the shares of Bitel. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited ("IPOC") although IPOC subsequently assigned its interest KMIC, and KMIC

was the claimant in the arbitration. This claim occurred prior to MTS Finance's acquisition of the KFG Companies. It is possible there may be additional or related disputes concerning agreements with respect to Tarino Limited. It is not possible at this time to predict the outcome or final resolution of any such disputes or litigation.

In addition, the KFG Companies have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel in the amount of approximately $25.2 million plus compensatory damages, and to recover approximately $3.7 million in losses and accrued interest. In the event that the defendants do not prevail in these lawsuits, MTS may be liable to Bitel for such claims. The KFG Companies have also asserted counterclaims against Bitel, and claims against other defendants including Altimo and Altimo Holding, for the wrongful appropriation and control of Bitel. It is not possible at this time to predict the outcome or resolution of these claims.

17. OTHER NON-CURRENT ASSETS

Other non-current assets as of December 31, 2006 and 2005 consisted of the following:

		2006		2005
Loans, promissory notes and deposits with third parties	$	121,206	$	5,423
Restricted cash		79,331		10,607
Long-term receivables		79,435		-
Net investments in leases		76,034		6,563
Loans, promissory notes and deposits with related parties		69,282		15,265
Mutual investment funds		34,317		11,168
Other		23,559		12,453
Total	**$**	**483,164**	**$**	**61,479**

Loans and promissory notes from related parties are mostly RUB-denominated and interest-free. The majority of such loans and promissory notes mature in 2008.

Restricted cash as of December 31, 2006 consists mainly of the deferred compensation of EURO 35 million ($46.1 million as at December 31, 2006) placed by SITRONICS on an escrow account deposit in accordance with the terms of the purchase agreement of Intracom Telecom, and of cash in the amount of $24.8 million deposited by Uzdunrobita, a subsidiary of MTS, on the special bank account.

Long-term receivables carry interest varying from 0.0% to EURIBOR+1.5%-2.5% per annum and mature in 2008 to 2013.

18. BANK DEPOSITS AND NOTES ISSUED

Bank deposits and notes issued as of December 31, 2006 and 2005 consisted of the following:

		2006		2005
Term deposits	$	629,638	$	294,711
Promissory notes issued		86,883		111,788
Deposits repayable on demand		269,048		90,330
		985,569		496,829
Less: amounts maturing after one year		(65,200)		(37,200)
Total	**$**	**920,369**	**$**	**459,629**

Bank deposits and notes issued as of December 31, 2006 and 2005 include deposits from and promissory notes issued to affiliates and other related parties for $4.5 million and $1.9 million, respectively.

The following table presents effective average interest rates by categories of bank deposits and notes issued as of December 31, 2006 and 2005:

	2006			2005		
	RUB	**USD**	**Other currencies**	**RUB**	**USD**	**Other currencies**
Term deposits:						
- corporate customers	5.9%	6.6%	5.9%	7.0%	6.6%	-
- individuals	10.3%	8.8%	7.0%	9.6%	8.4%	5.9%
Promissory notes issued	8.3%	9.3%	6.0%	8.2%	4.7%	6.8%
Deposits repayable on demand:						
- corporate customers	2.4%	4.9%	-	1.6%	1.8%	0.2%
- individuals	2.0%	0.5%	0.5%	1.0%	0.4%	0.5%

19. INSURANCE-RELATED LIABILITIES

Insurance-related liabilities as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Unearned premium provision, net of reinsurance	$ 317,247	$ 167,446
Loss provision, net of reinsurance	126,904	89,571
Undisbursed GFOMI funds	144,269	80,071
Other insurance-related liabilities	132,772	75,240
Total	**$ 721,192**	**$ 412,328**

Usage of GFOMI funds, in the amount of $144.3 million, accumulated and undisbursed by Rosno as of December 31, 2006, is limited to payments for medical facilities and care provided to RF citizens by medical centers under GFOMI's obligatory medical insurance program.

20. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Payroll and other accrued expenses	$ 477,077	$ 236,454
Bitel liability (Note 16)	170,000	-
Accrued interest on loans	121,951	77,746
Customers' advances	96,679	46,974
Payable for purchase of Intracom Telecom shares (Note 3)	46,122	-
Tax and legal provisions	29,756	35,020
Dividends payable	3,468	2,137
Other	76,822	119,120
Total	**$ 1,021,875**	**$ 517,451**

21. SHORT-TERM LOANS PAYABLE

Short-term loans payable as of December 31, 2006 and 2005 consisted of the following:

	Interest rate (Actual at December 31, 2006)	2006	2005
USD-denominated:			
ABN Amro Bank	LIBOR+1.2% (6.6%)	$ 675,000	$ 49,816
Deutsche Bank	8.7%	140,000	132,000
Nomura International	8.5%	100,000	-
UBS AG	8.7%	100,000	-
Citibank, ING Bank N.V. and Raiffeisen AG	-	-	200,000
ING Bank N.V.	-	-	150,000
Other	Various	44,359	78,630
		1,059,359	610,446
EUR-denominated:			
Societe Generale – Geniki Bank	EURIBOR+1.2% (5.4%)	25,662	-
Eurobank	EURIBOR+1.2% (5.4%)	10,937	-
Other	Various	34,279	-
		70,878	-
Borrowings in other currencies	Various	162,816	6,943
Loans from related parties	Various	4,115	6,943
Total		**$ 1,297,168**	**$ 637,769**

Short-term loans and notes payable are not secured and mature in 2007.

The Deutsche Bank, Nomura International and UBS AG credit facilities require Sistema-Hals not to incur indebtedness unless the aggregate of all indebtedness does not exceed 60% of the aggregate market value of Sistema-Hals properties as valued by an internationally recognized valuation expert, and the ratio of EBITDA to interest expense is no less than 2:1. The loan facilities also include certain negative covenants restricting or limiting Sistema-Hals ability to dispose of any assets unless such disposal is made for consideration at least equal to the fair market value of the assets disposed of, and at least 75% of the consideration received is in the form of cash, cash equivalents or certain capital stock; to change substantially the general nature of Sistema-Hals business; to merge or otherwise reorganize, save where Sistema-Hals is the surviving entity and such reorganizations might not reasonably be expected to have a material adverse effect; to repay or prepay any indebtedness of the Group which is subordinated in right of payment to the facility; and to make investments in certain of the Group subsidiaries.

22. LONG-TERM DEBT

Long-term debt as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Notes and corporate bonds	$ 2,497,838	$ 2,192,521
Loans from banks and financial institutions	3,005,509	1,475,535
Loans from related parties	23,162	26,594
Capital leases	15,874	9,902
Vendor financing	6,001	16,260
Other borrowings	28,060	12,029
	5,576,444	3,732,841
Less amounts maturing within one year	(280,427)	(523,530)
Total	**$ 5,296,017**	**$ 3,209,311**

Notes and corporate bonds as of December 31, 2006 and 2005 consisted of the following:

	Currency	Interest rate	2006	2005
Sistema Capital Notes due 2011	USD	8.9%	$ 350,000	$ 350,000
Sistema Finance Notes due 2008	USD	10.3%	312,471	350,000
MTS Finance Notes due 2012	USD	8.0%	400,000	400,000
MTS Finance Notes due 2010	USD	8.4%	400,000	400,000
MTS Finance Notes due 2008	USD	9.8%	400,000	400,000
SITRONICS Finance Bonds due 2009	USD	7.8%	200,000	-
MBRD Loan Participation Notes due 2016	USD	8.9%	60,000	-
MBRD Loan Participation Notes due 2008	USD	8.6%	150,000	150,000
MBRD Capital Notes due 2009	USD	8.8%	100,000	-
MGTS Bonds due 2010	RUB	8.3%	55,842	52,115
MGTS Bonds due 2009	RUB	7.1%	27,533	52,115
DMC Bonds due 2015	RUB	8.5%	43,654	39,954
			2,499,500	2,194,184
Less: unamortized discount			(1,662)	(1,663)
Total notes and corporate bonds			**$ 2,497,838**	**$ 2,192,521**

Sistema Capital Notes are listed on the London Stock Exchange and Sistema Finance Notes are listed on the Luxembourg Stock Exchange. JSFC Sistema is a guarantor of the notes. The notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions on mergers or consolidations, limitations on liens and dispositions of assets and limitations on transactions with affiliates. In addition, these notes provide the holders with a right to require the Group to redeem all of the notes outstanding at 101.0% of the principal amount of the notes plus accrued interest upon any change in control.

Sistema Finance Notes are secured by 193,473,900 shares of common stock of MTS.

MTS Finance Notes are fully and unconditionally guaranteed by MTS. The notes are listed on the Luxembourg Stock Exchange. Subject to certain exceptions and qualifications, the indentures governing MTS' notes contain covenants limiting MTS' ability to incur debt; create liens; lease properties sold or transferred by MTS; enter into loan transactions with affiliates; merge or consolidate with another person or convey its properties and assets to another person; and sell or transfer any of its GSM licenses for Moscow, St. Petersburg, Krasnodar and Ukraine license areas. In addition, if MTS experiences certain types of mergers, consolidations or other changes in control, noteholders will have the right to require MTS to redeem the notes at 101.0% of their principal amount, plus accrued interest. MTS is also required to take all commercially reasonable steps necessary to maintain a rating of the notes from Moody's or Standard & Poor's. The notes also have cross default provisions with publicly traded debt issued by JSFC Sistema. If MTS fails to meet these covenants, after certain notice and cure periods, the noteholders can accelerate debt to be immediately due and payable.

SITRONICS Finance Bonds are fully and unconditionally guaranteed by SITRONICS. The notes are listed on the London Stock Exchange and are subject to certain restrictive covenants to SITRONICS, including, but not limited to, limitations on the incurrence of additional indebtedness, any merger, consolidation or disposition of assets, and compliance with certain financial ratios.

MBRD Loan Participation Notes and MBRD Capital Notes are traded on the Luxembourg Stock Exchange. MBRD's notes are subject to certain restrictive covenants including, but not limited to, limitations on mergers, liens and dispositions of assets and transactions with MBRD's subsidiaries and affiliates.

MGTS and DMC bonds are listed on MICEX. The principal of DMC bonds is fully and unconditionally guaranteed by the Moscow City Government. Concurrently, JSFC Sistema has pledged to Moscow City Government real estate and shareholdings for the amount of approximately $62.8 million.

Management believes that the Group is in compliance with all restrictive provisions of notes and corporate bonds as of December 31, 2006.

Loans from banks and financial institutions as of December 31, 2006 and 2005 consisted of the following:

	Maturity	**Interest rate (Actual at December 31, 2006)**	**2006**	**2005**
USD-denominated:				
Syndicated Loan Facility to MTS	2008-2011	LIBOR+0.8% (6.4%)	$ 860,000	-
Syndicated Loan to MTS	-	-	-	$ 460,000
VTB	2010	8.5%	600,000	52,920
EBRD	2011	LIBOR+3.1% (8.5%)	250,000	139,387
Citibank International plc and ING Bank N.V.	2007-2014	LIBOR+0.3% (5.7%)	150,208	111,009
HSBC Bank plc and ING BHF Bank AG	2007-2013	LIBOR+0.4% (5.8%)	149,984	171,816
Commerzbank AG, ING Bank AG and HSBC Bank plc	2007-2014	LIBOR+0.3% (5.7%)	118,324	92,826
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	2007-2014	LIBOR+0.3% (5.7%)	117,109	63,338
Barclays Bank plc	2007-2014	LIBOR+0.2% (5.5%)	98,672	80,086
Vnesheconombank	2008-2009	LIBOR+3.0% (8.4%)	71,213	-
Dresdner Bank	2008	LIBOR+1.3% (6.7%)	50,000	-
ABN AMRO Bank	2007-2013	LIBOR+0.4% (5.7%)	44,009	70,297
Commerzbank (Eurasia)	2007-2010	LIBOR+3.5% (8.9%)	42,516	34,071
Other	2007-2015	Various	76,249	78,637
			$ 2,628,284	$ 1,354,387
EUR-denominated:				
Syndicated Loan to Intracom Telecom	2007	EURIBOR+1.6% (5.1%)	121,200	-
Deutsche Bank AG	2009	EURIBOR+4.0% (7.9%)	105,360	-
ING BHF Bank and Commerzbank AG	2007-2009	EURIBOR+0.7% (4.5%)	34,360	43,168
ABN AMRO Bank	2007-2013	EURIBOR+0.4% (4.2%)	31,921	32,882
VTB	2010-2012	EURIBOR+3.8%-5.4% (7.7%-9.6%)	21,428	13,107
Other	2007-2010	Various	35,417	11,206
			$ 349,686	$ 100,363
Other currencies	2007-2018	Various	$ 27,539	$ 20,785
Total			**$ 3,005,509**	**$ 1,475,535**

The syndicated Loan Facility to MTS provided by a group of international financial institutions, including The Bank of Tokyo-Mitsubishi UFJ Ltd., Bayerische Landesbank, HSBC Bank plc., ING Bank N.V., Raiffeisen Zentralbank Oesterreich AG and Sumitomo Mitsui Banking Corporation Europe Ltd., is subject to certain restrictive covenants, including, but not limited to, certain financial ratios, limitations on dispositions of assets and limitations on transactions with the Group.

The loan facility of $600.0 million from VTB is collateralized by the pledge of 19.9% of the shares of each of Novoil, Ufimsky NPZ, Ufaneftekhim, ANK Bashneft and Ufaorgsintez and 18.6% of Bashnefteproduct. The facility is subject to certain restrictive covenants, including, but not limited to, any merger, consolidation or disposition of assets, which can deteriorate Sistema-Invest’s solvency.

Other credit facilities provided to MTS by international financial institutions, including (i) EBRD, (ii) Citibank International plc and ING Bank N.V., (iii) HSBC Bank plc and ING BHF Bank AG, (iv) Commerzbank AG, ING Bank AG and HSBC Bank plc, (v) HSBC Bank plc, ING Bank Deutschland AG and Bayerische Landesbank, (vi) Barclays Bank plc and (vii) ABN AMRO Bank, are subject to certain restrictive covenants, including, but not limited to, certain financial ratios and covenants restricting MTS’ ability to convey or dispose its properties and assets to another person and limitations on transactions with the Group.

The loan from Dresdner Bank is subject to certain covenants, including, but not limited to, covenants restricting JSFC Sistema’s ability to convey or dispose its properties and assets to another person.

The Intracom Telecom Syndicated Loan is guaranteed by Intracom Holding S.A. and contains certain restrictive covenants, including, but not limited to, compliance with certain financial ratios.

Equipment with approximate carrying value of $30.2 million is pledged to collateralize some of the other loan facilities provided to the Group.

Management believes that the Group is in compliance with all restrictive provisions of loans and credit facilities as of December 31, 2006.

The Group's lease arrangements are primarily for telecommunication equipment and vehicles. The net book value of leased assets comprised $12.1 million and $24.7 million as of December 31, 2006 and 2005, respectively. Interest expense on the leases was $0.2 million and $0.6 million for the years ended December 31, 2006 and 2005, respectively.

Loans from related parties and vendor financing are denominated in various currencies and primarily are interest free.

The schedule of repayments of long-term debt over the five-year period beginning on December 31, 2006 is as follows:

Year ended December 31,		
2007	$	280,427
2008		1,553,385
2009		1,164,091
2010		1,231,579
2011		493,148
Thereafter		853,814
Total	**$**	**5,576,444**

Available Credit Facilities – In December 2006, the Group established a $3,000.0 million Guaranteed Debt Issuance Programme which has been approved for listing and regulated market trading purposes by the London Stock Exchange. The Programme provides for the issuance of notes with maturities of up to 30 years, subject to compliance with all relevant laws, regulations and directives.

In December 2006, Sistema-Hals entered into an agreement with Eurohypo AG to open a credit facility to finance the development of the Hals Mart ("Leto"), retail and entertainment complex in Saint-Petersburg. The amount of the facility is the lower of $106.4 million or 70% of budgeted costs for financing of the development. The facility may be prolonged up to 12 years and the facility amount can be extended up to $187.5 million. To obtain the facility Sistema-Hals must comply with certain conditions precedent. As of the date of these financial statements, the conditions precedent have not been fulfilled.

The Group's other available credit facilities as of December 31, 2006 comprised $481.0 million, including $470.0 million under the MTS Syndicated Loan Facility.

Hedging Transactions – In December 2004, MTS entered into two variable-to-fixed interest rate swap agreements with ABN AMRO Bank and with HSBC Bank plc to hedge MTS' exposure to variability of future cash flows caused by the change in LIBOR related to the Syndicated Loan. MTS agreed with ABN AMRO to pay a fixed rate of 3.3% and receive a variable interest of LIBOR on $100.0 million for the period from October 2004 up to July 2007. MTS agreed with HSBC Bank plc to pay a fixed rate of 3.3% and receive a variable interest of LIBOR on $150.0 million for the period from October 2004 up to July 2007. As of December 31, 2005, the Group recorded an asset of $3.6 million in relation to these contracts in the accompanying consolidated balance sheet and an income of $1.5 million, net of minority interest of $1.3 million and tax of $0.4 million, as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements. The Syndicated Loan was repaid ahead of schedule in July 2006, which resulted in early termination of the swap agreements.

In January 2006, MTS entered into a variable-to-fixed interest rate swap agreement with HSBC Bank Plc to hedge MTS' exposure to variability of future cash flows caused by the change in EURIBOR related to the ABN AMRO Bank. MTS agreed with HSBC Bank plc to pay a fixed rate of 3.3% and receive a variable interest of EURIBOR on EUR 26.0 million for the period from April 2006 up to October 2013. As of December 31, 2006, the Group recorded an asset of $1.0 million in relation to hedge contract in the accompanying consolidated balance sheet and an income of $0.4 million, net of minority interest of $0.4 million and tax of $0.1 million, as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements.

23. SUBSCRIBER PREPAYMENTS

Subscriber prepayments as of December 31, 2006 and 2005 consisted of the following:

	2006	2005
Current portion		
Advances and customers' deposits	$ 463,134	$ 389,340
Connection fees	89,863	83,333
	552,997	472,673
Non-current portion		
Connection fees	136,861	163,897
Total	**$ 689,858**	**$ 636,570**

24. INCOME TAX

The Group's provision for income taxes for the years ended December 31, 2006 and 2005 was:

	2006	2005
Current provision	$ 911,569	$ 618,913
Deferred benefit	(108,140)	(105,920)
Total income tax expense	**$ 803,429**	**$ 512,993**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate of 24% to income before income tax, equity in net income of energy companies in the Republic of Bashkortostan, minority interests and extraordinary gain. The items causing this difference are as follows:

	2006	2005
Income tax provision computed on income before taxes at statutory rate	$ 544,909	$ 428,150
Adjustments due to:		
Change in valuation allowance	(19,950)	(1,366)
Bitel liability and investments write-off	76,800	-
Other non-deductible items	175,872	61,334
Non-taxable items	(13,043)	(5,775)
Taxable losses not carried forward	16,623	36,820
Currency exchange and translation differences	46,170	(9,714)
Effect of rates different from standard	(23,952)	3,544
Income tax expense	**$ 803,429**	**$ 512,993**

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	2006	2005
Deferred tax assets		
Subscriber and customer prepayments	$ 85,517	$ 86,300
Property, plant and equipment	148,439	71,650
Intangible assets	46,991	25,966
Deferred revenues	27,205	25,007
Allowance for doubtful accounts and loans receivable	36,411	31,414
Accrued expenses	121,159	57,381
Tax losses carried forward	6,193	14,369
Other	14,523	17,813
	486,438	329,900
Less: valuation allowance	(33,144)	(13,416)
Total deferred tax assets	**$ 453,294**	**$ 316,484**
Deferred tax liabilities		
Intangible assets	(198,898)	(231,838)
Property, plant and equipment	(206,055)	(118,784)
Undistributed earnings of subsidiaries and affiliates	(59,115)	(23,345)
Debt issuance costs	(19,253)	(19,839)
Other	(43,507)	(31,590)
Total deferred tax liabilities	**$ (526,828)**	**$ (425,396)**
Net deferred tax assets, current	$ 195,672	$ 123,681
Net deferred tax assets, long-term	$ 73,623	$ 33,472
Net deferred tax liabilities, current	$ (52,714)	$ (28,149)
Net deferred tax liabilities, long-term	$ (290,115)	$ (237,916)

Deferred tax assets relating to tax losses carried forward in the amount of $3.4 million as of December 31, 2006, expiring in 2011, are attributable to Intracom Telecom. Deferred tax assets relating to tax losses carried forward in the amount of $2.8 million as of December 31, 2006, expiring in 2016, are attributable to Comstar UTS.

The Group does not record a deferred tax liability related to undistributed earnings of its subsidiaries, except for MTS, as it intends to permanently reinvest these earnings. The deferred tax liability on future distributions of MTS is recorded in accordance with the MTS dividend policy.

25. POSTRETIREMENT BENEFITS

Intracom Telecom

Intracom Telecom's postretirement benefit obligations relate to a defined benefit plan in accordance with the Greek labor legislation, based on which the employee is entitled to indemnity in the event of termination of employment upon dismissal or retirement.

The amount of compensation is based on the number of years of service and the amount of remuneration at the date of dismissal or retirement. If the employees remain in the employment of the Group until normal retirement age, they are entitled to retirement compensation which is equal to 40% of the compensation amount that would be payable if they were dismissed at that time.
In addition, Intracom Telecom is required to pay a lump-sum payment equivalent to 14 up to 28 monthly salaries, payable upon death of an employee depending on past service.

Intracom Telecom's postretirement benefit liability is unfunded. The following are the key assumptions used in determining the projected benefit obligation and net periodic benefit cost:

Discount rate	4.6%
Future salary increases	4.5%

The change in the projected benefit obligation and the change in plan assets for the year ended December 31, 2006, are presented in the following table:

		2006
Projected benefit obligation, beginning of the year	$	4,066
Service cost		523
Interest cost		253
Plan amendments		787
Benefit payments		(512)
Actuarial losses		1,085
Currency translation effect		588
Projected benefit obligation, end of the year	**$**	**6,790**

The components of the net periodic benefit cost for the year ended December 31, 2006 are as follows:

		2006
Service cost	$	523
Interest cost		253
Net periodic benefit cost	**$**	**776**

The future payments to employees under the plan are expected as follows:

Year ended December 31,		
2007	$	580
2008		632
2009		698
2010		764
2011-2015		4,116
Total	**$**	**6,790**

As of December 31, 2006, the long-term portion of post-retirement benefit liabilities amounted to $6.2 million.

MGTS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently the main features under the defined benefit pension program include the following:

Monthly Regular Pension – Employees retiring with at least fifteen years of service receive lifetime payments varying from RUB 3,600 (equivalent of USD 137 as of December 31, 2006) to RUB 50,400 (equivalent of USD 1,914 as of December 31, 2006) per year depending on employee's actual years of service and qualification;

Death-in-Service – Lump-sum payment of RUB 15,000 (equivalent of USD 570 as of December 31, 2006), payable upon death of an employee, irrespective of past service;

Lump-sum upon Retirement – Lump-sum payment upon retirement of employees with at least five years of service varying from RUB 3,700 (equivalent of USD 141 as of December 31, 2006) to RUB 22,200 (equivalent of USD 843 as of December 31, 2006) depending on employee's actual years of service;

Monthly Telephone Subsidy – Qualifying pensioners (those who served more than 30 years at MGTS) get 50% subsidy (approximately USD 3.5 per month as of December 31, 2006) for their monthly telephone bills from MGTS;

Death-while-pensioner – MGTS pays lump-sum benefits to relatives of deceased pensioners of up to RUB 10,000 (equivalent of USD 380 as of December 31, 2006).

The Group's contributions to MGTS' plan assets are managed by Pension Fund Sistema, a subsidiary of Sistema. The following are the key assumptions used in determining the projected benefit obligation and net periodic benefit cost:

	2006	2005
Discount rate	6.5%	9.2%
Future salary increases	6.5%	9.2%
Future pension increases	0.0%	0.0%
Average life expectancy of members from date of retirement	17 years	17 years

The change in the projected benefit obligation and the change in plan assets are presented in the following table:

	2006	2005
Change in projected benefit obligation		
Projected benefit obligation, beginning of the year	$ 18,868	$ 13,550
Service cost	(8,538)	2,914
Interest cost	1,232	1,441
Actuarial losses	6,352	2,118
Benefit payments	(365)	(668)
Currency translation effect	(1,607)	(487)
Projected benefit obligation, end of the year	15,942	18,868
Change in fair value of plan assets		
Fair value of plan assets, beginning of the year	2,651	2,037
Actual return on plan assets	337	667
Employer contributions	3,137	614
Benefits paid	(365)	(666)
Fair value of plan assets, end of the year	5,760	2,650
Unfunded status of the plan, end of the year	**$ 10,182**	**$ 16,216**

The changes in the projected benefit obligation due to actuarial losses for the years ended December 31, 2006 and 2005 relate primarily to the changes in discount rate and employees turnover assumptions.

The accumulated benefit obligation as of December 31, 2006 and 2005 was $15.9 million and $18.9 million, respectively. The components of the net periodic benefit cost for the years ended December 31, 2006 and 2005 are as follows:

	2006	2005
Service cost	$ (8,538)	$ 2,914
Interest cost	1,232	1,441
Net periodic benefit cost	**$ (7,306)**	**$ 4,355**

The Group's management expects contributions to the plan during the year ended December 31, 2007 to amount to $1.1 million.

The future benefit payments to retirees under the defined benefit plan are expected as follows:

Year ended December 31,		
2007	$	3,737
2008		1,441
2009		1,390
2010		1,343
2011		1,300
2012-2016		4,867
Total	**$**	**14,078**

26. DEFERRED REVENUE

Deferred revenue is comprised of property, plant and equipment contributions and grants received by the Group and as of December 31, 2006 and 2005 was as follows:

		2006		**2005**
Deferred revenue at the beginning of the year	$	125,700	$	130,913
Contributions received during the year		5,616		6,369
Currency translation effect		11,442		(4,693)
		142,758		132,589
Deferred revenue amortized		(3,996)		(6,889)
Effect of acquisitions		(9,642)		-
Deferred revenue at the end of the year	**$**	**129,120**	**$**	**125,700**

27. PUTTABLE SHARES OF SITRONICS

In September 2006, SITRONICS entered into a subscription agreement with European Bank for Reconstruction and Development ("EBRD") pursuant to which SITRONICS issued 293,476,990 new common shares which were acquired by EBRD for a total cash consideration of $80.0 million. As a result, EBRD became a holder of a 3.67% stake in SITRONICS. In addition, JSFC Sistema and EBRD entered into a shareholders' agreement pursuant to which JSFC Sistema agreed, for the duration of the agreement, not to reduce its ownership interest in SITRONICS to less than 50.0%+1 share without the prior consent of EBRD. Furthermore, if JSFC Sistema decides to sell its controlling interest in SITRONICS, it must offer EBRD the opportunity to sell its shares on the same terms.

In addition, if JSFC Sistema contemplates a purchase of additional shares in SITRONICS, either existing or newly issued, EBRD must be given the opportunity to participate in such a purchase on a pro rata basis, unless such purchase is necessary or desirable for the success of an initial public offering of SITRONICS' shares. The Group has the right of first refusal if EBRD decides to divest its interests in SITRONICS. EBRD also agreed not to sell any of its shares for 180 days following the initial public offering of SITRONICS' shares. The term of the agreement extends up to two years after the date of the offering, except in certain circumstances.

In addition, simultaneously with the subscription agreement and the shareholders' agreement, JSFC Sistema entered into a put option agreement with EBRD pursuant to which EBRD has the right to sell to JSFC Sistema all of its shares in SITRONICS under certain circumstances during the period of up to two years after the date of the offering. If EBRD exercises its put option, Sistema will pay EBRD approximately $80.0 million plus (1) interest at a rate of 10.0% per annum if the value of SITRONICS' shares is between $1.6 billion and $2.1 billion upon the completion of the offering or (2) interest at the LIBOR+2.5% (7.2% as of December 31, 2006) per annum if the value of SITRONICS' shares is less than $1.6 billion or more than $2.1 billion upon the completion of the offering.

28. SHARE CAPITAL

At January 1, 2005, JSFC Sistema had 8,100,000 voting common shares issued and outstanding with par value of RUB 90.0.

In February 2005, JSFC Sistema completed an initial public offering of 1,550,000 common shares, with a nominal value of RUB 90 per share in the form of 77,500,000 global depositary receipts ("GDRs"), with 50 GDRs representing one share. On February 14, 2005, JSFC Sistema's GDRs were admitted to trade on the London Stock Exchange. The proceeds from the offering, net of underwriting discount and other direct costs, were $1,284.6 million. Simultaneously, certain shareholders of the Group sold 42,663 common shares in the form of 2,133,150 GDRs. In addition, shareholders exercised their option to sell additional 238,900 shares in the form of 11,945,000 GDRs.

In June 2005, JSFC Sistema declared dividends for the year ended December 31, 2004, amounting to $8.8 million.

In March and October 2006, the Group purchased 3% of its own outstanding common stock for a total cash consideration of $347.1 million. The acquired shares are intended for the funding of a share option program for Sistema's top management, terms of which have not been finalized yet, and may also be used in connection with certain future acquisition activities.

In June 2006, JSFC Sistema declared dividends for the year ended December 31, 2005, amounting to $10.0 million.

29. SEGMENT INFORMATION

FAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance.

The Group's operating segments are: Telecommunications, Technology, Insurance, Banking, Real Estate, Mass Media, Retail and Corporate and Other. The Group's management evaluates performance of the segments based on both operating income and net income before minority interests and cumulative effect of an extraordinary gain and a change in accounting principle.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the years ended December 31, 2006 and 2005 is as follows:

For the year ended December 31, 2006	**Tele-commu-nications**	**Technology**	**Insurance**	**Banking**	**Real Estate**	**Mass Media**	**Retail**	**Corporate and Other**	**Total**
Net sales to external customers [(a)]	7,469,439	1,268,368	604,220	204,010	273,096	78,872	335,144	629,633	10,862,782
Intersegment sales	6,150	342,366	34,412	24,181	9,770	27,834	165	17,933	462,811
Equity in net income of investees	91,717	245	391	-	-	5,529	-	139,637	237,519
Interest income	56,483	11,223	-	-	4,454	289	863	30,780	104,092
Interest expense	(200,424)	(32,235)	-	-	(7,560)	(727)	(7,927)	(127,670)	(376,543)
Net interest revenue [(b)]	-	-	34,578	26,792	-	-	-	-	61,370
Depreciation and amortization	(1,198,980)	(42,706)	(4,393)	(3,236)	(7,153)	(11,155)	(5,706)	(16,937)	(1,290,266)
Operating income	2,377,358	129,809	42,015	33,971	85,974	15,447	15,152	310,648	3,010,374
Income tax expense	(645,042)	(40,847)	(14,202)	(8,276)	(16,564)	(2,575)	(2,413)	(73,510)	(803,429)
Income before minority interests and extraordinary gain	1,278,668	68,854	25,779	25,837	64,068	14,672	6,432	337,692	1,822,002
Investments in affiliates	266,488	-	-	-	-	6,675	-	842,159	1,115,322
Segment assets	12,656,286	1,638,708	946,831	2,513,548	943,348	355,477	238,138	3,514,069	22,806,405
Indebtedness [(c)]	(3,908,943)	(505,333)	(1,317)	(399,069)	(359,727)	(17,693)	(90,890)	(1,590,640)	(6,873,612)
Capital expenditures	2,001,973	103,869	14,440	11,414	134,738	83,714	32,341	3,874	2,386,363

[(a)] – Interest income and expenses of the Insurance and Banking segments are presented as revenues from financial services in the Group's consolidated financial statements.
[(b)] – The Banking segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, only the net amount is disclosed.
[(c)] – Represents the sum of short-term and long-term debt

For the year ended December 31, 2005	**Tele-commu-nications**	**Technology**	**Insurance**	**Banking**	**Real Estate**	**Mass Media**	**Retail**	**Corporate and Other**	**Total**
Net sales to external customers [(a)]	5,892,232	665,680	371,936	78,228	73,552	26,137	207,972	277,812	7,593,549
Intersegment sales	651	295,453	36,924	28,557	4,896	26,291	36	5,782	398,590
Equity in net income of investees	66,382	16	239	1,231	-	-	-	10,165	78,033
Interest income	32,386	715	-	-	660	260	148	43,874	78,043
Interest expense	(148,681)	(10,155)	-	-	(5,702)	(1,393)	(2,266)	(81,126)	(249,323)
Net interest revenue [(b)]	-	-	-	13,046	-	-	-	-	13,046
Depreciation and amortization	(989,210)	(12,044)	(4,373)	(1,555)	(2,104)	(4,540)	(1,618)	(9,148)	(1,024,592)
Operating income/(loss)	1,933,269	143,517	28,417	12,722	10,399	7,070	10,445	(63,012)	2,082,827
Income tax expense	(444,975)	(31,705)	(11,175)	(3,967)	(4,248)	(1,174)	(2,712)	(13,037)	(512,993)
Income/(loss) before minority interests and extraordinary gain	1,352,892	101,892	19,679	8,755	2,315	3,814	5,649	(111,582)	1,383,414
Investments in affiliates	214,259	-	-	17,749	2,397	469	-	679,329	914,203
Segment assets	9,268,693	553,165	564,775	1,134,962	331,793	81,905	146,284	2,052,771	14,134,348
Indebtedness [(c)]	(3,076,414)	(96,537)	(955)	(150,000)	(38,977)	(13,807)	(45,488)	(948,432)	(4,370,610)
Capital expenditures	2,339,371	30,512	8,417	5,170	18,571	28,423	8,971	44,882	2,484,317

[(a)] – Interest income and expenses of the Insurance and Banking segments are presented as revenues from financial services in the Group's consolidated financial statements.
[(b)] – The Banking segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, only the net amount is disclosed.
[(c)] – Represents the sum of short-term and long-term debt

The reconciliation of segment operating income to the consolidated income before income tax, equity in net income of energy companies in the Republic of Bashkortostan, minority interests and extraordinary gain and reconciliation of segment assets to the consolidated segment assets are as follows:

		2006		2005
Total segment operating income	$	3,010,374	$	2,082,827
Intersegment eliminations		(277,125)		(148,990)
Interest income		65,439		66,132
Change in fair value of derivative financial instruments		(60,000)		-
Interest expense		(355,326)		(225,684)
Currency exchange and translation gain/(loss)		67,300		(13,913)
Bitel liability and investments write-off		(320,000)		-
Consolidated income before income tax, equity in net income of energy companies in the Republic of Bashkortostan, minority interests and extraordinary gain	**$**	**2,130,662**	**$**	**1,760,372**
Total segment assets	$	22,806,405	$	14,134,348
Intersegment eliminations		(2,674,921)		(1,043,498)
Consolidated assets	**$**	**20,131,484**	**$**	**13,090,850**

For the years ended December 31, 2006 and 2005, the Group's revenues outside of RF were as follows:

		2006		2005
Ukraine	$	1,689,900	$	1,391,138
Central and Eastern Europe		248,809		158,146
Greece		175,546		-
Asia-Pacific region		116,872		18,120
Others		305,814		133,892
Total	**$**	**2,536,941**	**$**	**1,701,296**

As of December 31, 2006 and 2005, the Group's long-lived assets located outside of RF were as follows:

		2006		2005
Ukraine	$	1,805,084	$	1,407,628
Central and Eastern Europe		81,290		30,592
Greece		129,392		-
Others		274,711		245,918
Total	**$**	**2,290,477**	**$**	**1,684,138**

For the years ended December 31, 2006 and 2005, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues.

30. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates and companies related by means of common control. During the years ended December 31, 2006 and 2005, the Group entered into transactions with related parties as follows:

	2006	2005
Sale of goods and services	$ (39,587)	$ (24,114)
Telecommunication services provided	(7,873)	(4,487)
Revenues from financial services	(3,534)	(4,506)
Telecommunication services purchased	73,878	41,181
Insurance premiums received	(862)	-
Purchases of goods for resale	1,878	9,807
Other	12,992	2,105

Related party balances as of December 31, 2006 and 2005 are disclosed in the corresponding notes to the financial statements.

31. STOCK BONUS AND STOCK OPTION PLANS

Comstar UTS

In September 2006, Comstar UTS approved the stock option and stock bonus program for the Board of Directors and top management of Comstar UTS. In order to fund the program, in September 2006, Comstar UTS approved the share buyback of up to 4.5% of the total number of shares issued in the form of GDRs to be completed by the end of the year ended December 31, 2009.

From the launch of the program on October 30, 2006 to December 31, 2006 Comstar UTS acquired 10,746,761 shares issued in the form of GDRs, or 2.6% of its total issued shares, for a total cash consideration of approximately $73.9 million.

Within the framework of the program and in accordance with a separate decision of Comstar UTS' Board of Directors, in November 2006, Comstar UTS granted stock bonuses in the form of shares (GDRs) for the total of 8,776,757 shares (2.1% of total issued shares) to Mr. Schebetov, Chairman of the Board of Directors, and Mr. Lagutin, a member of the Board of Directors. The fair value of the awards as of the grant date approximated $62.2 million and was included in operating expenses for the year ended December 31, 2006.

In November 2006, Comstar UTS approved the grant of options to certain members of its Board of Directors and top management. The exercise price for these options is RUB 122 (approximately $4.6 as of December 31, 2006) per share. These stock options vest in November 2008.

The following table summarizes information about non-vested common stock options during the year ended December 31, 2006:

	Shares	Exercise price, USD
Outstanding as of December 31, 2005	-	-
Granted	3,343,525	4.6
Exercised	-	-
Forfeited	-	-
Outstanding as of December 31, 2006	**3,343,525**	**4.6**

The fair value of options granted during the year ended December 31, 2006 was estimated using the binomial option pricing model using the following assumptions:

Risk-fee rate	4.82%
Expected dividend yield	-
Expected volatility	38.1%
Expected life (years)	2
Fair value of options (per share)	$3.16

MTS

In 2000, MTS established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. During its initial public offering in 2000, MTS allotted 9,966,631 shares of it common stock to fund its option plan.

Since 2002, MTS made grants pursuant to its stock option plan to employees and directors of MTS. These options generally vest over a two year period from the date of the grant, contingent on continued employment of the grantee with MTS. A summary of the status of MTS' option plan is presented below:

	Shares	**Weighted average exercise price (per share), USD**	**Weighted average fair value of options (per share), USD**	**Aggregate intrinsic value, thousands of USD**
Outstanding as of January 1, 2005	3,530,970	4.09	1.65	2,777
Granted	1,778,694	6.89	1.74	907
Exercised	(1,801,622)	2.43	1.02	(924)
Forfeited	(320,802)	5.25	2.06	(305)
Outstanding as of December 31, 2005	3,187,240	6.47	2.02	2,455
Granted	-	-	-	-
Exercised	(639,357)	5.95	2.36	(695)
Forfeited	(1,112,882)	6.23	2.17	(1,017)
Outstanding as of December 31, 2006	**1,435,001**	**6.89**	**1.74**	**743**

None of the options outstanding at December 31, 2006 were exercisable.

The fair value of options granted during the year ended December 31, 2005 were estimated using the binomial option pricing model using the following assumptions:

Risk-free rate	4.7%
Expected dividend yield	3%
Expected volatility	40.0%
Expected life (years)	2
Fair value of options (per share)	$1.74

In accordance with the Russian legislation, Comstar UTS and MTS Board members and key employees may be considered insiders with respect to these entities and thus may be restricted from selling their shares.

32. DERIVATIVE FINANCIAL INSTRUMENTS

Comstar UTS

In December 2006, Comstar UTS acquired 25%+1 share of Svyazinvest (Note 3). Simultaneously with the acquisition, MGTS Finance S.A., Comstar UTS' subsidiary, and "2711 Centerville Cooperatief U.A." ("2711 UA"), an affiliate of the seller, signed a call and put option agreement, which gives 2711 UA a right to purchase and sell 46,232,000 shares of Comstar UTS, representing 11.06% of its total issued shares, from MGTS Finance S.A. The call option acquired by 2711 UA may be exercised at a strike price of $6.97 per share at any time following the signing of the agreement with respect to 10.5% of Comstar UTS' shares. The call option for the remaining 0.56% stake may be exercised at any time beginning from April 1, 2007. The call option will expire one year from the date of signing of the agreement. 2711 UA may exercise its put option at any time within two years from the date of exercising the call option at a strike price, which will be calculated based on a weighted average price of Comstar UTS' GDRs during the period.

Fair value of the call and put option as of the date of acquisition was estimated at $90.0 million and was included in the cost of investment in shares of Svyazinvest. The Group estimates the fair value of the respective liability using an option pricing model and re-measures it as of each balance sheet date. As of December 31, 2006 the fair value of the respective liability amounted to $150.0 million. Respective gains and losses are included in the statement of operations and comprehensive income for the period. For the year ended December 31, 2006, the loss from re-measurement of this option amounted to $60.0 million.

SITRONICS

In 2002, Intracom Holdings S.A. entered into a swap agreement with Alfa-Bank to eliminate foreign currency exposure risk and to effectively convert a syndicated loan of $121.2 million at a rate of three months LIBOR+1.50% to EUR 118.0 million ($155.5 million as of December 31, 2006) bearing three months EURIBOR+1.59% interest rate (Note 22). The terms of the swap matched the terms of the underlying debt. The arrangement did not qualify for hedge accounting. In 2005, the loan and the swap were transferred to Intracom Telecom. As of December 31, 2006, the Group recorded a liability of $34.3 million in relation to this instrument in the accompanying consolidated balance sheet and a loss of $15.5 million for the year ended December 31, 2006, which was offset by the foreign exchange gain resulted from underlying debt.

33. COMMITMENTS AND CONTINGENCIES

Operating Leases – The Group leases land, buildings and office space mainly from municipal organizations through contracts, which expire in various years through 2049.

Future minimum rental payments under operating leases in effect as of December 31, 2006, are as follows:

Year ended December 31,		
2007	$	126,345
2008		95,213
2009		84,100
2010		83,741
2011		92,026
Thereafter		170,527
Total	**$**	**651,952**

Operating Licenses – In connection with provision of telecommunication services, the Group has been issued various operating licenses by the Russian Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Russian Ministry of Information

Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. Licenses to the foreign subsidiaries of the Group are granted by the local communication authorities.

Each of the MTS' licenses, except for the licenses covering the Moscow license area and Uzbekistan, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. MTS has met these targets or received extensions to these dates in those regional license areas in which MTS has not commenced operations.

The Group's operating licenses do not provide for automatic renewal. However, licenses that expired during the year ended December 31, 2006 were renewed. The Group has limited experience with the renewal of its existing licenses. Management believes that licenses required for the Group's operations will be renewed upon expiration.

Management believes that the Group is in compliance with all material terms of its licenses.

Capital Commitments – As of December 31, 2006, MTS had executed non-binding purchase agreements in the amount of approximately $347.1 million to subsequently acquire property, plant and equipment.

In December 2003, MGTS announced its long-term investment program for the period from 2004 to 2012 providing for extensive capital expenditures including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of the Moscow City Government on December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately $1,600.0 million and include reconstruction of 350 local telephone stations and installation of 4.3 million of new phone numbers.

Sistema-Hals has contracted for construction works and other general construction expenditures under its development projects. Aggregate commitments under these contracts amounted to $141.3 million as of December 31, 2006. In addition, in connection with one of these projects, Sistema-Hals undertook obligations to provide the Central Army Sports Club ("CSCA") with 17,437 sq.m of residential housing.

Sistema-Hals has obligations to manage a number of construction projects which will be completed subsequent to the balance sheet date. The Moscow City Government has the obligation to finance these construction projects, Sistema-Hals generating commissions based on the agreed upon budget cost of the project.

In the year ended December 31, 2006, Mikron entered into purchase agreements for supply of equipment in the amounts of approximately $120.0 million. As of December 31, 2006, Intracom Telecom had executed non-binding purchase agreements in the amounts of approximately EUR 37.0 million (equivalent of $48.8 million) to subsequently acquire property, plant and equipment.

Other Commitments – In August 2005, the Group entered into a binding agreement with the other shareholder of SkyLink, the Group's affiliate, to protect the other shareholder from losses in case the joint venture does not reach certain targets in terms of customer base, cash flows and earnings. If SkyLink does not reach certain quantitative targets by the end of 2006, the Group will have, at the discretion of the other shareholder, to purchase the 50% share in SkyLink for a total cash consideration of $200.0 million, or reimburse the other shareholder in the amount determined as $200.0 million multiplied by the percentage of deviation from the agreed quantitative targets. As of the date of these financial statements the Group does not expect any payments to be made under this agreement.

Issued Guarantees – As of December 31, 2006, MTS has issued guarantees to third party banks for the loans taken by MTS Belarus, MTS' affiliate, for the total amount of $3.0 million. The guarantees expired in April 2007.

MBRD guaranteed loans for several companies, including related parties, which totaled $54.3 million as of December 31, 2006.

EWUB guaranteed loans for several companies and individuals, which totaled $29.3 million as of December 31, 2006.

The issued guarantees are recorded at fair value in the accompanying consolidated balance sheet. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2006, no event of default has occurred under any of the guarantees issued by the Group.

Minimum Capital Requirements – The Law on Insurance in Russia sets minimum capital requirements for insurance organizations, depending on the type of insurance they are underwriting. The minimum capital requirement for insurance organizations conducting reinsurance operations is set at 120.0 million RUB (equivalent of $4.6 million as of December 31, 2006). As of December 31, 2006, Rosno's statutory share capital amounted to 1,184.0 million RUB (equivalent of $45.0 million as of December 31, 2006).

The Central Bank of Russia sets minimum capital requirements for banks. The minimum capital requirement is set at Euro 5.0 million for each newly-founded bank. As of December 31, 2006, MBRD's share capital amounted to 998.0 million RUB (equivalent of $37.9 million as of December 31, 2006).

Operating Environment – The Russian and Ukrainian economies, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

The Group's operations in Turkmenistan are subject to certain restrictions in accordance with the local regulatory environment including, but not limited to, hard currency sale on the local market and hard currency repatriation. The effect of those restrictions on the financial statements is represented by a loss from currency translation transactions in Turkmenistan in the amount of $24.3 million which are recognized as other non-operating expense in the Group's consolidated statement of operations for the year ended December 31, 2006.

Industry Regulations – The new Federal Law on Communications sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. In addition, the law created a universal service fund ("USF") charge, which became effective May 3, 2005, calculated as 1.2% of revenue from services provided to customers, excluding interconnection and other operators' traffic routing revenue. As of December 31, 2006 and 2005 the Group has incurred approximately $45.1 million and $30.3 million in USF charge, respectively, which is recorded in other operating expenses.

On March 4, 2006, the Russian President approved amendments to the Telecommunications Law that introduced the Calling Party Pays rules. Effective July 1, 2006, under the CPP Rules, all incoming calls on fixed and mobile lines in Russia became free of charge, and only the fixed-line or mobile operators originating the call may charge the subscriber for the call. The CPP Rules primarily impacted the fixed-to-mobile calls, as fixed-line operators traditionally did not charge any fee for outgoing calls to mobile lines in Russia.

Construction and development of real estate in Russia is primarily governed by the Civil Code, the Federal Land Code, the City Construction Code, the Federal Law on the State Registration of Rights to Immovable Property and Transactions Therewith, construction norms and regulations approved by the Ministry of Industry and Energy, and others. Construction and development involves compliance with burdensome regulatory requirements, and authorizations from a large number of authorities at the federal, regional and local levels. In particular, the Federal Agency on Construction, Housing and the Communal Sector, or Rosstroi, the Federal Service for Supervision in the Sphere of Use of Natural Resources, the Federal Service on Ecological, Technologic and Nuclear Supervision and regional bodies of the state architectural and construction supervision are involved in the process

of authorizing and supervising real estate development. In addition, construction is subject to all applicable environmental, fire safety and sanitary norms and regulations.

Sistema-Hals is constructing a number of cottages without obtaining necessary construction permits. However, management is in the process of addressing this issue and does not foresee that this will adversely affect the Group's financial position or results of operations.

Taxation – Russia and Ukraine currently have a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, corporate income tax (profits tax), UST, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems. Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2006, tax declarations of the Group for the preceding two fiscal years were open for further review.

In September 2006, the Russian tax authorities audited MTS OJSC's compliance with tax legislation for the year ended December 31, 2003 and 2004. Based on the results of this audit, the Russian tax authorities assessed that 1,283,660 thousand rubles (approximately $48.8 million as at December 31, 2006) of additional taxes, penalties and fines were payable by the Group. The Group has prepared and filed with the Arbitrary Court of Moscow a petition to recognize the tax authorities' resolution to be partially invalid. The amount of disputed taxes and fines equals 1,220,096 thousand rubles (approximately $46.3 million). The final court hearing considered the issue and this resulted in court judgments in favour of MTS.

There are regulatory uncertainties in Ukraine related to treatment for VAT purposes of contributions payable to the Ukrainian State Pension Fund ("Pension Fund") in respect of the cash paid for the consumption of telecommunication services by customers. This could also have an influence on income tax and other taxes paid by UMC.

As a result of the tax audit of the period from October 1, 2002 to June 30, 2004, additional VAT charges (including penalties) calculated on the Pension Fund contributions could be up to $13.5 million. In 2005, UMC initiated a litigation case in respect of this issue against the tax authorities, and has received favorable rulings from the courts of three instances (the last one is the Highest Administrative Court of Ukraine), which can hardly be further appealed from the tax authorities. Management believes that VAT was not applicable to the Pension Fund contributions during the period under the tax authorities' review. Further, management believes that UMC is in line with industry practice and has already defended its position in the courts. At December 31, 2006, no VAT charges in relation to the above litigation had been accrued in the Group's consolidated financial statements or paid to the tax authorities.

In January 2007, U.S. Internal Revenue Services ("IRS") started auditing BCTI's compliance with U.S. Federal tax legislation for the year ended December 31, 2004. Based on the preliminary findings of the audit, the Group consultants assessed potential profit tax exposure for the years 2003-2006 could be up to $28.3 million. The Group's management assessed its maximum potential liabilities at $3.3 million and that amount was recognized in the Group's consolidated statement of operations for the year ended December 31, 2006.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

Other Contingencies – As discussed in Note 16, in January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the LCIA in order to compel MTS Finance to purchase the remaining 49% stake in Tarino Limited for $170.0 million. Nomihold seeks specific performance of the put option, unspecified monetary damages, interest, and costs. The matter is currently pending.

As also discussed in Note 16, there is on-going arbitration in the United Kingdom related to Tarino's ownership in Bitel. Kyrgyzstan Mobitel Investment Company Limited ("KMIC") has initiated a separate arbitration proceeding against the three Isle of Man companies affiliated with the Group ("the KFG Companies") claiming that the KFG Companies breached a May 31, 2003 Transfer Agreement concerning the shares of Bitel. It is possible there may be additional or related disputes concerning agreements with respect to Tarino Limited. It is not possible at this time to predict the outcome or final resolution of any such disputes or litigation.

As further discussed in Note 16, the KFG Companies have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel and the KFG Companies have also asserted counterclaims against Bitel, and claims against other defendants including Altimo and Altimo Holding, for the wrongful appropriation and control of Bitel. It is not possible at this time to predict the outcome or resolution of these claims.

During the second half of 2006, holders of preferred shares of MGTS filed a lawsuit against MGTS, disputing MGTS' decision not to declare dividends on preferred shares for 2005. During 2006, the court of first instance and the court of appeals ruled in favor of MGTS. In February 2007, the Moscow Federal Arbitration Court returned the case to the court of first instance for re-trial, directing the court to reconsider the decision. Management believes that MGTS has a sustainable position in defending the case, and MGTS' decision not to declare or pay any dividends for 2005 does not violate provisions of MGTS' Charter and relevant legislation, and therefore the company will prevail in the proceedings. However, should the holders of the preferred shares win the case against MGTS, the latter will be liable to pay dividends for 2005 on its preferred shares. Such dividend, if declared and paid, may amount to 879.0 million Rubles (approximately $31.1 million as of December 31, 2006).

During the 2006 and January 2007, Rostelecom filed several claims in the Moscow Arbitration Court against MGTS for the disputed interconnection fees from traffic to mobile operators generated by MGTS' subscribers and transferred via Rostelecom. The disputed revenues of MGTS from Rostelecom amount to approximately $5.5 million for the first half of 2006 and was recognized as revenues in the financial statements for the six months ended June 30, 2006, since management believed that the amount would be paid by Rostelecom. In the second half of 2006, the Arbitration Court ruled in favor of Rostelecom and therefore, no revenue was recognized in relation to disputed traffic in the second half of 2006. In December 2006, management recorded an allowance for a receivable from Rostelecom in the amount of approximately $5.5 million.

In December 2006, a claim was filed with London Court of International Arbitration by Winwood Holdings Limited ("Winwood") pertaining to the proposed sale by the Group of its 25% plus one share stake in MBRD pursuant to a sale and purchase agreement. Winwood alleges that the Group breached the sale and purchase agreement by failing to transfer shares by the closing date under the agreement. Winwood is seeking payment of lost profits, contractual break fee and escrow interest totaling up to $102.0 million. The Group asserts that the conditions precedent for completion of the sale of shares were not met, and amounts claimed by Winwood are not payable. As of the date of these financial statements no hearing was held. The matter will proceed to disclosure and witness evidence, following which a hearing will be convened. The Group believes that the plaintiff's position in this litigation is without merit and intends to vigorously defend itself in the litigation.

In the ordinary course of business, the Group may be party to various legal proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which the Group operates. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceedings or other matters will not have a material effect upon the financial condition, results of operations or liquidity of the Group.

34. SUBSEQUENT EVENTS

Acquisitions

In January 2007, SITRONICS Management, SITRONICS' subsidiary, acquired 188,683,000 shares of SITRONICS from NED Electronic GmbH for a total cash consideration of $36.0 million. As a result of this transaction, the Group's effective ownership in SITRONICS increased to 87.6%.

In May and June 2007, the Group purchased a 100.0% stake in Medexpress, provider of voluntary medical insurance in the north-west region of RF, for a total cash consideration of approximately $10.0 million.

In March 2007, the Group purchased a remaining minority share of 26.0% in Digital TV Broadcasting for a total cash consideration of $3.0 million, therefore increasing its ownership interest in Digital TV Broadcasting to 100.0%.

In March 2007, SITRONICS acquired a 3.0% stake in VZPP-Micron for a cash consideration of $0.5 million increasing its ownership to 100.0%.

Disposals

In March 2007, Comstar UTS sold a 45.0% equity stake in Metrocom, an alternative fixed-line telecommunications operator in St. Petersburg, for a cash consideration of $20.0 million.

In February 2007, the Group sold its stake in Rosno for a cash consideration of $750.0 million to Allianz AG. The transaction resulted in a gain from disposal of approximately $522.9 million. After the transaction, the Group purchased a minority interest in ROSNO of 2.8% from ROSNO managers.

In February 2007, SITRONICS completed an initial public offering of 1,675,000,000 common shares, with a par value of 1 RUB per share, comprising 125,160,800 ordinary shares and 30,996,784 global depositary receipts ("GDRs"), with 1 GDR representing 50 shares. Proceeds from the offering, net of the underwriters' discount and other direct costs, comprised of $356.4 million. As a result of the IPO, the Group's effective ownership in SITRONICS decreased from 87.6% to 71.4%.

In December 2006, Mikron, a subsidiary of SITRONICS, effected an additional issue of 1,088,000 additional common shares in a closed subscription to the Federal Agency for Management of Federal Property of the Russian Federation. The attracted financing under the transaction amounted to approximately $10.6 million. The registration of the issue was completed in January 2007. As a result of this transaction, SITRONICS' ownership interest in Mikron decreased from 78.0% to 69.0%.

Debt issuance

In April 2007, Intourist issued RUB 1.0 billion (equivalent of $39.0 million) of 9.0% notes, due in April 2010. Interest payments on the notes are due semi-annually in April and October of each year, commencing October 2007. The notes are listed at MICEX.

Legal proceedings

In April 2007, Rosprirodnadzor and the Federal Agency for Federal Property Management of the RF filed a lawsuit against Sistema-Hals in respect of the legality of construction of a waterfront structure at "Aurora" cottage village. Sistema-Hals management believes that the construction was carried out in compliance with the applicable legislation and intends to defend its interests in court.

In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the LCIA in order to compel MTS Finance to purchase the remaining 49% stake in Tarino Limited for $170.0 million (Note 16). A group of individual shareholders of Sistema has agreed to compensate MTS Finance for any potential loss up to $170.0 million should the arbitration decision regarding exercise of the aforementioned put option prove unfavorable to MTS Finance.

In a separate arbitration proceeding initiated against the KFG Companies by Kyrgyzstan Mobitel Investment Company Limited ("KMIC") under the rules of the LCIA, the arbitration tribunal in a partial final award dated May 25, 2007 and received by the Group on June 7, 2007, found that the KFG Companies breached a May 31, 2003 Transfer Agreement concerning the shares of Bitel (see Note 16). The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interest in Bitel was to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. The Group is not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

Other

In April 2007, SITRONICS' Board of Directors established a stock option plan for 23 selected officers and key employees of SITRONICS, where they can buy up to 747,742,688 shares, representing 7.83% of the share capital, from the SITRONICS treasury stock, contingent on continued employment of the grantees with SITRONICS or, in some cases, with the Group. According to the terms of the plan, grantees are entitled to buy option shares in four installments, representing 1/6 of the total amount due to each person during the years 2007, 2008 and 2009, and the remaining 1/2 of the total amount in 2010. The exercise price is 1 RUB per share. All the participants of this option plan are restricted from selling their shares until 2010.

Starting from January 1, 2007, MTS' subsidiaries in RF introduced RUB tariffs for settlements with the majority of their customers. As a result of the changes, MTS reevaluated the functional currency criteria under FAS No. 52 and determined that, beginning January 1, 2007, the functional currency of the MTS' subsidiaries domiciled in Russia is the RUB. The change is adopted prospectively beginning January 1, 2007 in accordance with FAS No. 52.

In April 2007, MTS received a federal license to provide 3G services in Russia that allows subscribers to use high-tech and innovative services coupled with high service quality and level of customer service. MTS is planning to start commercial use of a 3G network within the next 2 years.

Along with MTS, Uzdunrobita in Uzbekistan acquired new 3G licenses. Uzdunrobita is planning to launch its 3G network in 2008.

In April 2007, the Russian registration authority approved the merger of ReCom and Telesot Alania, MTS' wholly-owned subsidiaries located in the RF, into MTS.

In April 2007, as part of the Comstar UTS' reorganization, Comstar UTS' wholly-owned subsidiaries Telmos and MTU-Inform were merged into Comstar UTS.

In May 2007, SITRONICS announced the intention to redeem its $200 million of outstanding Eurobond Notes due 2009 on June 27, 2007. Sitronics Finance S.A. will redeem the Notes with a coupon rate of 7.875%, which were issued in March 2006, at a principal amount plus the applicable premium (as defined in the terms and conditions to the Notes) and an accrued and unpaid interest, if any, on the Notes up to but not including the redemption date.