

# **OJSC “Tattelecom”**

**Independent Auditors’ Report**

**Financial Statements**

For the Year Ended 31 December 2006

# OJSC "TATTELECOM"

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## OJSC "TATTELECOM"

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

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The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the financial statements of OJSC "Tattelecom" (the "Company").

Management is responsible for the preparation of the financial statements that present fairly in all material respects the financial position of the Company at 31 December 2006, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Company will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Russian Federation;
- Taking such steps as are reasonably available to them to safeguard the assets of the Company; and
- Preventing and detecting fraud, errors and other irregularities.

The financial statements for the year ended 31 December 2006 were authorized for issue on 14 May 2007 by:



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**General Director**  
L.N. Shafigoullin

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of OJSC "Tattelecom":

We have audited the accompanying financial statements of Open Joint Stock Company "Tattelecom" ("Tattelecom" or the "Company"), which comprise the balance sheet at 31 December 2006, and the related statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditors' Responsibility

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

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

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

## Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2006, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

*Debitte & Touche*

Moscow  
14 May 2007



# OJSC "TATTELECOM"

## BALANCE SHEET AS OF 31 DECEMBER 2006 (in US Dollars and in thousands)

	Notes	2006	2005
<b>ASSETS</b>			
<b>LONG-TERM ASSETS:</b>			
Property, plant and equipment	7	286,417	240,643
Intangible assets	8	937	650
Long-term investments	9	433	297
Other long-term assets		-	113
		<u>287,787</u>	<u>241,703</u>
<b>CURRENT ASSETS:</b>			
Inventories	10	3,846	2,104
Trade accounts receivable	11	16,163	8,817
Other accounts receivable	12	3,121	3,229
Prepaid taxes		2,549	5,896
Short-term financial investments	13	124	274
Cash	14	4,300	4,483
		<u>30,103</u>	<u>24,803</u>
<b>TOTAL ASSETS</b>		<u><b>317,890</b></u>	<u><b>266,506</b></u>
<b>EQUITY AND LIABILITIES</b>			
<b>EQUITY:</b>			
Common shares	15	75,852	75,852
Treasury shares		(2,987)	-
Cumulative translation reserve		8,596	(4,875)
Retained earnings		88,695	66,838
<b>TOTAL EQUITY</b>		<u><b>170,156</b></u>	<u><b>137,815</b></u>
<b>LONG-TERM LIABILITIES:</b>			
Long-term borrowings	16	25,390	40,689
Long-term obligations under finance lease	17	217	381
Deferred tax liabilities	18	11,364	12,388
Deferred revenue	19	31,172	26,851
Post-retirement benefit obligations	20	3,953	3,307
Fixed assets granted	21	9,130	8,963
		<u>81,226</u>	<u>92,579</u>
<b>CURRENT LIABILITIES:</b>			
Current portion of long-term borrowings	16	29,194	5,777
Short-term obligations under finance lease	17	647	738
Trade accounts payable	22	17,442	13,887
Taxes payable		1,861	3,344
Other accounts payable	23	11,271	6,846
Deferred revenue, current portion	19	6,093	5,520
		<u>66,508</u>	<u>36,112</u>
<b>TOTAL EQUITY AND LIABILITIES</b>		<u><b>317,890</b></u>	<u><b>266,506</b></u>

The notes on pages 9 to 29 form an integral part of these financial statements.

## OJSC "TATTELECOM"

### INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006 *(in US Dollars and in thousands)*

	Notes	<u>2006</u>	<u>2005</u>
REVENUE	24	143,593	119,580
OPERATING EXPENSES	25	<u>(109,875)</u>	<u>(97,196)</u>
OPERATING PROFIT		33,718	22,384
Interest expense		(1,102)	(1,235)
Interest income		19	383
Foreign exchange gain		<u>22</u>	<u>205</u>
INCOME BEFORE TAX		32,657	21,737
INCOME TAX	18	<u>(7,779)</u>	<u>(4,920)</u>
NET INCOME		<u><u>24,878</u></u>	<u><u>16,817</u></u>

The notes on pages 9 to 29 form an integral part of these financial statements.

## OJSC "TATTELECOM"

### STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands)

	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Income before tax	32,657	21,737
Adjustments for:		
Depreciation of property, plant and equipment	19,854	14,970
Amortization of intangible assets	632	312
Loss on disposal of property, plant and equipment	4,367	1,481
Interest income	(19)	(383)
Increase in allowance for doubtful receivables for doubtful receivables	422	1,636
Increase in allowance for obsolete inventory	61	10
Depreciation of fixed assets granted	(755)	(673)
Foreign exchange gain	(22)	(205)
Interest expense and expenses under finance lease contracts	1,102	1,235
<b>Operating cash inflow before changes in working capital</b>	<b>58,299</b>	<b>40,120</b>
Trade receivables	(6,742)	(2,045)
Inventories	(1,558)	330
Other accounts receivable	4,169	1,333
Trade payables	1,398	(1,597)
Other accounts payable	4,461	1,691
Taxes payable	(1,734)	(1,417)
Post-retirement benefit obligations	327	(280)
Deferred revenue	(384)	(595)
<b>Cash flows from operations</b>	<b>58,236</b>	<b>37,540</b>
Income taxes paid	(10,623)	(7,386)
Interest paid	(5,678)	(5,256)
<b>Net cash provided by operating activities</b>	<b>41,935</b>	<b>24,898</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(40,053)	(34,954)
Purchases of intangible assets	(851)	(354)
Proceeds from sale of property, plant and equipment	133	2,061
Interest received	19	383
Proceeds from sale of promissory notes and other financial assets	181	4,329
<b>Net cash used in investing activities</b>	<b>(40,571)</b>	<b>(28,535)</b>



## OJSC "TATTELECOM"

### STATEMENT OF CASH FLOWS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006 *(in US Dollars and in thousands)*

	<u>2006</u>	<u>2005</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from borrowings	29,371	16,851
Repayment of borrowings	(26,128)	(6,849)
Finance lease payments	(1,788)	(2,086)
Dividends paid	(3,021)	(3,422)
<b>Net cash (used in)/ provided by financing activities</b>	<u><b>(1,566)</b></u>	<u><b>4,494</b></u>
NET (DECREASE)/INCREASE IN CASH	(202)	857
Effect of translation to presentation currency	19	(91)
CASH, beginning of year	4,483	3,717
CASH, end of year	<u><u>4,300</u></u>	<u><u>4,483</u></u>
<b>SUPPLEMENTAL INFORMATION:</b>		
Non-cash activities:		
Fixed assets granted	109	1,746
Fixed assets acquired under finance lease	805	657

The notes on pages 9 to 29 form an integral part of these financial statements.

## OJSC "TATTELECOM"

### STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands)

	Common shares	Treasury shares	Cumulative translation reserve	Retained earnings	Total
<b>At 1 January 2005</b>	75,852	-	-	53,443	129,295
Net income	-	-	-	16,817	16,817
Dividends	-	-	-	(3,422)	(3,422)
Effect of translation to presentation currency	-	-	(4,875)	-	(4,875)
<b>At 31 December 2005</b>	<b>75,852</b>	<b>-</b>	<b>(4,875)</b>	<b>66,838</b>	<b>137,815</b>
Net income	-	-	-	24,878	24,878
Dividends	-	-	-	(3,021)	(3,021)
Acquisition of common shares from minority shareholders	-	(2,987)	-	-	(2,987)
Effect of translation to presentation currency	-	-	13,471	-	13,471
<b>At 31 December 2006</b>	<b>75,852</b>	<b>(2,987)</b>	<b>8,596</b>	<b>88,695</b>	<b>170,156</b>

The notes on pages 9 to 29 form an integral part of these financial statements.

# OJSC "TATTELECOM"

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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### 1. NATURE OF BUSINESS

OJSC "Tattelecom" ("Tattelecom" or the "Company") is the largest telecommunications operator in the Republic of Tatarstan, the region of the Russian Federation. OJSC "Tattelecom" was established on 22 July 2003 as a result of privatization of State Unitary Enterprise for Communications Management (GUP UES) "Tattelecom" pursuant to Resolution of the Cabinet of Ministers of the Republic of Tatarstan № 350 of 2 July 2003 and Resolution of the Ministry of Land and Property Relations of the Republic of Tatarstan № 87 of 8 July 2003. The Company's structure comprises of the head office and 7 branches: Almetyevsky, Arsky, Buisky, Nizhnekamsky, Chistopolsky, Kazansky and Naberezhno-Chelninsky zonal telecommunication nodes.

**Reorganization** – In the second quarter of 2006, OJSC "Svyazinvestneftekhim", a controlling shareholder of OJSC "Tattelecom" and OJSC "Kazan City Telephone Network" ("KGTS"), completed the Company's reorganization through OJSC "KGTS" merger with OJSC "Tattelecom" (collectively – the "Group"). In the course of reorganization the share capital of OJSC "Tattelecom" was increased through issuance of additional common shares and their subsequent swap for common and preferred shares of KGTS. The reorganization was recorded at historical cost of the assets and liabilities of the Group's entities. The Company's equity for prior years was restated to account for reorganization, as if it was completed at the beginning of the earliest period presented in the financial statements.

Financial results and cash flows of the Group over the periods prior to the reorganization could have differed from the information presented in the financial statements, had the Group operated during those periods as a single entity.

At 31 December 2006, the major shareholders of the Company were as follows:

	As of 31 December 2006	
	Number of Shares	Ownership interest, %
OJSC "Svyazinvestneftekhim"	18,182,331,372	87.2%
Other (individually less than 5%)	2,661,645,028	12.8%
<b>Total</b>	<b>20,843,976,400</b>	<b>100%</b>

### 2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Company has adopted all of the new and revised Standards and Interpretations issued by International Accounting Standards Board ("IASB") and International Financial Reporting Interpretations Committee ("IFRIC") of IASB that are relevant to its operations and effective for 2005 and 2006 annual reporting periods.



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 *(in US Dollars and in thousands, unless otherwise stated)*

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At the date of authorization of these financial statements, the following new and revised Standards and Interpretations were in issue but not yet effective:

<b>New or revised Standards and Interpretations</b>	<b>Effective for annual periods beginning on or after</b>
Amendments to IAS 1 "Capital Disclosures"	1 January 2007
IRFS 7 "Financial Instruments: Disclosure"	1 January 2007
IFRS 8 "Operating segments"	1 January 2009
Amendment to IAS 23 "Interest expense related to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009"	1 January 2009
IFRIC Interpretation 7 "Applying the Restatement Approach under IAS 29 "Financial Reporting in Hyperinflationary Economies"	1 March 2006
IFRIC Interpretation 8 "Scope of IFRS 2"	1 May 2006
IFRIC Interpretation 9 "Reassessment of Embedded Derivatives"	1 June 2006
IFRIC Interpretation 10 "Interim Financial Reporting and Impairment"	1 November 2006
IFRIC Interpretation 11 "IFRS 2 – Group and Treasury Shares Transactions"	1 March 2007
IFRIC Interpretation 12 "Service Concession Arrangements"	1 January 2008

Currently the Company estimates the effect of these standards and interpretations on its financial statements for the subsequent periods.

### 3. STATEMENT OF COMPLIANCE

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). International Financial Reporting Standards include standards and interpretations approved by the International Accounting Standards Board ("IASB"), including International Accounting Standards ("IAS") and interpretations issued by the International Financial Reporting Interpretations Committee.

### 4. BASIS OF PRESENTATION

*Accounting and reporting basis* – The Company maintains its accounting records and prepares statutory financial statements in Russian Roubles in accordance with laws and accounting and reporting regulations of the Russian Federation.

The accompanying financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with IFRS, which are not recorded in the Company's accounting books.

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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These financial statements are prepared under the historical cost convention, except that property, plant and equipment are carried at deemed cost as of 1 January 2005.

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

Related parties may enter into transactions which unrelated parties would not enter into. Transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

Transactions with related parties in 2006 and outstanding amounts as of the year end are disclosed in Note 27.

**Functional and presentation currency** – The Company's financial statements are measured in the currency prevailing in the economic environment in which the Company operates (functional currency). The functional currency of the Company is the Russian Rouble ("RUB"). The financial statements are presented in US dollars ("USD").

Transactions with other foreign currencies are translated into the functional currency using the exchange rates prevailing at the date of transactions. Exchange rate differences arising from such transactions and from translation of monetary assets and liabilities denominated in foreign currency at the closing exchange rate are recorded in the income statement.

The financial statements are translated to US dollars as follows:

- Assets and liabilities are translated at the closing exchange rate at the balance sheet date;
- The share capital and retained earnings as of the beginning of the reporting period are translated at the historical rates;
- Income and expenses for the period are translated at the average rate for the period.

In 2006, the Russian Rouble was not a fully convertible currency outside the territory of the Russian Federation. The translation of RUB denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Company could or will in the future convert the reported values of the assets and liabilities in USD.

The exchange rates of the Russian Rouble to the USD as of 31 December 2006 and 2005 were RUB 26.33 and 28.78 to 1 USD, respectively.

## 5. SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies used for the preparation of these financial statements are described below.

**Property, plant and equipment** – Property, plant and equipment as of 1 January 2005 are recorded at revalued amount as of that date. The valuation is confirmed by an independent appraiser. Those values were treated as deemed cost at the date of IFRS adoption. Property, plant and equipment purchased after 1 January 2005 are carried at cost.



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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

Significant renovations are capitalized if they extend the life of the asset or significantly increase its revenue generating capacity. Repair and maintenance costs are recognized in the income statement as incurred.

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives. The accrual of depreciation charges commences from the month following the one in which the item is ready for use. The Company set the following useful lives of property, plant and equipment:

	<u>Years</u>
Buildings	40
Telecommunications equipment	10
Transmission devices	15
Vehicles	7
Office equipment and other	3-5

Property, plant and equipment used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the assets may have impaired. The management believes that no such events took place in 2006.

Property, plant and equipment contributed to the Company free-of-charge by the state authorities under programs for the development and upgrading of wire-line telecommunications networks are recorded at fair value as of the date of transfer. The transfer of such assets is recorded as deferred revenue, which is amortized over the useful lives of respective assets.

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

**Asset retirement obligations** – The Company records asset retirement obligations if it has a legal obligation to incur costs associated with the future retirement of assets. As of 31 December 2006, asset retirement obligations were not material for the Company's financial statements.

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

For capital leases, the present value of future minimum lease payments at the inception of the lease is recorded in the lessee balance sheet. Amounts due within one year after the balance-sheet date are classified as short-term liabilities and the remaining balance as long-term.

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



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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Lease payments under operating leases are recognized as expenses on a straight-line basis over the lease term.

**Intangible assets** – Intangible assets primarily represent licenses and software products: programs that automate management of subscriber accounts (billing systems) and other software.

Software products and other intangible assets purchased separately are initially recorded at cost of their acquisition. Subsequently, intangible assets are carried at cost, less accumulated amortization and any accumulated impairment loss.

Finite-life intangible assets are amortized over their useful lives and reviewed for impairment whenever any impairment indicators arise. Indefinite-life intangible assets are not amortized and annually reviewed for impairment.

Licenses and software are amortized on a straight-line basis over their useful lives determined as the license term or the period for which the rights to use the software are granted.

**Impairment of long-term assets** – At each balance sheet date the Company's management reviews the carrying amounts of fixed assets, intangible assets and other long-lived assets to determine whether there is any indication that those assets have suffered an impairment loss. If any indications of the possible impairment of a long-lived asset have been identified, the asset's recoverable amount is determined. Where it is impossible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash generating unit to which the asset belongs.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Any impairment loss is recorded in the income statement.

The Company's management believes that no impairment of long-lived assets of the Company occurred as of 31 December 2006.

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

**Fair value of financial instruments** – Financial instruments carried on the balance sheet include cash, short-term and long-term investments, receivables, payables and loans received. The particular recognition methods adopted are disclosed in the individual policy associated with each item below.

Short-term financial instruments primarily include cash, short-term investments, receivables and payables, short-term borrowings. The estimated fair value of short-term financial instruments as of 31 December 2006 approximated their carrying value.

Long-term financial instruments primarily comprise long-term borrowings and long-term investments. As of 31 December 2006, the fair value of long-term borrowings and financial investments insignificantly differed from their carrying value.

**Accounts receivable** – Accounts receivable are stated at their net realisable value after deducting an allowance for doubtful debts. Such allowance reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectibility. Concentrations of credit risk with respect to trade receivables are limited due to a highly diversified customer base, which includes a large number of individuals, private businesses and state-financed institutions.

Doubtful debt expenses are charged to the income statement.



## OJSC “TATTELECOM”

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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**Inventories** – Inventories comprise cables, spare parts and telephones and are stated at the lower of cost or net realizable value. Inventories are written off using the first-in-first-out method (FIFO).

Net realizable value represents the estimated selling price determined under ordinary business terms less costs of completion and marketing costs.

**Investments** – Investments in associates are recorded using the equity method of accounting. Investments in corporate shares where the Company owns more than 20% of share capital, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Company owns less than 20% of share capital, are accounted for at cost of acquisition.

Management periodically assesses impairment of the carrying values of such investments and records valuation allowances, if required.

**Retirement and Post-Retirement Benefits** – 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. The rates of contributions to the pension fund vary from 20% to 2% depending on the annual gross salary of each employee. These contributions are recorded in the income statement on an accrual basis.

**Other post-employment and post-retirement benefits** – In accordance with the collective agreement and the agreement on additional retirement benefits, the Company provides additional retirement benefits to both currently employed and retired employees. Most of the Company’s employees are eligible for retirement benefits subject to certain conditions, including years of service, age and salary level.

The Company accounts for post-retirement benefit plans in accordance with IAS 19 “Employee benefits”. The Company measures liabilities and assets under defined benefit plans separately for each plan at each balance-sheet date. The measurement of plan liabilities and fair values of the plan assets is confirmed by the independent actuary.

Contributions of OJSC “Tattelecom” under the employee retirement benefit plans are managed by Non-Governmental Pension Fund “Volga-Capital”, an affiliated company of the Group.

**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 reimbursed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not reimbursed as of the balance sheet dates are recorded in other receivables.

**Income taxes** – Taxes on income are calculated in accordance with the laws of the Russian Federation. Income tax rate in the Russian Federation (“RF”) equals 24%.

Deferred taxes are calculated under the balance sheet liability method in respect of temporary differences arising from differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used to determine taxable profit.

Deferred tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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Deferred taxes are calculated at rates that are expected to apply to the period when the asset is realized or the liability is settled.

**Provisions** – Provisions are recognized if the Company has current obligations as a result of past events, and it is probable that outflow of certain resources will be required to settle the obligations and a reliable estimate of the obligations can be made.

**Revenue recognition** – Revenue is measured at the fair value of consideration received or receivable from sale of goods, rendering of services in the normal course of business, net of any discounts and sales taxes.

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

1. Intrazonal telecommunications services;
2. Local telecommunications services (subscription system);
3. Installation and connection services;
4. Telegraph services;
5. Lease of cable capacity;
6. Interconnection services to other operators;
7. Other services (including Internet access).

**Intrazonal telecommunications services** – Revenue is recognized in the period in which the service is rendered. Revenue from intrazonal telecommunications services is calculated based on the time of the call, its length, direction and the type of the subscriber.

**Local telecommunications services** – Monthly subscriber fees are recognized in the month in which telephone services are rendered.

**Installation and connection services** – Upfront fees received for installation and activation of wire line services, including non-refundable connection fees, are deferred and recognized as revenue over the expected subscriber relationship period. According to management estimates, the subscriber relationship period for wire line voice phone subscribers is 15 years for residential subscribers and 5 years for all other categories of subscribers.

**Telegraph services** – Revenue from telegraph services represents revenue received from sending telegrams and other data transmission over telegraph lines. The Company recognizes revenue from telegraph services in the period in which the service is rendered.

**Lease of cable capacity** – The Company recognizes revenue from the lease of cable capacity over the term of the lease.

**Interconnection services to other operators** – Revenue from rendering services to other telecommunications operators is split into two categories. The first category represents revenue from terminating long-distance domestic and international traffic from other operators within the Company's network. The second category represents revenue from connection of operators to the Company's network.

The Company recognized interconnection revenues in the period in which telecommunications services are rendered.



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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*Other services (including Internet access)* – Revenue from other services is recognized as follows:

- Revenue from Internet-services is recognized at the date when the service is rendered to a subscriber;
- Revenue from operating leases is recognized over the lease term.

*Borrowing costs* – Borrowing costs directly attributable to items of property, plant and equipment, which take a substantial period to get ready for their intended use, are capitalized. Capitalized borrowing costs for 2006 and 2005 amounted to USD 5.6 mln. and USD 5.0 mln. respectively.

All other borrowing costs are recorded in the income statement in the period when they are incurred.

*Dividends* – Dividends for distribution to the shareholders are approved by the annual shareholders' meeting based on recommendations of the Board of Directors. Profit available for distribution is determined based on the statutory accounting records. Dividends are recognized in the period in which they are approved by the shareholders' meeting.

## 6. KEY ASSUMPTIONS AND ESTIMATES

The preparation of financial statements in conformity with IFRS 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 balance sheet date and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Applying the accounting policies, as described in Note 5, the Company's management made the following significant assumptions:

*Impairment of long-term assets* – At each balance sheet date, the Company's management reviews the carrying amounts of its fixed assets, intangible assets and other long-lived assets to determine whether there is any indication that those assets have suffered an impairment loss. If any indications have been identified of the possible impairment of an asset, the asset's recoverable amount should be determined. The key assumptions underlying the Company's estimation of impairment losses represent the discount rate and cash flow forecast.

*Valuation allowances and provisions* – At each balance sheet date the Company considers accrual of valuation allowances for obsolete inventories, doubtful receivables, deferred tax assets and contingent liabilities.

*Compliance with tax legislation* – The practice of enforcement of tax legislation in the Russian Federation is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges. The considerations relating to the compliance with the tax laws may be judgmental from the point of view of interpreting regulatory requirements.

*Subscriber life* – According to management estimates, the customer relationship period for wire line voice phone subscribers is 15 years for residential customers and 5 years for all other categories of subscribers. The subscriber lives are established based on the management's expectations and statistical data for the previous periods.



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

(in US Dollars and in thousands, unless otherwise stated)

*Post-retirement benefit obligations* – The Company's liabilities to pay post-retirement benefits to employees under the defined benefit plans were estimated based on the following assumptions: the discount rate, expected average salary raise and average life expectancy of benefit plan participants upon retirement.

## 7. PROPERTY, PLANT AND EQUIPMENT

Movements of fixed assets and accumulated depreciation for 2006 are presented as follows:

	Building	Telecommu- nications equipment	Transmission devices	Vehicles	Office equipment and other	Construction in progress	Total
<b>Cost</b>							
As of 1 January 2005	51,645	31,140	114,893	2,175	7,004	9,018	215,875
Additions	-	-	-	-	-	51,513	51,513
Transfers into operation	3,109	17,908	27,648	469	2,306	(51,440)	-
Disposals	(1,956)	(933)	(609)	(145)	(43)	-	(3,686)
Effect of translation to presentation currency	(1,875)	(1,411)	(4,593)	(83)	(291)	(325)	(8,578)
<b>As of 31 December 2005</b>	<b>50,923</b>	<b>46,704</b>	<b>137,339</b>	<b>2,416</b>	<b>8,976</b>	<b>8,766</b>	<b>255,124</b>
Additions	-	-	-	-	-	47,859	47,859
Transfers into operation	1,179	18,248	12,507	213	2,179	(34,326)	-
Disposals	(267)	(719)	(4,360)	(165)	(52)	-	(5,563)
Effect of translation to presentation currency	4,771	4,917	13,051	226	905	358	24,228
<b>As of 31 December 2006</b>	<b>56,606</b>	<b>69,150</b>	<b>158,537</b>	<b>2,690</b>	<b>12,008</b>	<b>22,657</b>	<b>321,648</b>
<b>Accumulated depreciation</b>							
As of 1 January 2005	-	-	-	-	-	-	-
Charges	(1,124)	(4,563)	(8,127)	(377)	(779)	-	(14,970)
Disposals	14	156	37	19	8	-	234
Effect of translation to presentation currency	20	76	139	7	13	-	255
<b>As of 31 December 2005</b>	<b>(1,090)</b>	<b>(4,331)</b>	<b>(7,951)</b>	<b>(351)</b>	<b>(758)</b>	<b>-</b>	<b>(14,481)</b>
Charges	(1,184)	(7,015)	(9,967)	(978)	(710)	-	(19,854)
Disposals	9	238	727	59	29	-	1,062
Effect of translation to presentation currency	(140)	(623)	(1,040)	(63)	(92)	-	(1,958)
<b>As of 31 December 2006</b>	<b>(2,405)</b>	<b>(11,731)</b>	<b>(18,231)</b>	<b>(1,333)</b>	<b>(1,531)</b>	<b>-</b>	<b>(35,231)</b>
<b>Net book value</b>							
As of 31 December 2005	49,833	42,373	129,388	2,065	8,218	8,766	240,643
As of 31 December 2006	54,201	57,419	140,306	1,357	10,477	22,657	286,417

As of 31 December 2006 and 2005, property, plant and equipment with book value of USD 37,320 thousand and USD 34,526 thousand, respectively, were pledged as collateral for certain loans obtained by Tatt telecom (Note 16).

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 8. INTANGIBLE ASSETS

Movements of intangible assets and accumulated amortization for 2006 are presented as follows:

	<u>Licenses</u>	<u>Software</u>	<u>Total</u>
<b>Cost</b>			
<b>At 1 January 2005</b>	<b>3</b>	<b>739</b>	<b>742</b>
Additions	35	319	354
Disposals	-	(43)	(43)
Effect of translation to presentation currency	(1)	(30)	(31)
<b>As of 31 December 2005</b>	<b>37</b>	<b>985</b>	<b>1,022</b>
Additions	594	257	851
Disposals	(35)	(286)	(321)
Effect of translation to presentation currency	22	90	112
<b>As of 31 December 2006</b>	<b>618</b>	<b>1,046</b>	<b>1,664</b>
<b>Accumulated depreciation</b>			
<b>At 1 January 2005</b>	<b>(1)</b>	<b>(113)</b>	<b>(114)</b>
Charges	(14)	(298)	(312)
Disposals	-	45	45
Effect of translation to presentation currency	-	9	9
<b>As of 31 December 2005</b>	<b>(15)</b>	<b>(357)</b>	<b>(372)</b>
Charges	(130)	(502)	(632)
Disposals	35	286	321
Effect of translation to presentation currency	(4)	(40)	(44)
<b>As of 31 December 2006</b>	<b>(114)</b>	<b>(613)</b>	<b>(727)</b>
<b>Net book value</b>			
<b>As of 31 December 2005</b>	<b>22</b>	<b>628</b>	<b>650</b>
<b>As of 31 December 2006</b>	<b>504</b>	<b>433</b>	<b>937</b>

#### 9. LONG-TERM INVESTMENTS

Long-term investments as of 31 December 2006 consisted of the following:

	<u>Ownership interest</u>	<u>2006</u>	<u>Ownership interest</u>	<u>2005</u>
"AK BARS" Bank	0.03%	79	0.03%	72
OJSC KamAZ	0.00%	6	0.00%	6
Loans to employees	-	348	-	219
<b>Total</b>		<b>433</b>		<b>297</b>

Loans to employees are interest-free loans with maturities of up to 3 years. The discount rate under these loans is 5.7%.

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 *(in US Dollars and in thousands, unless otherwise stated)*

#### 10. INVENTORIES

Inventories as at 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Cables and spare parts for telecommunications equipment	3,232	1,645
Finished goods and goods for sale	101	106
Other inventory	873	652
Provision for obsolete inventory	(360)	(299)
<b>Total</b>	<b><u>3,846</u></b>	<b><u>2,104</u></b>

#### 11. TRADE ACCOUNTS RECEIVABLE

Trade receivables as at 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Due from subscribers for communication services	21,456	13,259
Allowance for doubtful debts	(5,293)	(4,442)
<b>Total</b>	<b><u>16,163</u></b>	<b><u>8,817</u></b>

The Company distinguished between the following key groups of debtors for communication services:

	<u>2006</u>	<u>2005</u>
Residential	9,921	5,837
Commercial organizations and operators	9,646	3,773
Budgetary organizations	1,798	1,549
Receivable from the budget for compensation of state benefits for certain subscribers	91	2,100
<b>Total</b>	<b><u>21,456</u></b>	<b><u>13,259</u></b>

#### 12. OTHER ACCOUNTS RECEIVABLE

Other receivables as at 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Prepayments and advances	1,236	827
Prepaid expenses	220	441
Other current assets	1,665	1,961
<b>Total</b>	<b><u>3,121</u></b>	<b><u>3,229</u></b>



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 13. SHORT-TERM FINANCIAL INVESTMENTS

Short-term financial investments consist of loans extended and as of 31 December 2006 comprise of the following:

	<u>2006</u>	<u>2005</u>
OOO "Taksofon"	-	181
Loans to employees, current portion (Note 9)	124	93
<b>Total</b>	<b><u>124</u></b>	<b><u>274</u></b>

#### 14. CASH

Cash as of 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Current bank accounts, Roubles	3,955	4,249
Cash in transit, Roubles	314	199
Petty cash, Roubles	31	35
<b>Total</b>	<b><u>4,300</u></b>	<b><u>4,483</u></b>

Cash on the Company's accounts with the affiliated Ak Bars Bank as of 31 December 2006 and 2005 amounted to USD 3,502 thousand and USD 2,964 thousand, respectively.

#### 15. SHARE CAPITAL

On 30 November 2005, an Extraordinary General Shareholders' Meeting of OJSC "Tattelecom" was held to address the issues of reorganization through merger with OJSC "KGTS" and increase in the share capital of OJSC "Tattelecom" through issuance of 4,958,836,400 additional common shares with par value of 10 kopecks. On 24 April 2006, the merger was completed through exchange of 1 common share of OJSC "KGTS" for 4 ordinary shares of OJSC "Tattelecom". A preferred share of OJSC "KGTS" was exchanged for 3 common shares of OJSC "Tattelecom".

As of 31 December 2005, OJSC "Tattelecom" had 15,885,140 issued common shares with par value of 100 Roubles. As of 31 December 2005, the share capital of OJSC "KGTS" consisted of 1,220,298,800 common shares and 25,880,400 preferred shares with par value of 10 kopecks each. As of 31 December 2006, OJSC "Tattelecom" had 20,843,976,400 issued common shares with par value of 10 kopecks.

The merger with KGTS, a company under common control, was accounted for at historical cost. Assets and liabilities of the acquired company were combined with assets and liabilities of Tattelecom. Changes to the financial statements of Tattelecom were applied retrospectively to report the merger of KGTS, as though it were performed at the beginning of the earliest period presented in the financial statements. The share capital was restated to account for business combination based on the share conversion ratio on the date of acquisition.

In June 2006, Tattelecom declared dividends for 2005 of RUB 0.00394 per share for the total amount of RUB 82,125 thousand (USD 3,021 thousand).

## OJSC “TATTELECOM”

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 16. LONG-TERM BORROWINGS

Long-term borrowings as at 31 December 2006 are further analyzed as follows:

	Currency	%	2006	2005
Corporate bonds, 2 <sup>nd</sup> issue	Roubles	11.8% – 12.5%	23,196	22,430
<b>Total corporate bonds</b>			<b>23,196</b>	<b>22,430</b>
Ak Bars Bank	Roubles	4.8-14.0%	22,697	22,690
International Moscow Bank	Roubles	8.5%	5,701	-
ING Bank (Eurasia)	Euro	7.2%	2,803	-
Other	Euro, Roubles		187	1,346
<b>Total loans</b>			<b>54,584</b>	<b>46,466</b>
Less amounts maturing within one year			(29,194)	(5,777)
<b>Total long-term debt</b>			<b>25,390</b>	<b>40,689</b>

**Corporate bonds** – On 20 May 2004, Tatt telecom floated on MICEX the second issue of non-convertible bearer bonds worth RUB 600 million maturing in 3 years. Nominal value of the bonds was RUB 1,000 (USD 37.98 as of 31 December 2006).

Following the offering, rates for the first four coupons were established at 12.5% per annum, rates from the fifth coupon were set up at 11.75% per annum.

The debt obligations as of 31 December 2006 have the following maturities:

2007	29,194
2008	10,154
2009	8,864
2010	4,320
2011	2,052
Thereafter	-
<b>Total</b>	<b>54,584</b>

In December 2006, the Company entered into a credit line with Banque Societe Generale Vostok for the period up to 25 December 2011 for the amount of RUB 245 mln. (USD 9,305 thousand at the exchange rate as of 31 December 2006). The credit facility bears interest of 8.25% per annum.



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 17. FINANCE LEASE OBLIGATIONS

Financial lease obligations as at 31 December 2006 were as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2006	2005	2006	2005
Within one year	807	1,028	647	738
Two to five years	243	462	217	381
Over five years	-	-	-	-
Less: future finance charges	(186)	(371)	-	-
Present value of lease obligations	<b>864</b>	<b>1,119</b>	<b>864</b>	<b>1,119</b>
Short-term portion			(647)	(738)
<b>Long-term portion</b>			<b>217</b>	<b>381</b>

During 2004-2006, the Company entered into several finance lease agreements for telecommunications and computer equipment and vehicles. The agreements expire in 2007-2009 and assume transfer of ownership to Tatttelecom after the last lease payment is effected. The net book value of leased assets amounted to USD 5,036 thousand and USD 4,379 thousand as of 31 December 2006 and 2005, respectively. Interest expense under finance lease agreements in 2006 and 2005 amounted to USD 355 thousand and USD 313 thousand, respectively.

#### 18. INCOME TAX

The Company's income tax expense in 2006 comprises:

	2006	2005
Current income tax	9,888	7,233
Deferred tax benefit	(2,109)	(2,313)
<b>Total</b>	<b>7,779</b>	<b>4,920</b>

The movement for the year in the Company's deferred tax position is as follows:

	2006	2005
<b>Net deferred tax liability at beginning of the year</b>	<b>12,388</b>	<b>15,207</b>
Deferred tax benefit	(2,109)	(2,313)
Effect of translation to presentation currency	1,085	(506)
<b>Net deferred tax liability at end of the year</b>	<b>11,364</b>	<b>12,388</b>

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

The tax effect of existing temporary differences giving rise to the deferred tax assets and liabilities as at 31 December 2006 is presented below:

	<u>2006</u>	<u>2005</u>
<b>Deferred tax assets</b>		
Investments	338	441
Deferred revenue	8,634	7,385
Accrued expenses	446	625
Other	2,236	2,710
<b>Total deferred tax assets</b>	<u><u>11,654</u></u>	<u><u>11,161</u></u>
<b>Deferred tax liabilities</b>		
Property, plant and equipment	20,804	22,192
Other	2,214	1,357
<b>Total deferred tax liabilities</b>	<u><u>23,018</u></u>	<u><u>23,549</u></u>
<b>Total deferred tax liabilities, net</b>	<u><u>11,364</u></u>	<u><u>12,388</u></u>

The taxation charge for the year is different from that which would be obtained by applying the statutory income tax rate to the net income before income tax. Below is a reconciliation of theoretical income tax at 24% to the actual expense recorded in the Company's income statement:

	<u>2006</u>	<u>2005</u>
Income before tax	32,657	21,737
Theoretical income tax at statutory rate of 24%	7,838	5,217
Adjusted for:		
Non-deductible expenses	420	351
Other	(479)	(648)
<b>Income tax expenses</b>	<u><u>7,779</u></u>	<u><u>4,920</u></u>

## 19. DEFERRED REVENUE

Deferred revenue as of 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Deferred revenue from connection fees, current portion	4,803	3,919
Subscriber advances	1,290	1,601
<b>Total current portion</b>	<u><u>6,093</u></u>	<u><u>5,520</u></u>
Deferred revenue from connection fees, long-term portion	31,172	26,851
<b>Total</b>	<u><u>37,265</u></u>	<u><u>32,371</u></u>

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 20. POST-RETIREMENT BENEFIT OBLIGATIONS

The post-employment and post-retirement benefit program run by the Company is primarily represented by pension plans. The pension plans cover full-time employees of Tatttelecom who make personal contributions to the non-governmental pension fund. Participants of the defined benefit plan are entitled to receive specific post-retirement benefits calculated using a formula. This formula considers certain parameters, including the employees' age and length of service. As of 31 December 2006 and 2005, the Company employed around 6,800 and 6,900 employees, respectively, eligible for certain elements of the post-retirement or long-term social program of the Company, out of them 3,500 employees were the participants in the defined benefit plan.

The defined benefit plan provides for pension benefits upon reaching normal retirement age and for disability benefits. In addition, the Company has some long-term employee benefit obligations that are close in nature to defined benefits, in particular lump sum payments upon death or retirement.

The most recent independent actuarial valuation of the post-retirement and other long-term social programs in accordance with IAS 19 was performed as of 31 December 2006.

The Company's obligations on post-retirement benefits to employees under the defined benefit plans were valued as of 31 December 2006 using the following assumptions:

	<u>2006</u>	<u>2005</u>
Discount rate (% per annum)	7.62%	7.62%
Expected annual salary raise (% per annum)	10.88%	10.88%
Average life expectancy of the plan participants from date of retirement	17 years	17 years

Post-retirement benefit obligations and plan assets as of 31 December 2006 are presented as follows:

	<u>2006</u>	<u>2005</u>
Present value of defined benefit obligations	7,875	6,256
Fair value of plan assets	(4,715)	(3,808)
<b>Present value of unfunded obligations</b>	<b>3,160</b>	<b>2,448</b>
Actuarial gains unrecognized	793	859
<b>Net liability at the end of the year</b>	<b><u>3,953</u></b>	<b><u>3,307</u></b>

Movements in the present value of the defined benefit obligations in 2006 were as follows:

	<u>2006</u>	<u>2005</u>
<b>Net liability at the beginning of the year</b>	<b>3,307</b>	<b>3,587</b>
Defined benefit plan expenses	469	476
Employer's contributions	(142)	(630)
Effect of translation to presentation currency	319	(126)
<b>Net liability at the end of the year</b>	<b><u>3,953</u></b>	<b><u>3,307</u></b>



## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

Expenses under the defined benefit plans in 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Service cost	429	363
Interest cost	534	516
Expected recognized return on plan assets	(353)	(262)
Actuarial gains recognized	(141)	(141)
<b>Defined benefit plan expenses</b>	<b><u>469</u></b>	<b><u>476</u></b>

In 2005 and 2006, in addition to the defined benefit plan expenses, the Company paid RUB 15,803 thousand and RUB 16,503 thousand (USD 600 thousand and USD 627 thousand as of 31 December 2006, respectively) under the defined contribution plan.

#### 21. FIXED ASSETS GRANTED

In the normal course of business the Company receives telecommunications infrastructure assets in constructed buildings from the Governments of Kazan and the Republic of Tatarstan free-of-charge. Assets granted in 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
<b>Fixed assets granted at the beginning of the year</b>	<b>8,963</b>	<b>8,231</b>
Fixed assets granted during the year	109	1,746
Depreciation of fixed assets granted	(755)	(673)
Effect of translation to presentation currency	813	(341)
<b>Fixed assets granted at the end of the year</b>	<b><u>9,130</u></b>	<b><u>8,963</u></b>

#### 22. TRADE ACCOUNTS PAYABLE

Trade payables as at 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Payable to related parties	3,765	983
Payable to third parties	13,677	12,904
<b>Total</b>	<b><u>17,442</u></b>	<b><u>13,887</u></b>

#### 23. OTHER ACCOUNTS PAYABLE

Other payables as at 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Accrued salaries	5,220	3,805
Other accruals	5,417	2,736
Tax provision	634	305
<b>Total</b>	<b><u>11,271</u></b>	<b><u>6,846</u></b>

## OJSC “TATTELECOM”

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

Other accounts payable as of 31 December 2006 and 2005 included payable for fixed assets, used by the Company in the reporting periods that would be later transferred to the Company free-of-charge or exchanged for other fixed assets, which fair value is less than the cost of the transferred equipment.

#### 24. REVENUE

Revenue for the year ended 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
<b>Residential subscribers</b>		
Fixed-line voice services	64,322	56,412
Other services	7,360	6,427
<b>Commercial organizations</b>		
Fixed-line voice services	33,605	38,427
Lease of capacity	5,141	5,512
Other services	15,084	11,555
<b>Operators</b>		
OJSC “Rostelecom”	12,632	748
Other	5,449	499
<b>Total</b>	<u><u>143,593</u></u>	<u><u>119,580</u></u>

In 2006, the terms and conditions of network interconnection agreements concluded between the Company and OJSC “Rostelecom” were amended. These amendments resulted in redistribution of revenues from domestic and international long-distance communication services to residential and corporate subscribers to OJSC “Rostelecom”.

In 2006, the Company concluded a new network interconnection agreement with OJSC “MTT” for domestic and international long-distance connection and traffic transmission services. Revenue under the agreement with OJSC “MTT” in 2006 amounted to USD 1,093 thousand.

#### 25. OPERATING EXPENSES

Operating expenses for the year ended 31 December 2006 consisted of the following:

	<u>2006</u>	<u>2005</u>
Payroll	40,005	34,296
Depreciation of property, plant, and equipment	19,854	14,970
Interconnection charges	14,986	16,657
Materials, repairs and maintenance	8,126	4,811
Loss on disposal of property, plant and equipment	4,367	1,481
Taxes, other than income tax	3,950	3,194
Rent	1,987	1,855
Contributions to the Universal Service Fund	1,463	1,251
Insurance	614	539
Amortization of intangible assets	632	312
Advertising	541	360
Allowance for doubtful debts	422	1,636
Fee for professional services	475	394
Bank charges	307	187
Depreciation of fixed assets granted	(755)	(673)
Other expense	12,901	15,926
<b>Total</b>	<u><u>109,875</u></u>	<u><u>97,196</u></u>



## OJSC “TATTELECOM”

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

#### 26. FIRST-TIME ADOPTION OF IFRS

The Company for the first time prepared its financial statements in accordance with IFRS for the year ended 31 December 2006. The transition to IFRS was accounted for under IFRS 1 “First-time Adoption of International Financial Reporting Standards”.

The shareholders’ equity recorded in Russian statutory (“RAS”) accounts as of 1 January 2005, the date of transition to IFRS, and 31 December 2006 was adjusted as follows:

	<u>31 December 2006</u>	<u>1 January 2005</u>
<b>Combined shareholders’ equity of OJSC “Tattelecom” and OJSC “KGTS” (before merger) as per RAS accounts (unaudited)</b>	<b><u>113,534</u></b>	<b><u>98,046</u></b>
Adjustments for:		
- revaluation of fixed assets	77,254	81,370
- translation to presentation currency	8,896	(4,875)
- recalculation of deferred revenue	(35,975)	(30,770)
- recalculation of deferred taxes	(11,229)	(12,388)
- accrual of post-retirement benefits	(3,953)	(4,096)
- accrual of unutilized vacation	(1,516)	(874)
- provision for obsolete inventory	(360)	(299)
- revaluation of financial investments	(258)	(258)
- other	<u>23,763</u>	<u>3,439</u>
<b>Total adjustments</b>	<b><u>56,622</u></b>	<b><u>31,249</u></b>
<b>Shareholders’ equity under IFRS</b>	<b><u>170,156</u></b>	<b><u>129,295</u></b>

Net income recorded on RAS accounts in 2006 and 2005 was adjusted as follows:

	<u>2006</u>	<u>2005</u>
<b>Combined net income of OJSC “Tattelecom” and OJSC “KGTS” (before merger) as per RAS accounts (unaudited)</b>	<b><u>27,602</u></b>	<b><u>18,770</u></b>
Adjustments for:		
- capitalization of interest expenses	5,625	5,037
- deferred tax assets	2,416	2,778
- deferred revenue	(4,451)	(10,436)
- depreciation of fixed assets	(4,116)	(3,695)
- other	<u>(2,198)</u>	<u>4,363</u>
<b>Total adjustments</b>	<b><u>(2,724)</u></b>	<b><u>(1,953)</u></b>
<b>Net income under IFRS</b>	<b><u>24,878</u></b>	<b><u>16,817</u></b>

## OJSC "TATTELECOM"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (in US Dollars and in thousands, unless otherwise stated)

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#### 27. RELATED PARTY TRANSACTIONS

##### Remuneration paid to key management personnel

Remuneration to the Board of Directors members and key executives of Tatttelecom (15 employees in 2006 and 12 employees in 2005) for 2006 and 2005 amounted to USD 397 thousand and USD 340 thousand, respectively.

##### Transactions with other related parties

Receivables from and payables to the related parties as of 31 December 2006 comprise of the following:

	<u>2006</u>	<u>2005</u>
Due from subscribers for communications services (Note 11)	6,227	3,076
Cash and cash equivalents (Note 14)	3,502	2,964
Payables to related parties (Note 22)	3,765	983
Long-term loans (Note 16)	22,697	22,690

Income from rendering telecommunications services to affiliated parties and expenses related to services provided by those companies for 2006 comprise of:

	<u>2006</u>	<u>2005</u>
Revenues (Note 24)	29,434	15,323
Operating expenses (Note 25)	20,908	17,091

#### 28. FINANCIAL RISK MANAGEMENT

The main risks inherent to the Company's operations are those related to liquidity, market movements in interest rates and credit risk exposures. A summary of the Company's risk management policies in relation to those risks is below:

**Liquidity risk** – Liquidity risk is the risk that Tatttelecom will not be able to settle all liabilities as they fall due. Tatttelecom has in place a detailed budgeting and cash forecasting process to ensure that it has adequate cash available to meet its payment obligations.

**Interest rate risk** – The interest rate risk derives from changes in interest rates, which may adversely affect the financial performance of Tatttelecom. Loans attracted by Tatttelecom bear fixed interest rates.

**Credit risk** – Credit risk is the risk that counterparty may default or not meet its obligations to the Company on a timely basis, leading to financial loss to the Company. The diversified subscriber base mitigates Tatttelecom's dependency upon limited number of customers.

#### 30. SUBSEQUENT EVENTS

In April 2007, the Company signed a loan agreement with the International Moscow Bank for the amount of RUB 600 mln. (USD 22,787 thousand at the exchange rate as of 31 December 2006). The credit facility bears interest of 8.40% per annum.

In April 2007, the Company entered into a credit line with Alfa-Bank for the period up to 6 July 2007 for the amount of RUB 100 mln. (USD 3,800 thousand at the exchange rate as of 31 December 2006). The credit facility bears interest of 8.75% per annum.