OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
Years Ended December 31, 2004, 2003 and 2002

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the shareholders of OAO Moscow City Telephone Network:

We have audited the accompanying consolidated balance sheets of OAO Moscow City Telephone Network ("MGTS") and its subsidiaries (collectively – the "Group") as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. 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 also 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5, MGTS accounts for its investments in MTU and Mediatel using the equity method of accounting during the year ended December 31, 2004. These companies were consolidated during the years ended December 31, 2003 and 2002.

April 25, 2005

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2004 AND 2003
(in U.S. dollars and in thousands, except for share amounts)

		2004		2003
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents (Note 6)		28,748		41,101
Short-term investments (Note 7)		25,609		66,150
Accounts receivable, advances and taxes receivable, net (Note 8)		75,323		72,470
Inventories		15,550		13,839
Deferred income taxes, net (Note 15)		11,432		9,423
Restricted cash (Note 11)		972		1,281
Assets of discontinued operations (Note 4)		-		58,999
Total current assets	$	157,634	$	263,263
NON-CURRENT ASSETS:				
Property, plant and equipment, net (Note 9)		1,028,878		931,639
Advance payments for property, plant and equipment		7,248		3,861
Long-term investments (Note 10)		171,332		78,422
Deferred income taxes, net (Note 16)		51,618		44,854
Total non-current assets		1,259,076		1,058,776
TOTAL ASSETS	$	**1,416,710**	$	**1,322,039**
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Short-term debt (Note 11)		72,278		51,700
Accounts payable, taxes payable and accrued liabilities (Note 12)		46,509		44,131
Deferred revenue, current portion (Note 13)		46,605		37,412
Liabilities of discontinued operations (Note 4)		-		42,498
Total current liabilities	$	165,392	$	175,741
NON-CURRENT LIABILITIES:				
Long-term debt (Note 11)		117,282		101,828
Deferred revenue (Note 13)		97,538		79,425
Retirement and post-retirement benefits (Note 14)		11,513		4,897
Property, plant and equipment contributions (Note 15)		103,822		88,388
Deferred income taxes (Note 16)		81,487		67,688
Total non-current liabilities		411,642		342,226
TOTAL LIABILITIES	$	**577,034**	$	**517,967**
MINORITY INTERESTS IN EQUITY OF SUBSIDIARIES		-		80,360
COMMITMENTS AND CONTINGENCIES (Note 28)		-		-
SHAREHOLDERS' EQUITY:				
Preferred stock, 15,965,850 shares authorized, issued and outstanding (Note 17)		22,538		22,538
Common stock, 79,829,200 shares authorized, issued and outstanding (Note 17)		112,462		112,462
Additional paid-in capital		61,806		61,806
Retained earnings		583,444		515,193
Accumulated other comprehensive income (Note 3)		59,426		11,713
Total shareholders' equity		839,676		723,712
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	**1,416,710**	$	**1,322,039**

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(in U.S. dollars and in thousands, except for per share amounts)

	2004	2003	2002
Operating revenues (Note 18)	$ 480,84	$ 472,5	$ 380,89
Operating expenses, net (Note 19)	(381,337	(331,6	(267,589
OPERATING INCOME	99,51	140,8	113,31
Interest income	3,43	4,6	1,92
Interest expense	(17,133	(17,2	(30,135
Currency transaction (loss)/gain	(470)	3,0	658
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE AND MINORITY INTERESTS	85,33	131,3	85,75
Income tax expense (Note 16)	(26,622	(33,7	(20,313
Income from affiliates	16,13	894	3,02
Minority interests	-	(20,0	(14,572
INCOME FROM CONTINUING OPERATIONS	74,84	78,4	53,89
Gain/(loss) from discontinued operations (net of income tax effect of $729, $1,589 and $850)	2,13	(8,6	3,56
(Loss)/gain on disposal of discontinued operations (net of income tax effect of $429 and $476)	(1,954	-	769
NET INCOME	$ **75,02**	$ **69,8**	$ **58,22**
Earnings per common share before gain/(loss) from discontinued operations, basic and diluted	$ 0.78	$ 0.84	$ 0.55
Gain/(loss) from discontinued operations	0.00	(0.11)	0.06
Earnings per common share, basic and diluted (Note 21)	$ **0.78**	$ **0.73**	$ **0.61**
Weighted average number of common shares outstanding	79,829,200	79,829,200	79,829,200

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(in U.S. dollars and in thousands)

	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 75,02	$ 69,81	$ 58,22
Adjustments to reconcile net income to cash provided by operating activities:			
(Loss)/gain from discontinued operations	(179)	8,62	(4,33
Allowance for doubtful accounts	(500)	348	1,27
Depreciation charge	68,01	69,29	61,42
Currency transaction loss/(gain)	470	(3,05	(658)
Income from affiliates	(16,13	(894)	(3,02
Deferred gain amortization	(735)	(735)	(735)
Deferred taxes	3,07	2,27	4,75
Post-retirement benefits	6,31	327	(2,57
Loss on disposal of property, plant and equipment	4,16	3,45	526
Gain on disposal of long-term investments	-	(3,56	-
Minority interest	-	20,06	14,57
Changes in operating assets and liabilities:			
Accounts receivable, advances and taxes receivable	(19,32	3,55	(1,20
Inventories	(865)	(1,53	644
Accounts payable, taxes payable and accrued liabilities	10,82	1,36	(23,36
Deferred revenue	26,66	10,24	18,31
Net cash provided by operating activities	156,81	179,58	123,84
CASH FLOWS FROM INVESTING ACTIVITIES:			
Dividends received from investees	474	830	1,64
Acquisition of subsidiary, net of cash received	-	-	(50)
Purchases of property, plant and equipment	(132,32	(75,90	(67,28
Proceeds from sale of property, plant and equipment	1,32	2,21	2,46
Proceeds from sale of long-term investments	652	4,10	-
(Purchases)/proceeds from sale of short-term investments, net	(13,62 -	(55,23	1,76
Net cash used in investing activities	$ (143,49	$ (123,99	$ (61,45
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	89,05	79,71	44,19
Repayments of borrowings	(76,12	(114,04	(69,03
Repayments of vendor financing	(12,78	(8,92	(13,48
Payments on capital leases	(9,27	(4,04	(5,20
Dividends paid	(9,22	(5,75	(3,01
Net cash used in financing activities	(18,34	(53,04	(46,55
NET CASH USED IN DISCONTINUED OPERATIONS	-	-	(6,51
EFFECTS OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	2,00	102	(665)
(DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(3,01	2,64	8,65
CASH AND CASH EQUIVALENTS, beginning of year	31,766 (*)	38,45	29,80

CASH AND CASH EQUIVALENTS, end of year	$	28,74	$	41,1(	$	38,45

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (continued)
(in U.S. dollars and in thousands)

		2004		2003		2002
SUPPLEMENTAL INFORMATION:						
Cash paid for interest, net of amounts capitalized	$	13,649	$	17,197	$	29,832
Income taxes paid	$	25,478	$	30,398	$	19,373
NON-CASH INVESTING AND FINANCING ACTIVITIES:						
Property, plant and equipment received free of charge	$	13,597	$	18,793	$	18,050
Equipment acquired through vendor financing (Note 11)	$	20,714	$	17,093	$	8,522
Equipment acquired under capital leases (Note 11)	$	25,765	$	1,571	$	4,770

(*) – excluding cash and cash equivalents of MTU-Inform as of December 31, 2003 (Note 5).

In addition, non-cash investing activities during the year ended December 31, 2004 included disposals of shares of subsidiaries and affiliates, as described in Notes 5 and 10.

See notes to consolidated financial statements.

OAO MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2004, 2003, AND 2002
(in U.S. dollars and in thousands, except for share and per share amounts)

	Preferred stock		Common stock		Additional paid-in capital	Retained earnings	Accumula-ted other compre-hensive income	Total
	Shares	Amount	Shares	Amount				
Balances at January 1, 2002	**15,965,850**	**$ 12,346**	**79,829,200**	**$ 61,502**	**$ 64,25**	**$ 463,43**	**$ -**	**$ 601,53**
Increase of par value of shares	-	10,192	-	50,960	-	(61,15	-	-
Net income	-	-	-	-	-	58,22	-	58,22
Effect of acquisition from a related party	-	-	-	-	(2,44	-	-	(2,44
Dividends declared on preferred shares	-	-	-	-	-	(3,54	-	(3,54
Dividends declared on common shares	-	-	-	-	-	(1,71	-	(1,71
Balances at December 31, 2002	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ 61,80**	**$ 455,24**	**$ -**	**$ 652,05**
Net income	-	-	-	-	-	69,81	-	69,81
Dividends declared on preferred shares	-	-	-	-	-	(6,57	-	(6,57
Dividends declared on common shares	-	-	-	-	-	(3,28	-	(3,28
Translation adjustment (Note 3)	-	-	-	-	-	-	47,05	47,05
Income tax effect of changes in the functional currency (Note 3)	-	-	-	-	-	-	(35,33	(35,33
Balances at December 31, 2003	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ 61,80**	**$ 515,19**	**$ 11,71**	**$ 723,71**
Net income	-	-	-	-	-	75,02	-	75,02
Dividends accrued on preferred shares	-	-	-	-	-	(6,77	-	(6,77
Translation adjustment (Note 3)	-	-	-	-	-	-	47,71	47,71
Balances at December 31, 2004	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ 61,80**	**$ 583,44**	**$ 59,42**	**$ 839,67**

The Group accrued 2004 dividends of \$0.08 on the preferred shares based on the provisions of MGTS' Charter (Notes 17 and 21).
Dividends paid per share in 2003 were \$0.04 (2002: \$0.02) on the common shares and \$0.41 (2002: \$0.23) on the preferred shares.

See notes to consolidated financial statements.

(in U.S. dollars and in thousands unless otherwise stated)

1. THE GROUP

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

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

Operating Entities	Short Name	Principal activity
ZAO "Company MTU-Inform"	MTU-Inform	Providing direct lines, digital channels and blocks of phone numbers to other telecom operators; providing data transmission services.
ZAO "AMT"	AMT	Radiotelephony services and repair of telecommunication equipment.
ZAO "Mediatel"	Mediatel	Resale and maintenance of telecommunication equipment and software.
ZAO "Petrodvor"	Petrodvor	Providing services to the entities of the Group.
ZAO "United TeleSystems MGTS"	United TeleSystems MGTS	Holding of the Group's investments in shares of alternative operators.

The Group's controlling shareholder is AFK Sistema.

Prior to 2004, the Group had two reportable segments, (1) MGTS and (2) MTU-Inform and other subsidiaries (see Note 19 for additional information on segments). As discussed in Note 5, effective January 1, 2004, the Group changed its method of accounting for MTU-Inform and Mediatel from consolidation to equity method of accounting. Consequently, in 2004 the Group did not account for MTU-Inform and other subsidiaries as a separate segment.

Affiliates of MGTS provide fixed-line and wireless telecommunication, data transmission, Internet, electronic and voice mail, and teleconferencing services throughout the Moscow metropolitan area.

Local telephone services are regulated tariff services and changes in rate structure are subject to approval of Federal Tariff's Service ("FTS"). In 2004 and 2003, approximately 61% and 68%, respectively, of MGTS segment revenues were generated from regulated tariff services. Fixed monthly fees approved by FTS during 2004 are presented in the table below:

In Rubles:	January 1 - September 30, 2004	October 1 - December 31, 2004
Residential customers (including VAT)	140	170
State-financed institutions	140	170
Corporate entities	165	200

Residential customers are charged a fixed monthly fee while corporate entities and state-financed institutions are charged for local traffic in addition to a fixed monthly fee.

2. STRATEGIC ACTIONS

In December 2003, the Group 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 Moscow City Government of December 16, 2003.

Capital expenditures under the investment program are currently estimated to be approximately $1.6 billion during the years 2004-2012 and include reconstruction of 350 local telephone stations and installation of 4.3 mln. of digital phone numbers.

As of December 31, 2004, the Group did not have any legally enforceable obligations in connection with the investment program and, accordingly, no amounts in respect of the investment program have been recorded in the Group's financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

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

Principles of Consolidation - The ownership interest of MGTS and proportion of voting power of the Group in the significant subsidiaries as of December 31, 2004 and 2003 are as follows:

Operating entities	**Ownership interest**		**Proportion of voting power**	
	2004	**2003**	**2004**	**2003**
MTU-Inform	51%	51%	51%	51%
PeCom (Note 4)	-	42%	-	83%
AMT	100%	100%	100%	100%
Mediatel	51%	51%	51%	51%
Petrodvor	100%	100%	100%	100%
United TeleSystems MGTS	100%	-	100%	-

The consolidated financial statements for the years ended December 31, 2004 and 2003 include the accounts of MGTS and its subsidiaries after the elimination of significant intercompany transactions and balances.

As discussed in Note 5, MGTS accounts for its investments in MTU and Mediatel using the equity method of accounting during the year ended December 31, 2004. These subsidiaries were consolidated during the years ended December 31, 2003 and 2002.

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 for the period. Actual results could differ from these estimates.

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

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

Foreign Currency Translation - The Group follows a translation policy in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 52, "Foreign Currency Translation". Due to a highly inflationary economy in the Russian Federation in 2002 and previous years, the U.S. dollar (the Group's reporting currency) has been designated as the Group's functional currency. Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. Management has determined that for the fiscal year beginning January 1, 2003, the functional currency of MGTS, AMT and Petrodvor is Russian Ruble. Accordingly, the reporting currency amounts were translated into Rubles at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for non-monetary assets and liabilities.

Pursuant to Emerging Issues Task Force ("EITF") Issue No. 92-8, "Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary", the differences between the new functional currency bases of non-monetary assets and liabilities and their tax bases represent temporary differences, for which deferred taxes must be recognized. Income tax effect of changes in the functional currency amounted to $35.3 mln. was reported within other comprehensive income for the year ended December 31, 2003.

The Group selected U.S. dollar ("USD") as its reporting currency and translated functional currency financial statements of its entities into USD. Assets and liabilities were translated at year-end exchange rates, while income and expense items were translated at the average rate for the quarter in which such transactions occurred. The resulting translation adjustment was recorded as a separate component of other comprehensive income.

The official rate of exchange, as determined by the Central Bank of the RF, between the Ruble and the U.S. Dollar at December 31, 2004 was 27.75 Rubles to 1 U.S. dollar (2003: 29.45; 2002: 31.78).

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

Revenue Recognition - The Group's revenues are principally derived from the provision of local telephone and data transmission services which consist of (i) usage charges, (ii) a monthly telephone service fee, (iii) service activation and installation fees, (iv) revenues from use of prepaid phone cards and (v) charges for value-added telecommunication services. The Group records revenues over the periods they are earned as follows:

(i) Revenues derived from local telephone usage and data transmission are recognized as the services are provided;

(ii) Monthly telephone service fees are recognized in the month during which the telephone services are provided to customers;

(iii) Upfront fees received for activation and installation of wireline and data transmission services are deferred and recognized over the expected customer relationship period. According to management estimates, the customer relationship period for wireline voice phone subscribers is 15 years for residential customers and 5 years for all other categories of subscribers;

(iv) Revenues from sale of prepaid calling cards are recognized as cards are used by customers or the prepaid cards expire;

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

Other related telecommunications service revenues are recognized as follows:

(i) Revenues from the provision of internet-services are recognized when the services are provided to customers;

(ii) Interconnection fees from other telecommunications operators are recognized when the services are provided to the operators;

(iii) Lease income from operating leases is recognized over the term of the lease.

Management believes that the Group is not subject to the requirements of FAS 71, "Accounting for the Effects of Certain Types of Regulation" as the regulated rates for certain types of services are not designed to recover the specific Group's costs of providing the regulated services or products.

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

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

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

Long-term financial instruments that potentially expose the Group to concentrations of credit risk consist primarily of long-term investments. It is not practicable for the Group to estimate the fair values of all of its long-term investments due to quoted market prices not being readily available and regular valuations are not being completed or obtained due to the excessive costs involved. Fair values of certain of the Group's long-term investments based on the valuations of independent appraisers are disclosed in Note 10.

Fair values of corporate bonds issued by MGTS are disclosed in Note 11.

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

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

Inventories - Inventories comprise cables, spare parts, telephones and accessories and are stated at the lower of cost or market. Cost is computed on an average cost basis.

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

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

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Leases are classified as capital leases whenever the terms of the lease transfer substantially all of the benefits and rewards incident to the ownership. All other leases are classified as operating leases. Capital leases are recorded at the fair market value of the asset or the present value of future minimum lease payments, whichever is lower. The discount rate used in determining present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to learn 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 balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

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

	Years
Buildings	47
Analogue telecommunication equipment	17
Digital telecommunication equipment	10
Transmission devices	31
Site improvements	44
Other equipment	3 – 25

Property, plant and equipment held and used by the Group are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may have been impaired. Management believes that no impairment has occurred relating to the Group's investments in property, plant and equipment as of December 31, 2004.

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

Property, plant and equipment which was transferred to the Group free of charge is capitalized at its market value at the date of transfer and deferred revenue is recorded and amortized to the consolidated statement of operations over the contributed assets' life.

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 have 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, 2004 the estimated assets retirement obligations were not significant to the Group's consolidated financial position and results of operations.

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

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

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

Retirement and Post-Retirement Benefits - Contributions are made to the Government's social and medical insurance and retirement benefit schemes at the statutory rates in force during the year.

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 35.6% 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 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

During the year ended December 31, 2002, MGTS established a defined contribution plan to provide eligible employees with additional income upon retirement. MGTS's contributions to the plan, totaling $0.2 mln. and $0.9 mln. in 2004 and 2003, respectively, are managed by the pension fund "Sistema", a party related by means of common control.

In addition, MGTS has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service (Note 14).

***Income Taxes* -** Income taxes have been computed in accordance with RF laws. From January 1, 2002, RF enacted an income tax rate of 24%. In July 2004, amendments to Russian income tax legislation were enacted to increase, effective January 1, 2005, the income tax rate on dividends paid within Russia to 9% (previously 6%).

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

***Borrowing Costs* -** The Group capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. For the years ended December 31, 2004, 2003 and 2002 capitalized borrowing costs amounted to $0.8 mln., $1.2 mln. and $0.6 mln., respectively. Other borrowing costs were recognized as an expense in the period in which they were incurred. Debt issue costs are amortized to expense over the term to maturity.

***Earnings Per Share* -** Earnings per share is computed using the two-class method. Net income available to common shareholders is divided by the weighted average number of common shares outstanding in the year. Net income available to common shareholders is determined by reducing net income by the greater of dividends declared in the accounting period on preferred shares or of dividends on preferred shares guaranteed under MGTS' Charter (Note 20).

***Comprehensive Income* -** Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is a reconciliation of comprehensive income, net of income tax effect:

	2004	2003	2002
Net income	75,02	69,81	58,22
Translation adjustment	47,71	47,05	-
Income tax effect of change in the functional currency	-	(35,33	-
Total comprehensive income	**122,74**	**81,52**	**58,22**

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

***Reclassifications* -** Certain reclassifications of prior years' amounts have been made to conform to the presentation adopted for 2004.

***New Accounting Pronouncements* -** In November 2003, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue No. 03-10, "Application of EITF Issue No. 02-16, 'Accounting by a

Customer (Including a Reseller) for Certain Consideration Received from a Vendor', by Resellers to Sales Incentives Offered to Consumers by Manufacturers." The consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller's purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The adoption of Issue No. 03-10 did not have a material impact on the Group's results of operations or financial position.

In December 2003, the Financial Accounting Standards Board ("FASB") issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003. The adoption of FIN 46R did not have a material impact on the Group's financial position or results of operations.

In March 2004, the EITF reached a consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share". This Issue defines participating security and clarifies some practical issues related to including participating securities in the calculation of EPS. EITF Issue No. 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of Issue No. 03-6 did not have a material impact on the Group's financial position or results of operations.

In July 2004, the EITF issued EITF No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock." A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The Task Force also reached a consensus on the definition of in-substance common stock and related guidance. EITF No. 02-14 is effective for reporting periods beginning after September 15, 2004. The Group is evaluating whether the adoption of EITF No. 02-14 will have a material impact on its financial position or results of operations.

In September 2004, the Emerging Issues Task Force ("EITF") issued a final consensus on EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination". In this issue the EITF reached a consensus that a business combination between two parties having a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship. This Issue requires certain additional disclosures for business combinations between parties with a preexisting relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. The Group does not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on its financial position or results of operations.
At the September 2004 meeting of the Emerging Issues Task Force, the SEC staff issued an announcement D-108, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill", which requires the companies to use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.
Under the new accounting guidance, the Group will use the direct method to measure the fair value of licenses acquired in the future business combinations. The Group does not anticipate impact from

adoption of the above SEC guidance to be material to its consolidated results of operations or financial position.

In October 2004, the EITF reached a consensus on EITF Issue No. 04-10, " Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds". EITF No. 04-10 provided additional guidance on when operating segments that are below the 10% threshold can be aggregated. EITF Issue No. 04-10 states that segments can only be aggregated if they have similar economic characteristics and if they are similar in areas such as production processes, types of customers, distribution channels and the products themselves are similar. The consensus reached by EITF No. 04-10 is effective for fiscal years ending after October 13, 2004. The adoption of SFAS EITF No. 04-10 did not have a material impact on the Group's financial position or results of operations.

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets", an amendment of APB Opinion No. 29, "Accounting for Nonmonetary Transactions". FAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. FAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2005. The Group does not anticipate the adoption of FAS No. 153 to have a material impact on its results of operations or financial position.

In December 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 123R, "Share-Based Payment" ("FAS No. 123R"), a revision of FAS No. 123, "Accounting for Stock-Based Compensation". FAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments grant-date to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. FAS No. 123R is effective for interim periods beginning after June 15, 2005, at which time companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. The Group does not anticipate the adoption of FAS No. 123R will have a material impact on its financial position, cash flows and results of operations.

In March 2005 FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143." This Interpretation clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity, in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. Interpretation 47 is effective for the Group beginning January 1, 2006. The Group is currently in the process of assessing effects of Interpretation 47 on its consolidated financial position and result of operations.

4. DISCONTINUED OPERATIONS

During 2003, the management of AFK Sistema, the parent company of the Group, made a decision to dispose of operations of PeCom, subsidiary of MTU-Inform. In August 2004, MTU-Inform sold 83.25% of voting common shares of PeCom to SkyLink, an affiliate of AFK Sistema, for the short-term promissory notes of SkyLink in the amount of $16,011.

In accordance with FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the consolidated financial statements of the Group reflect PeCom business as discontinued operations for the years ended December 31, 2004, 2003 and 2002. Accordingly, revenues, costs and expenses, assets, liabilities and cash flows of PeCom have been excluded from the respective captions in the statements of operations, balance sheets, and statements of cash flows and have been reported as income or loss from discontinued operations, net of applicable taxes; as assets and liabilities of discontinued operations; and as net cash used in discontinued operations for the years ended December 31, 2004, 2003 and 2002.

Revenues from discontinued operations and gain/(loss) from discontinued operations before income taxes and minority interest for the years ended December 31, 2004, 2003 and 2002 are presented in the table below:

	2004	**2003**	**2002**
Revenues from discontinued operations	32,4	51,3	44,5
Gain/(loss) from discontinued operations before income taxes and minority interest	8,4	(13,3	10,7

Assets and liabilities of discontinued operations as of December 31, 2003 consisted of the following:

	2003
Current assets	9,688
Non-current assets	49,311
Total assets of discontinued operations	**58,999**
Current liabilities	27,639
Non-current liabilities	11,994
Minority interest	2,865
Total liabilities of discontinued operations	**42,498**

Assets of discontinued operations as of December 31, 2002 included goodwill in amount of $19.3 mln. assigned to PeCom. In May 2003, the management of AFK Sistema announced its intention to curtail further investments in PeCom. Concurrently, the Group performed an impairment test of goodwill assigned to PeCom and recorded an impairment charge of $19.3 mln., which was included in net loss from discontinued operations for the year ended December 31, 2003.

5. DECONSOLIDATION OF MTU-INFORM AND MEDIATEL

In May 2004, AFK Sistema announced completion of the operational merger of its three digital operators: MTU-Inform, Comstar and Telmos. The completion of the legal merger is expected in 2005. The merged company will operate under the name of "Comstar United Telesystems".
In May 2004, the Group and the minority shareholders of MTU-Inform controlled by AFK Sistema agreed to transfer the operating and financial control over operations of MTU-Inform to Comstar, a subsidiary of AFK Sistema. In July 2004, MTU-Inform entered into agreement with Comstar for the transfer to Comstar of management functions over MTU-Inform's operations. As a result of the contractual arrangement the Group ceased to have the controlling financial interest and currently exercises significant influence over MTU-Inform's operations.

In 2004, the Group entered into contractual arrangement with the minority shareholder of its subsidiary Mediatel. Under the terms of the arrangement the Group transferred control over financial and operational activities of Mediatel to a subsidiary of AFK Sistema. Management believes that the Group exercises significant influence over Mediatel's operations.

Following the transfer of the control over MTU-Inform and Mediatel to the subsidiaries of AFK Sistema the Group discontinued consolidating the accounts of MTU-Inform and Mediatel in its consolidated financial statements. Starting from January 1, 2004, the Group's share in the earnings of MTU-Inform and Mediatel was recorded using the equity method of accounting. If the Group had accounted for its investments in MTU-Inform and Mediatel under the equity method during the three years ended December 31, 2004 the pro forma financial data for the years ended December 31, 2004, 2003 and 2002 would have been as follows:

	2004	2003	2002
Operating revenue	480,84	385,74	301,08
Operating expenses	(381,337	(298,634	(230,837
Income from continuing operations before income tax expense and minority interest	85,33	72,49	41,57
Income tax	(26,622	(18,257	(10,342
Income from affiliates	16,13	24,20	22,65
Gain/(loss) from discontinued operations	179	(8,626	4,33
Net income	**75,02**	**69,81**	**58,22**

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2004 and 2003 consisted of the following:

	2004	2003
Rubles	24,068	20,982
U.S. Dollars	919	207
Other currencies	28	15
Cash equivalents	3,733	19,897
Total	**28,748**	**41,101**

Cash and cash equivalents held by the Group with Moscow Bank for Reconstruction and Development ("MBRD"), a company related to the Group by means of common control, as of December 31, 2004 and 2003 amounted to $14.5 mln. and $29.4 mln., respectively.

7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2004 and 2003 consisted of the following:

	2004	**2003**
RUR-denominated time deposit in MBRD	19,821	8,488
USD-denominated time deposit in MBRD	4,600	1,300
RUR-denominated promissory notes from related parties	-	28,289
USD-denominated promissory notes from related parties	41	12,000
RUR-denominated bank promissory notes	-	7,128
USD-denominated bank promissory notes	-	2,000
EUR-denominated bank promissory notes	-	1,250
PeCom RUR-denominated promissory note	-	5,070
Other non-interest bearing loans to related parties	1,147	625
Total	**25,609**	**66,150**

USD-denominated promissory notes from related parties are issued by MBRD and bear interest of 0.1% per annum and mature in 2005. Interest income received from related parties is disclosed in Note 23.

The interest rates of RUR-denominated notes in MBRD vary from 7.8% for a 4 months deposit to 12.0% for a 12 months deposit. USD-denominated time deposits in MBRD have the original term of 4 and 5 months and bear interest of 6.0% and 7.0% per annum, respectively.

The interest-free loans to Priazovie and ZAO Investment Pension Company mature in 2005.

8. ACCOUNTS RECEIVABLE, ADVANCES AND TAXES RECEIVABLE, NET

Accounts receivable, advances and taxes receivable as of December 31, 2004 and 2003 consisted of the following:

	2004	**2003**
Customers	20,6	23,6
Related parties, including affiliates, Rostelecom and state-financed institutions	20,3	21,0
Other receivables and advances	10,6	15,5
VAT recoverable	22,1	12,6
Other taxes receivable	3,1	2,0
Allowance for doubtful accounts	(1,5	(2,4
Total	**75,3**	**72,4**

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

Rostelecom pays a fee to MGTS for the transit of domestic long distance and international calls originated by MGTS subscribers. Respective revenue amounts are disclosed in Note 18.

9. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of December 31, 2004 and 2003 consisted of the following:

	2004	2003
Buildings and site improvements	212,76	193,92
Switches and transmission devices	953,86	870,21
Other fixed assets	188,19	167,59
Construction in progress	89,15	70,48
Total cost	1,443,97	1,302,22
Accumulated depreciation	(415,10C	(370,586
Total	**1,028,87**	**931,63**

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

10. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2004 and 2003 consisted of the following:

	2004		2003	
	Ownership, %	Investment	Ownership, %	Investment
Investments in affiliates:				
ZAO MTU-Inform	51	95,062	51	Consolidated
ZAO Comstar	50	37,691	50	36,520
ZAO Telmos	40	20,108	40	17,009
OAO MCC	-	-	24	7,262
ZAO MTU-Intel	30	6,736	30	5,695
Total investments in affiliates		159,597		66,486
Other investees, at cost	Various	7,090	Various	6,771
PeCom RUR-denominated promissory notes		3,964		3,735
MTU-Intel RUR-denominated promissory note		526		419
Interest free loans to investees		155		1,011
Total		**171,332**		**78,422**

In October 2004, the Group sold shares of OAO MCC shares to Sky Link, a party related by means of common control, for $0.7 mln. in cash. As a result of this transaction the Group recognized loss from investments in affiliates of $6.9 mln.

In October 2002, the Group sold its 50% share in ZAO Golden Line to MTU-Intel in exchange for 4.5% of MTU-Intel's common shares, an interest-free promissory note with a face value of RUR 23.2 mln. ($0.8 mln.) and $0.1 mln. in cash. The promissory note maturing in 2007 is included in long-term investments at its estimated fair value of $0.5 mln. at Decmeber 31, 2004. Fair value has been determined using the current interest rates at which similar loans would have been offered to the Group by non-related borrowers.

In 2004, the Group performed valuation of certain of its long-term investments by independent appraiser. The fair values of these long-term investments are as follows:

	Ownership, %	Investment
ZAO MTU-Inform	51	131,673
ZAO Telmos	40	16,561
ZAO MTU-Intel	30	39,666

The following table summarizes the combined financial information for equity investments in affiliated companies ZAO MTU-Inform, ZAO Comstar and ZAO Telmos for the year ended December 31, 2004:

Revenues	219,747
Income before income taxes	62,007
Net income	46,951
Current assets	177,796
Non-current assets	203,425
Current liabilities	52,027
Non-current liabilities	14,180

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

11. DEBT OBLIGATIONS

Debt obligations as of December 31, 2004 and 2003 consisted of the following:

	Currency	2004	2003
Bonds 2nd issue	RUR	-	18,69
Bonds 3rd issue	RUR	36,03	33,95
Bonds 4th issue	RUR	54,05	-
Total corporate bonds		**90,09**	**52,64**
Citibank	USD	15,14	8,61
Sberbank	RUR	12,61	30,55
Vneshtorgbank	EURO	9,90	-
Vneshtorgbank	USD	7,07	11,65
Raiffeisenbank	USD	3,75	15,00
Guta-bank	USD	773	2,83
Long-term portion of vendor financing	Various	9,61	17,50
Short-term portion of vendor financing	Various	16, 07	9,13
Long-term portion of finance leases	Various	19,24	2,13
Short-term portion of finance leases	Various	5,27	3,45
Total debt		**189,56**	**153,52**
Less amounts maturing within one year		(72,27ᵋ	(51,70(
Total long-term debt		**117,28**	**101,82**

Corporate Bonds - In the fourth quarter of 2001, MGTS issued RUR-denominated bonds (second issue) with face value of RUR 1,000 mln. (equivalent of $36.0 mln. as of December 31, 2004) due in 2004. The Group has fully repaid the second issue of the bonds as of December 31, 2004.

In February 2003, MGTS issued 2-year RUR-denominated bonds (third issue) with the face value of 1,000 mln. RUR (equivalent of $36.0 mln. as of December 31, 2004) due in 2005. The bonds carry a coupon of 12.3% during the first year of trading and of 17.0% during the second year. In February 2005, MGTS has fully repaid the third issue of the bonds.

In April 2004, MGTS issued 5-year RUR-denominated bonds (fourth issue) with face value of 1,500 mln. RUR (equivalent of $54.1 mln. as of December 31, 2004). The bonds carry coupons of 10% during the first two years. MGTS made an unconditional offer to repurchase the bonds at par value in April 2006.

As of December 31, 2004, the fair value of the bonds was approximately $90.8 mln. and ranged from 100.0% to 102.0% of the principal amount.

Citibank - In May and August 2004, MGTS entered into two credit facilities with Citibank for a total amount of $9.5 mln. Both facilities bear interest of LIBOR+1.6% and are repayable in 8 semi-annual installments every six months with the last payment in 2009. Credit facilities were opened to finance acquisition of equipment from Strom Telecom, a company related by means of common control. The facilities are collateralized by equipment with approximate carrying amount of $4.2 mln. as of December 31, 2004 and are guaranteed by Export Guarantee and Insurance Corporation of the Czech Republic. As of December 31, 2004, the amount outstanding under facilities was $8.0 mln.

In 2003, MGTS received a loan from Citibank for purchase of equipment in amount of $7.1 mln. The loan bears interest of LIBOR+1.6% and is repayable in 8 semi-annual installments with the last payment in 2008. The loan is collateralized by pledge of equipment with approximate carrying value of $5.4 mln., deposit of $1.0 mln. in Citibank and is guaranteed by Export Guarantee and Insurance Corporation of the Czech Republic.

Based on restrictive covenants of the Citibank loan agreements, the Debt to Equity ratio and Debt Service to Earnings Before Interest and Taxes ("EBIT") ratio of MGTS should not exceed 3:1. MGTS is not allowed to obtain borrowings individually exceeding $30.0 mln. (apart from the Sberbank loan, Raiffeisenbank loan and the third and forth issue of MGTS bonds) or alienate more than 10% of its assets without the written approval of the Bank and its aggregate debt may not exceed $250.0 mln.

Sberbank credit facilities - In September 2004, MGTS entered a credit line with Sberbank limited to 600 mln. RUR ($21.6 mln. as of December 31, 2004) to finance its current assets. The loan matures in 2007. As of December 31, 2004, $10.8 mln. was outstanding under this credit line.
The interest rate of the credit line depends on the gross cash flow on MGTS account opened in Sberbank, and was 11% per annum as of December 31, 2004.

In December 2000, MGTS signed a credit facility with Sberbank for a total amount equivalent to $90.0 mln. to refinance its obligations under Eurobond borrowings. The loan was received in three tranches during the first quarter of 2001. In September 2002, MGTS prolonged repayment of the outstanding balance to the first quarter of 2005. The interest rate on the prolonged loan was 18% during the first six months and 12% during the second six months of the year. As of December 31, 2004, $1.8 mln. was outstanding under this loan. The loan was fully repaid in February 2005.

Vneshtorgbank - In July 2004, MGTS entered into two credit agreements for a total amount of EURO 7.3 mln. (equivalent of $9.9 mln. as of December 31, 2004) to finance equipment acquisition. The interest rate is the highest of Euribor+5.4% or 7.5%. Equipment with approximate carrying amount of $7.8 mln. is pledged to collateralize the outstanding balance as of December 31, 2004.

During the year ended December 31, 2002, the Group received a number of loans from Vneshtorgbank maturing in 2003-2007 to finance working capital. As of December 31, 2004, amount of $7.1 was outstanding under these loans. The loans are collateralized by equipment with approximate carrying amount of $5.0 mln. The weighted average interest rate on the loans outstanding as of December 31, 2004 is 11.0% per annum.

Raiffeisenbank - In September 2002, MGTS entered a credit line with Raiffeisenbank limited to $15.0 mln. and maturing in 2007. The approximate carrying amount of equipment pledged under the credit line as at December 31, 2004 was $25.9 mln. In addition, MGTS is required to maintain monthly gross cash flows with the bank of not less than $1.5 mln. The first loan from the credit line bears interest of LIBOR+5.0% (7.6% as of December 31, 2004) and matures in 2005. As of December 31, 2004, $3.8 mln. was outstanding under the credit line.

Guta-bank - In 1999 and 2000, loans were provided to MGTS by Guta-bank for purchase of equipment from a foreign vendor. Under the terms of the agreements, MGTS is required to maintain monthly gross cash flows on the specified bank accounts in the amount of $10.0 mln. One of the two loans was fully repaid in 2004; while the other matures in 2005. As of December 31, 2004, $0.8 mln. was outstanding under this loan. The interest rate on the Guta-bank loan is 13.1%.

Vendor Financing - Foreign suppliers of telecommunications equipment provide uncollateralized commercial credit to the Group denominated in various currencies on short-term and long-term bases, mostly interest free. The present value of the obligations under vendor financing agreements as of December 31, 2004 was determined using the Group’s incremental borrowing rate of 10.0%.

Finance Leases - During 2001-2004, MGTS entered several lease agreements for telecommunications equipment. The agreements expire in 2005-2008 and assume transfer of ownership for equipment to MGTS after the last lease payment is effected. The net book value of leased assets comprised $38.6 mln. and $14.7 mln. as of December 31, 2004 and 2003, respectively, while interest expense for the years 2004, 2003 and 2002 amounted to $1.9 mln., $0.8 mln. and $1.3 mln., respectively.

The following table presents future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of December 31, 2004:

Payments due in the year ended December 31,	
2005	7,7
2006	9,2
2007	8,1
2008	4,5
Total minimum lease payments (undiscounted)	29,6
Less: amount representing interest	(5,1
Present value of net minimum lease payments	24,5
Less: current portion of lease obligations	(5,2
Non-current portion of lease obligations	**19,2**

The weighted average interest rate of all borrowings denominated in currencies other than the Ruble at December 31, 2004 and 2003 was 6.6% and 5.6%, respectively, while it was 12.6% and 12.0%, respectively, for borrowings denominated in RUR. These figures are calculated without taking into account borrowings from related parties, vendor financing arrangements and capital lease agreements.

The debt obligations as of December 31, 2004 have the following maturities:

2005	72,278
2006	76,509
2007	26,864
2008	10,576
2009	3,333
Total	**189,560**

12. ACCOUNTS PAYABLE, TAXES PAYABLE AND ACCRUED LIABILITIES

Accounts payable, taxes payable and accrued liabilities as of December 31, 2004 and 2003 consisted of the following:

	2004	2003
Taxes payable	13,174	13,040
Accrued payroll	8,061	5,391
Trade accounts payable	7,137	9,837
Accrued interest	3,591	2,263
Accounts payable to related parties	2,027	2,678
Other liabilities	12,519	10,922
Total	**46,509**	**44,131**

Related party balances as of December 31, 2004 and 2003 are disclosed in Note 23 to the financial statements.

13. DEFERRED REVENUE

Deferred revenue as of December 31, 2004 and 2003 consisted of the following:

	2004	2003
Short-term portion		
Deferred revenue from connection fees	27,588	24,489
Advances from customers	19,017	12,112
Deferred gain on disposal of an investment	-	811
Total	**46,605**	**37,412**
Long-term portion		
Deferred revenue from connection fees	97,538	79,425
Total	**97,538**	**79,425**

In 2003, the gain on sale of an investment to a related party was reported in deferred revenue and was recognized in income as the Group fulfilled its obligations under the transaction.

14. RETIREMENT AND POST-RETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently such benefits include bonus payments of a fixed amount to retiring employees with at least five years of service from RUR 12,300 ($443 at the exchange rate current as of December 31, 2004) to RUR 24,600 ($886), depending on actual years of service); lifetime payments of a fixed amount to employees retiring with at least fifteen years of service from RUR 3,600 ($130) to RUR 57,600 ($2,076) per employee, per year for the year ended December 31, 2004, depending on employee' qualification level and actual years of service); and discounted telephone service to employees retiring with at least thirty years of service. An employee is withdrawn from the benefit scheme if their employment with MGTS is discontinued prior to retirement.

The assumed discount rate used in determining net periodic cost is 8% per annum. The future benefit payments to retirees are expected to be paid as follows:

2005	3,155
2006	1,075
2007	1,023
2008	977
2009	936
2010-2014	3,225
Thereafter	1,122
Total	**11,513**

For the year ended December 31, 2004 and 2003 the contributions paid by MGTS under the plan were not significant.

15. PROPERTY, PLANT AND EQUIPMENT CONTRIBUTIONS

In the course of its business the Group receives telecommunication infrastructure which is intended to operate as an integral part of the city wire line network from the real estate constructors free of charge as provided by the regulations of the city government. Property, plant and equipment contributions received by the Group as of December 31, 2004 and 2003 were as follows:

	2004	**2003**
Property, plant and equipment at the beginning of the period	88,38	64,49
Contributions received during the period	13,59	18,79
Currency translation effect	4,99	7,69
	106,97	90,97
Deferred revenue amortized	(3,156	(2,589
Property, plant and equipment at the end of the period	**103,82**	**88,38**

16. INCOME TAX EXPENSE

The Group's provision for income tax for the years ended December 31, 2004, 2003 and 2002 is as follows:

	2004	**2003**	**2002**
Current taxes	23,552	31,499	15,557
Deferred taxes	3,070	2,274	4,756
Total income tax expense	**26,622**	**33,773**	**20,313**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate to net income before income tax and minority interests. The items causing this difference are as follows:

	2004	2003	2002
Income tax charge computed on income before taxes at standard tax rate applicable to the Group of 24%	20,4[illegible]	31,5[illegible]	20,5[illegible]
Income tax charge on income from affiliates	1,4[illegible]	54	182
Effect of change in income tax rate attributable to income from affiliates	2,0[illegible]	-	-
Currency exchange and translation differences	895	(968)	(1,11
Non-deductible expenses	1,7[illegible]	3,1[illegible]	666
Income tax expense	**26,6[illegible]**	**33,7[illegible]**	**20,3[illegible]**

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2004 and 2003:

	2004	2003
Deferred tax assets		
Accrued operating expenses	1,72	2,54
Post-retirement benefits	2,76	1,17
Property, plant and equipment contributions	24,91	21,21
Deferred revenues	30,03	25,13
Tax losses carry forward	-	1,53
Allowance for doubtful accounts	3,61	2,66
Total	**63,05**	**54,27**
Deferred tax liabilities		
Undistributed earnings of affiliates	(8,33[illegible]	(4,33[illegible]
Depreciation of property, plant and equipment	(72,90[illegible]	(63,18[illegible]
Other	(240)	(163)
Total	**(81,48[illegible]**	**(67,68[illegible]**

17. SHAREHOLDERS' EQUITY

Common shares carry voting rights with no guarantee of dividends. Preferred shares carry guaranteed dividend rights amounting to the higher of (a) 10% of the income of MGTS as determined under Russian accounting regulations and (b) the dividends paid on common shares. No dividends may be declared on common shares before dividends on preferred shares are declared. Where the preferred dividend payable according to the Charter is not paid in any year the preferred shares also carry voting rights. At the annual shareholders meetings in June 2004, 2003 and 2002 the payment of a dividend to preferred shareholders was approved.

Preferred shares carry no voting rights except on resolutions regarding liquidation or reorganization of MGTS, changes to dividend levels of preferred shares, or the issuance of additional preferred stock. Such resolutions require two-thirds approval of preferred shareholders. The preferred shares have no rights of redemption. In the event of liquidation, preferred shares have priority over common shares. In this circumstance, holders of preferred shares receive the par value of their shares, or the amounts payable to common shareholders, if higher.

In accordance with the Charter, MGTS is permitted to repurchase, on the open market, up to 10% of its common and preferred shares each year. Repurchased shares must either be sold or cancelled within one year of being purchased. MGTS has no treasury shares at December 31, 2004.

The distributable earnings of the Group as of December 31, 2004, as determined under Russian accounting regulations amounted to approximately RUR 3,488 million (equivalent of $125.7 mln. as of December 31, 2004).

18. OPERATING REVENUES

Operating revenues for the years ended December 31, 2004, 2003 and 2002 consisted of the following:

	2004	2003	2002
Fixed monthly charges			
Companies	64,459	61,607	58,225
State financed institutions	29,827	24,006	17,648
Residential customers	149,909	113,176	74,096
Local traffic fees			
Companies	25,940	26,483	23,022
State financed institutions	2,493	2,430	2,337
Amortization of service activation fees			
Companies	19,684	15,077	13,286
State financed institutions	1,477	1,411	1,220
Residential customers	5,739	5,094	4,056
Data transmission	26,877	14,847	6,421
OAO Rostelecom interconnect	28,755	24,742	21,244
Rental of lines	89,315	37,177	27,241
Other	36,372	38,221	39,651
MTU-Inform and other subsidiaries	-	108,241	92,452
Total	**480,847**	**472,512**	**380,899**

MGTS doesn't provide domestic long-distance and international long-distance, or DLD/ILD, telecommunications services directly to its subscribers, but must route such traffic through a DLD/ILD licensed operator. As a result, DLD/ILD traffic originated by MGTS subscribers is carried by Rostelecom, which bills MGTS subscribers directly. In 2004, MGTS had an agreement with Rostelecom pursuant to which Rostelecom paid MGTS approximately $2.4 mln. per month of its DLD/ILD revenues generated by MGTS subscribers against $2.0 mln. in 2003.

19. OPERATING EXPENSES, NET

Operating expenses for the years ended December 31, 2004, 2003 and 2002 consisted of the following:

	2004	2003	2002
Employee costs	154,5	126,0	86,4
Depreciation charge	68,0	69,2	61,4
Repairs and maintenance	59,9	52,3	41,8
Taxes other than income taxes	26,0	12,9	14,6
Utilities and energy	15,2	13,0	10,2
Rent	10,5	9,4	8,2
Bank charges	8,6	6,5	4,7
Insurance	6,3	6,0	4,0
Advertising	3,3	5,8	2,8
Transportation	2,7	2,3	1,9
Network traffic	-	4,0	5,3
Allowance for doubtful accounts	(500)	348	1,2
Gain on disposal of long-term investments	-	(3,5	-
Sundry expenses	26,4	26,8	24,6
Total	**381,3**	**331,6**	**267,5**

20. SEGMENT INFORMATION

SFAS 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. Management of the Group regularly reviews certain operational and statistical information, and therefore the performance is measured and decisions about resource allocation are made by management based on operating income by major legal entities.

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.

As discussed in Notes 1 and 5, effective January 1, 2004, the Group does not account for MTU-Inform and other subsidiaries as a separate reportable segment; MGTS is the only reportable segment in 2004. In 2002-2003, the Group had two operating segments with information as follows:

Year ended December 31, 2003	**MGTS**	**MTU-Inform and other subsidiaries**	**Total**
Net sales to external customers	364,27	108,24	472,51
Intersegment sales	16,11	-	16,11
Income from affiliates	894	-	894
Interest income	2,20	2,44	4,65
Interest expense	(17,057	(143)	(17,200
Depreciation charge	(59,514	(9,784	(69,298
Operating income	82,50	54,79	137,30
Income tax expense	(18,147	(15,626	(33,773
Investments in affiliated companies	73,25	-	73,25
Segment assets	1,104,58	178,85	1,283,44
Capital expenditures	99,10	14,25	113,36

Year ended December 31, 2002	MGTS	MTU-Inform and other subsidiaries	Total
Net sales to external customers	288,4	92,4	380,8
Intersegment sales	14,5	-	14,5
Income from affiliates	3,0	-	3,0
Interest income	950	971	1,9
Interest expense	(29,9	(145)	(30,1
Depreciation charge	(52,3	(9,0	(61,4
Operating income	70,2	43,0	113,3
Income tax expense	(10,3	(9,9	(20,3
Investments in affiliated companies	72,3	-	72,3
Segment assets	966,9	130,2	1,097,1
Capital expenditures	82,5	15,4	97,9

The reconciliation of segment assets to the respective information in the consolidated financial statements is as follows:

	2003	2002
Total segment assets	1,283,44	1,097,15
Assets of discontinued operations	58,99	76,03
Intersegment assets	(20,400	(18,210
Consolidated assets	**1,322,03**	**1,154,97**

21. EARNINGS PER SHARE

Earnings per common share have been calculated using the two-class method on the basis of income available for common shareholders, calculated as follows:

	2004	2003	2002
Net income from continuing operations	74,84	78,43	53,89
Gain/(loss) from discontinued operations	179	(8,626	4,33
Less: dividends on preferred shares	(6,776	(6,576	(3,549
Less: undistributed income attributable to preferred shares	(5,729	(5,059	(6,155
Net income available to common shareholders	**62,52**	**58,17**	**48,52**

As of the date of these financial statements no dividends on preferred or common shares for the year ended December 31, 2004 have been declared by the Group. In accordance with MGTS' Charter, dividends on preferred shares should not be less than 10% of MGTS' net income as reported under the Russian statutory accounting principles. The Group accrued dividends on preferred shares for the year ended December 31, 2004 based on the provisions of MGTS' Charter.

If the Group has elected to distribute the total amount of net income for the periods presented, the preferred shareholders of the Group would be entitled to dividend payments of not less than the per share dividend received by the common shareholders. The Group uses this assumption in calculation of earnings per share.

Weighted average number of common shares outstanding was 79,829,200 for each of three years in the period ended December 31, 2004.

22. OPERATING LEASES

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

(b) As lessee - The land on which the Group's buildings and other facilities are located is owned by the City of Moscow. The Group pays the city rent for the land based on the total area and location of land occupied. Land rental expenses were approximately $2.9 mln., $2.8 mln. and $0.9 mln. for each of the years ended as of December 31, 2004, 2003 and 2002, respectively.

The Group leases buildings, office premises, bridgeworks and collectors mainly from Moscow Government through contracts, which expire in 1 to 20 years. Rental expenses under operating leases are included in the statement of operations (Note 19).

Future minimum lease payments due under non-cancelable leases at December 31, 2004 are:

2005	8,288
2006	2,581
2007	2,431
2008	2,394
2009	2,238
Thereafter	20,062
Total	**37,993**

23. RELATED PARTIES

Related party balances as of December 31, 2004 and 2003 comprised of the following:

	2004	2003
Accounts receivable		
MTU-Inform	7,581	Consolidated
Rostelecom	3,910	3,309
Central Telegraph	1,822	-
Comstar	1,391	1,092
MTU-Intel	911	216
Other	4,738	1,924
Total accounts receivable from related parties	**20,353**	**8,130**
Accounts payable		
Strom Telecom	1,635	2,399
Other	392	279
Total accounts payable to related parties	**2,027**	**2,678**

The Group provides communication services and rents premises to its affiliates and companies related by means of common control. The following table summarizes revenues received from related parties during the years ended December 31, 2004, 2003 and 2002.

	2004	2003	2002
Communication services			
MTU-Intel	22,493	12,943	7,616
MTU-Inform	19,439	Consolidated	Consolidated
Central Telegraph	14,309	8,155	9,487
Comstar	9,318	9,798	4,898
Telmos	4,385	5,534	3,276
Mobile TeleSystems	5,165	4,150	3,515
Rent of premises			
Comstar	3,422	2,033	1,142
MTU-Inform	2,689	Consolidated	Consolidated
Telmos	2,206	1,877	1,276
Mobile TeleSystems	1,142	633	294

Rostelecom

In 2004, 2003 and 2002, the Group routed domestic long-distance and international long-distance traffic originated by its subscribers through Rostelecom, a subsidiary of Svyazinvest, a minority shareholder of the Group. Pursuant to agreements with Rostelecom MGTS received \$30.6 mln., \$24.7 mln. and \$21.2 mln. for the years ended December 31, 2004, 2003 and 2002, respectively.

In 2004, the Group started purchasing communication services from Rostelecom. The respective expenses in 2004 amounted to \$1.3 mln.

Invest-Svyaz-Holding

In 2004 and 2003, the Group entered into agreements with Invest-Svyaz-Holding, a subsidiary of AFK Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SFAS No. 13, "Accounting for Leases." The present value of future lease payments is reflected as a liability in the balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities.
The net book value of assets leased under such agreements as of December 31, 2004 and 2003 was \$27.1 mln. and \$1.7 mln., respectively. The interest rate implicit in the leases varies from 14% to 16%.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2004.

Payments due in the year ended December 31,	
2005	6,8
2006	9,2
2007	8,1
2008	4,5
Total minimum lease payments (undiscounted)	28,7
Less: amount representing interest	(5,1
Present value of net minimum lease payments	23,6
Less: current portion of lease obligations	(4,4
Non-current portion of lease obligations	**19,2**

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in amount of \$8.5 mln. to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group.

For the year ended December 31, 2004 principal and interest paid to Invest-Svyaz-Holding were $4.8 mln. and $1.7 mln., respectively. No payments in favor of Invest-Svyaz-Holding were executed for the year ended December 31, 2003.

Rosno

The Group purchases insurance services from Rosno, a company related by means of common control. The respective insurance expenses in 2004, 2003 and 2002 amounted to $6.1 mln., $4.8 mln. and $4.7 mln., respectively.

Strom Telecom

The Group purchases telecommunications equipment from Strom Telecom, a company related by means of common control. The cost of equipment purchased from Strom Telecom in 2004, 2003 and 2002 was $10.8 mln., $9.7 mln. and $8.1 mln., respectively.

Central Telegraph

The Group purchases telecommunications equipment from Central Telegraph, a subsidiary of Svyazinvest. The cost of equipment purchased from Central Telegraph in 2004, 2003 and 2002 was $6.4 mln., $3.7 mln. and $3.2 mln., respectively.

Mediatel

The Group purchases telecommunications equipment and repair and technical maintenance services from its former subsidiary Mediatel. The cost of equipment purchased in 2004 amounted to $3.4 mln.

Moscow Bank of Reconstruction and Development (MBRD)

During the years ended December 31, 2004, 2003 and 2002, the Group kept certain bank and deposit accounts and acquired promissory notes from MBRD, a party related by means of common control. Interest income received from MBRD on bank and deposit accounts during the years ended December 31, 2004, 2003 and 2002 amounted to $2.4 mln, $1.2 mln. and $0.4 mln., respectively. Interest income received on MBRD promissory notes during the years ended December 31, 2004, 2003 and 2002 amounted to $nil, $1.7 mln. and $0.3 mln., respectively.

24. COMMITMENTS AND CONTINGENCIES

Issued Guarantees - MGTS is a guarantor under the credit facility with a limit of $65.0 mln. provided to Comstar by Vnesheconombank. The facility is effective till January 2005. The guarantee amounted to $2.3 mln. and $7.5 mln. as of December 31, 2004 and 2003, respectively.

In December 2004, MGTS became a guarantor under the credit facility between Systema-Hals, a subsidiary of AFK Sistema, and West LB Vostok Bank. The loan of $10.4 mln. matures in December 2006. The guarantee amounted to $5.0 mln. as of December 31, 2004.

In 2004, MGTS became a guarantor under the credit facility between Commerzbank (Eurasia) and Invest-Svyaz-Holding. The credit line opened for the amount of $17.0 mln. matures in 2006. The guarantee amounted to $8.5 mln as of December 31, 2004.

Under these guarantees the Group could be potentially liable for a maximum amount of $15.8 mln. in case of the borrower's default under the obligations. As of December 31, 2004, no event of default has occurred under any of the guarantees issued by the Group.

Contingencies - The Russian economy, 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 legal, and economic reforms.

On January 1, 2004, a new Law on Telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector.

According to the new Law on Telecommunications, and effective as of January 1, 2005, all subscribers will be required to pay the full price for residential service, and those entitled to discounts are to receive reimbursement from the government rather than discounts from MGTS.

The Law on Telecommunications introduces a Universal Service Fund ("USF") which will result in higher costs for all operators, including the Group. The USF is designed to fund socially important but economically unviable projects. In April 2005, Russian government approved several provisions clarifying how the USF will be collected and administered. Starting July 1, 2005 the amount of the universal service charge will be 1.2% of the total revenues received from the usage of public telecommunication network less connection fees and revenues received from interconnection services provided to other operators.

The Russian government has also issued several implementing acts under the Law on Telecommunications, such as Resolution No. 87, dated February 18, 2005, approving the list of the types of licensed telecommunication activities, and Resolution No. 68, dated February 11, 2005, regarding the rules applicable to the state registration of telecommunication infrastructure such as real property. However, it is presently not yet clear how these regulations would be implemented. Thus, the uncertainty related to the Law on Telecommunications continues.

In recent years, the Russian government has initiated revisions of the Russian tax system. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws. Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), property and payroll (social) taxes, together with others. The government's policy on implementation of these regulations is often inconsistent or nonexistent. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

The tax inspection is currently challenging the application by MGTS of certain provision of the tax legislation, including application of the investment allowance for income tax purposes in 2001. The tax inspection assessment amounted to the equivalent of $5.4 mln. at the rate current at balance sheet date. In November 2004, the Group contested the assessment in Moscow Arbitrage. On March 9, 2005, Moscow Arbitrage made a decision to disaffirm the tax inspection claims in part of application of the investment allowance. The Arbitrage considered the tax inspectorate's claims for the amount of $1.8 mln. to be valid. MGTS appealed against the court's decision in April 2005.

Inspite the decision of the Arbitrage to disaffirm the tax inspection claims in part of application of the investment allowance management evaluate risk as probable. An accrual has been made for the amount of $4.6 mln in the accompanying financial statements with respect of the above mentioned claims.

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.

In the ordinary course of business, the Group may be party to various legal and tax proceedings, and subject to claims. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of the Group.

Licenses - Substantially all the Group's revenues are derived from operations conducted pursuant to licenses to operate in Moscow and the Moscow region granted by the Russian Government. The Voice Phone Communication license expires in December 2013. Suspension or termination of the Group's main license or any failure to renew it could have a material adverse effect on the financial position and operations of the Group. However, the Group has no reason to believe that the license will not be renewed or suspended or terminated, and the management estimates the possibility of such events as very low.

Commitments - During September - December 2004, MGTS entered into series of agreements with Sistema-Hals on project development and reconstruction of buildings of automatic telephone exchanges. The main part of work under the contracts is to be performed in 2005-2008. As of December 31, 2004, no obligations to Sistema-Hals exist except for agent fee payable for the total amount of $0.3 mln.

In November 2004, MGTS enetered into an agreement to acquire telecommunications equipment and related services from ECI Telecom (Israel). The vendor financing amounting to $3.5 mln. will bear interest of LIBOR + 4% and be repayable in 7 equal quarterly installments starting April 2005.

In December 2004, MGTS entered a credit facility with Citibank of $8.5 mln. under guarantee of Export Guarantee and Insurance Corporation of the Czech Republic, to finance acquisition of telecommunications equipment and cover insurance expenses. The loan will bear interest of LIBOR+1.6 %. The equipment with a fair value of $7.4 mln. is pledged as a guarantee.

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

25. SUBSEQUENT EVENTS

In January 2005, the MGTS Shareholders' Meeting approved appointment of Alexey Goltsov as General Director of MGTS effective January 31, 2005.

In March 2005 the Group sold 10% of MTK-Trunk shares to individual shareholders for the total cash consideration of 1,525 thousand RUR (equivalent of $0.6 mln. as of December 31, 2004).

In March 2005 MGTS signed an agreement to acquire telecommunication equipment and related services from Lucent Technologies for the total amount of $1.5 mln.

In March 2005 MGTS Board of directors meeting approved issue of RUR-denominated bonds (fifth issue) with face value of 1,500 mln. RUR (equivalent of $54.1 mln. as of 31, December 2004) and final maturity date in 2010. Interest on a coupon will be defined at the date of bonds issuance by means of tender among potential investors.