ROSTELECOM

ANNUAL REPORT
2007

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ROSTELECOM AT A GLANCE

Rostelecom is Russia's national telecommunications operator, providing a wide range of products and services. The Company owns and operates the country's most extensive and technologically advanced nationwide fiber-optic backbone network (about 150,000 km in length), which enables Rostelecom to provide voice, data and IP services to business and residential customers across the entire Russian Federation as well as to domestic and international operators.

Rostelecom continues to primarily provide fixed-line domestic (DLD) and international (ILD) long-distance services to corporate and residential end-customers in all Russian regions. These services are provided through the last-mile infrastructure of local or regional operators.

The high capacity of Rostelecom's network enables it to handle the majority of long-distance traffic transit and leased line services for Russian and international operators. The Company is also a major provider of telecommunications services for state organizations and governmental agencies, television and radio broadcasters.

In addition to traditional services, Rostelecom is further expanding its diverse lineup to include new value-added product and service offerings incorporating intelligent network services (INS), videoconferencing, Internet and VPN services for operators and business customers, among others.

Rostelecom is the market leader in the international telecom segment, having established direct international connections with more than 150 operators in 70 countries, participating in 25 international cable systems and cooperating with approximately 600 fixed-line and mobile operators inside and outside of Russia.

As Russia's primary national long-distance operator, Rostelecom belongs to a number of international industry organizations, including the International Telecommunication Union (ITU) and the Telecommunication Operators Board of the Regional Commonwealth in the field of Communications (RCC).

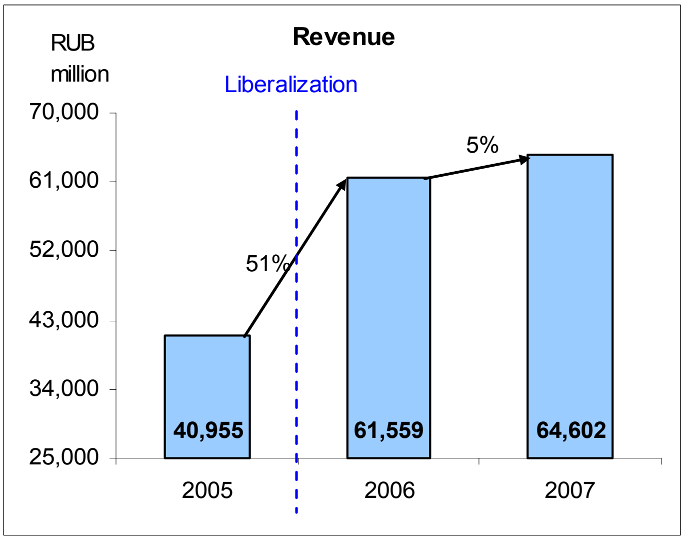
Rostelecom is committed to delivering value for its shareholders, with a focus on maintaining its strong financial position. Svyazinvest, the state-controlled holding company, is Rostelecom's majority shareholder, with ownership of 51% of ordinary (voting) shares. Rostelecom's public free float is comprised of the remaining 49% of the ordinary shares and 100% of the Company's preferred shares. Rostelecom's securities are listed on major Russian stock exchanges – the RTS and MICEX, and also on the New York Stock Exchange (level II ADR program launched in 1998; ticker symbol ROS). The Company's shares are also quoted on major European trading floors.

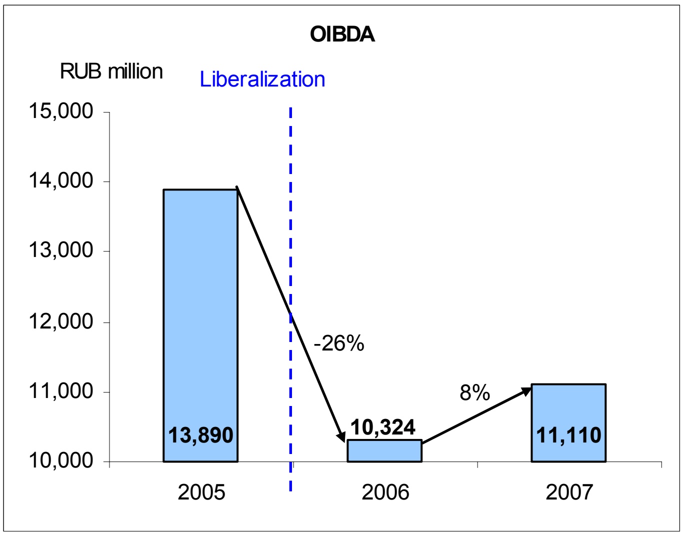
KEY FINANCIAL AND OPERATING HIGHLIGHTS

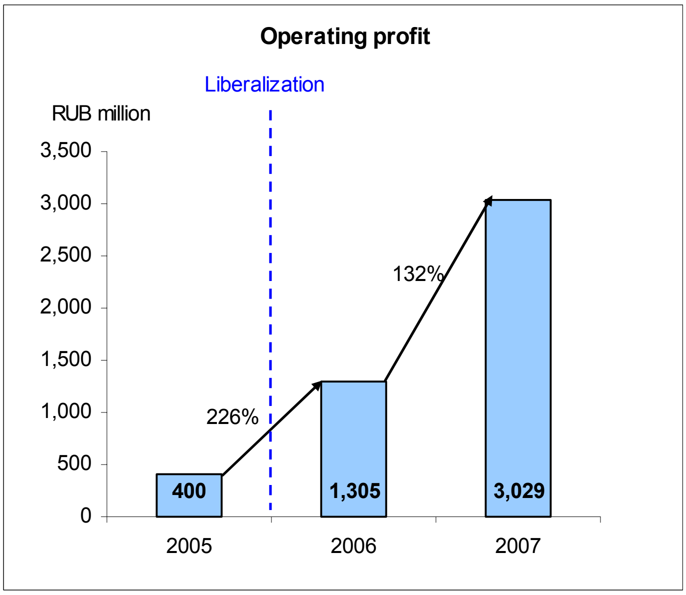
Million minutes	2007	2006	*% change YoY*
Domestic long-distance traffic	**10,174.8**	**9,722.1**	***4.7%***
International outgoing long-distance traffic	**1,820.1**	**1,932.8**	***-5.8%***
International incoming long-distance traffic	**3,062.2**	**2,460.7**	***24.4%***
***RUB million*[1]**			
Revenue	**64,602.0**	**61,559.0**	***4.9%***
OIBDA[2]	**11,110.0**	**10,324.0**	***7.6%***
OIBDA margin, %	***17.2%***	***16.8%***	***n.a.***
Operating income	**3,029.0**	**1,305.0**	***132.1%***
Operating margin,, %	***4.7%***	***2.1%***	***n.a.***
Net profit (loss)	**2,806.0**	**1,456.0**	***92.7%***
Net margin, %	***4.3%***	***2.4%***	***n.a.***
Dividends			
On preferred shares	942.4	718.5	*31.2%*
On ordinary shares	1,413.6	1,077.7	*31.2%*

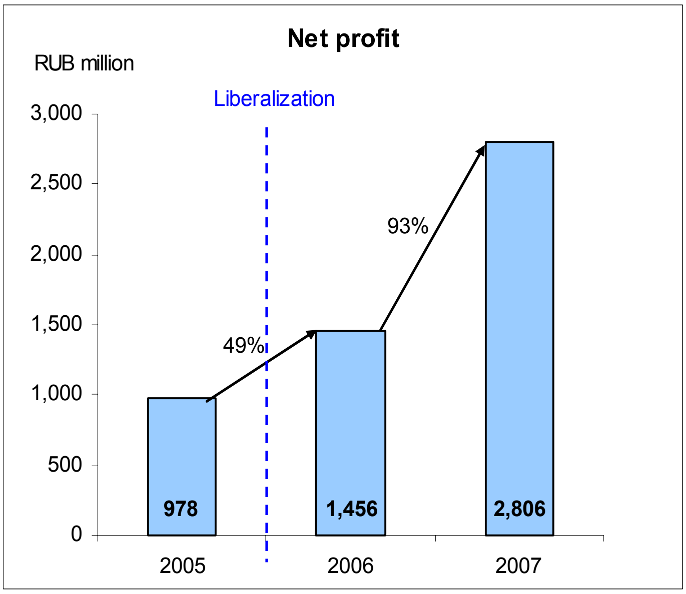
[1] This annual report contains financial statements prepared in accordance with International Financial Reporting Standards (IFRS). In order to ensure comparability of Rostelecom's performance to peer companies, all absolute figures in the profit and loss statements and the balance sheets, included in the text of the annual report, are stated in Russian rubles (RUB).

[2] OIBDA is a non-U.S. GAAP financial measure, which the Company defines as operating income before depreciation, amortization and loss on disposal of PP&E. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. OIBDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under U.S. GAAP.

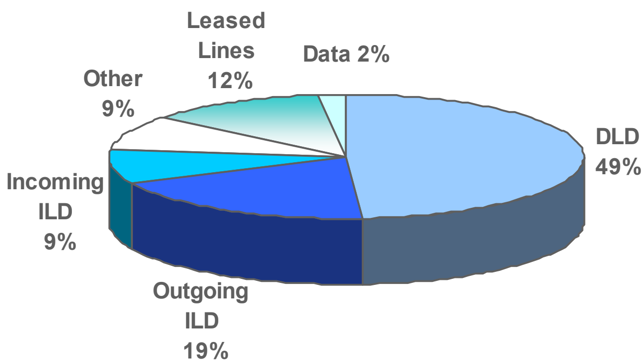








Revenue breakdown by service*



*In accordance with FY 2007 IFRS results

CHAIRMAN'S STATEMENT

Looking back on our 2007 results, Rostelecom has once again sustained its position as one of the leading companies in the Russian telecommunications sector. Rostelecom continued to provide high-quality services to telephone network subscribers in all regions of Russia, executing business development initiatives under increasing competition from new long-distance telecommunications operators.

Responding to market challenges and the emergence of new competitors in 2007, the Company continued to implement plans to transform into a universal operator. Rostelecom provided clients with a wide range of modern telecommunications services and flexible tariff plans, developed innovative telecommunications services and expanded into new markets, all while further increasing the quality of its services.

The effectiveness of the Company's efforts to secure sustainable development in the competitive environment was evidenced by the fact that Rostelecom remains the long distance operator most frequently chosen by customers making domestic and international calls. Moreover, the financial results achieved by the Company in 2007 demonstrate that Rostelecom has further solidified its leading position in the Russian telecommunications market.

I am confident that our committed team of highly qualified managers and employees, using the capabilities of our modern telecommunications network, will ensure Rostelecom's sustained growth in the long term, strengthen the Company's competitive position and uncover new market opportunities.

Alexander Kiselev
Chairman of the Board of Directors, Rostelecom

GENERAL DIRECTOR'S MESSAGE

Last year, Rostelecom focused its efforts on developing competitive advantages to strengthen its market position both in the Company's traditional segments and in new markets where the Company is promoting its innovative telecommunications services.

In response to increasing demand from residential and corporate clients for modern telecommunications services, Rostelecom continued to expand its offering and provide bundled service packages as a single operator. In 2007 the Company further improved service quality by developing its own Customer Care Centers across the country.

Rostelecom continued to cooperate with national and foreign operators. The Company attracted additional traffic volume to its network by expanding its international presence, increasing the efficiency of existing inter-operator agreements and securing new ones, promoting traffic transit services between Europe and Asia, and developing and offering new state-of-the-art products and services.

Rostelecom continued to focus on its technology to drive further competitive advantages and help retain its leading position in various segments of the telecom market. The Company continued to develop its high-capacity nationwide backbone network, providing ample international connections. Construction of new telecoms lines, expansion of throughput capacity and the speed of the network ensure the Company's capability to render high-quality telecom and data transmission services to its clients.

Rostelecom's 2007 results confirm that our priorities are sound. Our goals are to ensure the successful long-term development of our services, and secure a leading position in the Russian telecommunications sector.

Konstantin Solodukhin
General Director, Rostelecom

ROSTELECOM'S INDUSTRY POSITION:
2007 RESULTS AND PROSPECTS

In 2007 the Company continued its success, operating in what has become a highly competitive environment following the liberalization of the long-distance market. Rostelecom's performance demonstrates its solid position in the traditional telecom segments and reflects the Company's increased presence in new service markets.

The Company's long-term leadership is ensured by its modern telecommunications network, allowing the provision of telecommunications services in every region of the Russian Federation. Rostelecom's expanding IP/MPLS network as well as a new intelligent platform enabled the Company to continue active promotion of advanced products and services and expansion into new markets.

Company's position in various segments of Russia's telecom market

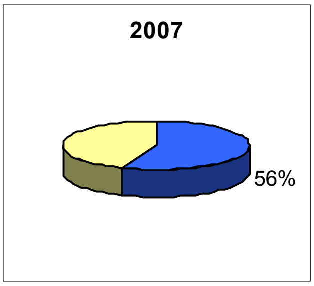
The proactive development and promotion of new products and services enabled the Company to deliver an impressive increase in revenue from data transmission services - one of the most promising growth segments for the Company. It has been a year since Rostelecom became actively engaged in the wholesale Internet services market, and during this time Rostelecom managed to attain 10% market share and plans to substantially increase its presence in this segment in the coming years.

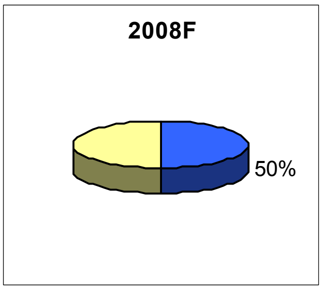
In 2007, by leveraging its competitive advantages, the Company was able to maintain its solid position in traditional long-distance services to end-customers while building on its strong position in the international operators' market.

DLD/ILD services for Russian residential & corporate end-customers

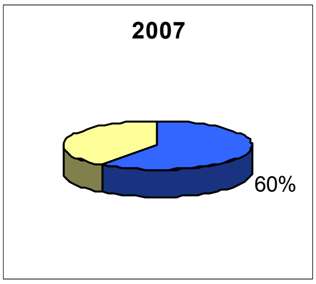
Rostelecom's market share*

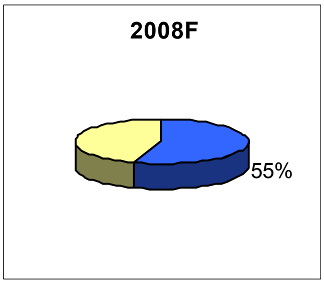
* Including fixed-line and IP long-distance telephony but excluding DLD and ILD traffic on mobile networks:





* Only fixed-line telephony:



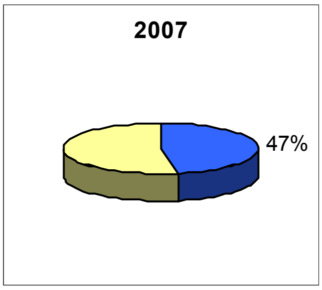


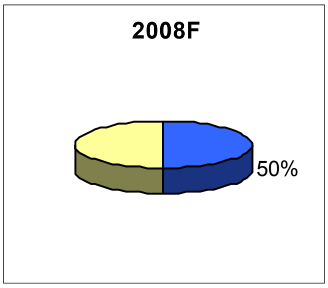
Rostelecom’s share in the residential fixed-line DLD/ILD service market:

2007	*2008F*
95%	85%

Incoming international traffic termination and transit

Rostelecom’s market share:

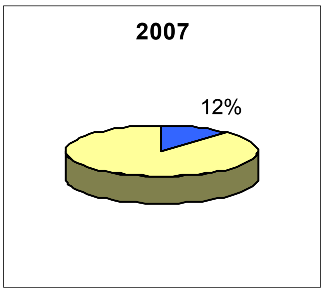


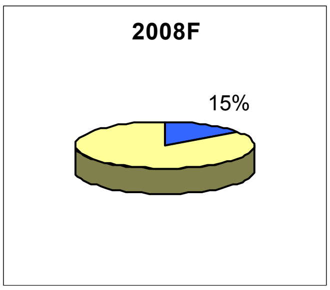


	2007	*2008F*
Incoming ILD traffic termination	56%	58%
International transit	36%	41%

DLD/ILD traffic transmission for Russian operators

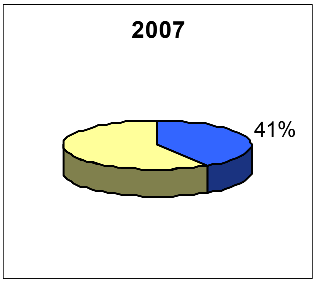
Rostelecom’s market share:

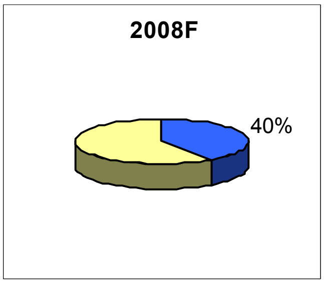




Leased line market

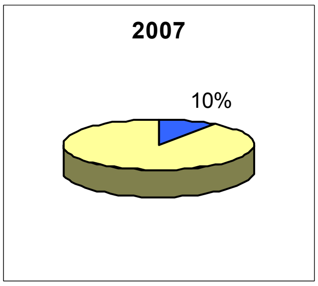
Rostelecom's market share:

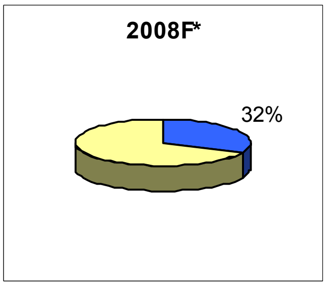




Wholesale Internet services

Rostelecom's market share:

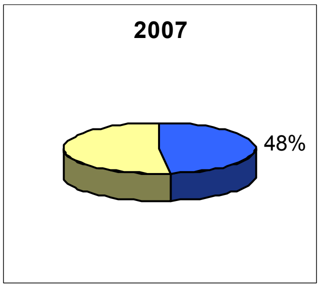


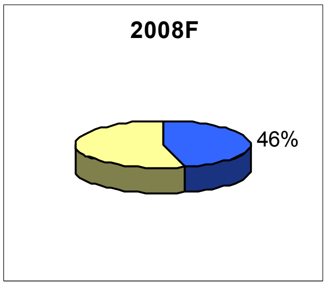


* Including consolidation of RTComm.RU

Intelligent network services (INS)

Rostelecom's market share:





Rostelecom's 2007 full year results in major markets by client

Having successfully adapted its business model to the changing operating conditions in the Russian telecommunications market, in 2007 the Company focused on sustaining its existing market positions and gaining new ones, primarily in the corporate and private end-customer segments in all regions of Russia.

In order to maintain its market position, Rostelecom's efforts were focused on the further development of competitive advantages which make it possible for the Company to add value for its clients and retain leadership in various segments of Russia's telecommunications sector. The Company's primary advantage is its powerful backbone telecommunications network enabling customers in all regions to access Rostelecom's services. By developing its network infrastructure, the Company can better meet the growing demand for modern, high-quality telecommunications products.

During the course of 2007, Rostelecom has become closer with its clients through direct interaction with them. Rostelecom strives to meet its customers' needs by rendering high-quality services, developing and launching new telecommunications services, forming comprehensive offers and a wide range of tariff plans.

End-customers market

Within the framework of developing stronger relationships with corporate and individual customers, the Company is primarily focused on retaining its position in the traditional domestic and international long-distance voice telecommunications segments. Simultaneously, the Company is focused on the diversification of its business by strengthening its position in new markets such as data transmission and intelligent network services.

Domestic and International long-distance telecommunications services

Domestic and international long-distance telecommunications services continue to be the Company's core business.

As a result of the liberalization of the long-distance telecommunications sector in Russia, since 2006 the Company has the opportunity to provide long-distance telecommunications services directly to end-customers, using regional telecommunications operators' network infrastructure. However, liberalization has also opened access to the domestic and international long-distance telecommunications market to other telecommunications operators, thus substantially increasing competition.

Despite the material changes in operation principles in the sector and the strengthening of competition from newcomers, the Company has managed to successfully adapt its business model to these new conditions. For the second year in a row it has maintained its market position, underpinned by revenue growth from domestic and international long-distance telecommunications services provided to end-customers in 2007.

In order to secure its leading position in this market, the Company implemented service offerings, designed to meet its clients' need for modern telecommunications products and improve the quality of telecommunications services and servicing efficiency.

Rostelecom created a comprehensive offer for corporate clients: a package of services consisting of traditional domestic and international long-distance telephone services, high-speed Internet access, IP VPN services as well as Rostelecom's intelligent network services, including those provided by the Company's subsidiaries. Moreover, to ensure the retention of its position in the Moscow corporate market, the Company acquired 10,000 subscribers of fixed-line local telephony in December 2007, with plans to provide a full range of services in 2008. This will enable corporate subscribers to feel secure in that all of its telecommunications services are provided by a single, high-quality operator.

In 2007, the Company initiated marketing efforts to increase the number of subscribers signing pre-select agreements with Rostelecom as a long-distance telecommunications operator, while continuing to expand its own nationwide network of Customer Care Centers. Development of direct business-to-client relationships with end-customers has made it possible to ensure consistent quality and servicing standards in all regions of the country, to enhance understanding of the clients' needs, and to optimize costs relating to the payment of agent fees to Inter-regional and local operators. In 2007, agent fees decreased by more than 20%, which also allowed Rostelecom to reduce the total amount of payments to Russian operators by 5% year on year to RUB 27,860 million.

While securing direct contracts for domestic and international long-distance telecommunications services, the Company also increased the efficiency of its service units and developed its own network of Customer Care Centers. As of the end of 2007, there were 88 Customer Care Centers established in the regions, and including Moscow (the MMT branch) there were 93. In these centers, Rostelecom's subscribers can easily and quickly settle any service issues, get advice from highly qualified experts on services and tariffs, access information about their debt and details of their domestic and international long-distance connections, pay invoices and execute service contracts. Moreover, to make it easier for subscribers to pay their invoices for Rostelecom's services, in 2007 the Company continued to expand its payment points network, the number of which already exceeded 8,500 in Moscow and the Moscow region, and the network continues to expand.

In 2007, the Company focused on increasing Rostelecom's brand awareness and reinforcing its image as a modern telecommunications operator in the eyes of end-customers. Throughout the year, Rostelecom carried out a nationwide advertising campaign aimed at improving the popularity of its brand and users' awareness of the Company's services. Moreover, in the regions where Rostelecom started to provide telecommunications services on hot-choice basis at every call, the Company conducted an information campaign promoting Rostelecom's prefixes for domestic and international long-distance calls – "8 – 55" and "8 – 10".

Intelligent network services (INS)

In 2007, the Company maintained its leading position in intelligent network services by offering clients high-quality services through its own extensive telecommunications network and modern intelligent platforms. For three years in a row, the Company's revenue from intelligent network services increased by approximately RUB 300 million per year. Anticipating growth in demand for intelligent services, the Company, in as early as in late 2006 introduced a new intelligent platform code 8-800-100 for the provision of Freephone services. This allows customers to make free outgoing local and long-distance calls from every region of the Russian Federation and a number of foreign countries via a single telephone number issued by Rostelecom.

To attract attention to intelligent services, the Company, in conjunction with Zebra Telecom – Rostelecom's subsidiary, focused on improving the efficiency of the sales process and provision of intelligent numbers for rendering Freephone services to its clients. As a result, a new unique service under Zebra FREEPHONE brand was designed, with planned promotion in 2008. The advantage of this service is that it can be purchased at any time via a web interface and paid for by various methods. As a result of the flexibility of settings installed directly by Zebra FREEPHONE user via the web interface, the Freephone service will become accessible and user-friendly not only for large companies operating on a nationwide basis, but also for medium-sized businesses, private entrepreneurs and individuals.

Data transmission services

In line with business diversification initiatives, Rostelecom increased its revenue from data transmission services on the base of its own IP/MPLS network by more than 5 times in 2007 compared to the previous year. This was due to the development of services aimed at both operators and corporates. For corporate customers these are IP VPN services and dedicated Internet access.

IP VPN services

Using the capabilities of its own extensive backbone network covering virtually all regions of Russia, as well as IP/MPLS data network, the Company continued to set up private virtual networks (IP VPN). These networks allow corporate customers to consolidate all branches into a single secure private corporate network with a whole range of telecommunications services with high reliability. During the course of the year, the Company set up over 600 points of connection to its IP VPN services.

In 2007, Rostelecom's efforts were aimed at further increasing quality of this service, and ensuring round-the-clock network monitoring and user support. The high-quality operating performance and reliability of Rostelecom's IP VPN services were certified by the "Telecommunications-Quality" Voluntary Certification System created in 2002 under the auspice of the Russian Ministry of Information Technologies and Communications to certify the quality of telecommunications services, facilities and carriers' quality management systems.

Videoconferencing services

To ensure that it offers the most modern telecommunications products, the Company also provides Videoconferencing, enabling customers to communicate "face-to-face" with their colleagues and partners from different cities and countries around the world. This allows clients to more effectively tackle issues and save time and money that would otherwise be allocated to travel.

With more than 100 videoconferencing rooms in Russia in 2007, Rostelecom was able to render videoconferencing service to its corporate clients. Using their own equipment, or leasing the necessary equipment from Rostelecom, users can arrange their own video conferences by connecting to the Company's network.

Development of technologies and equipment such as High Definition Digital TV, have improved the quality of the transmission of audio and video signals, thus creating a virtual presence for remote participants in a conference. This should undoubtedly help drive additional demand for video conference services and expand its potential customer base.

Operators' market

Cooperation with Russian Operators in proving long-distance telecommunications services

As a result of the Russian telecommunications sector reforms, the principles of interaction among operators rendering long-distance telecommunications services changed drastically in 2006.

Beginning January 1, 2006 the Company's services to end-customers across Russia are provided through the last-mile infrastructure of local and regional operators. The Company now pays network operators for origination and termination of telephone calls on both an intra-regional and local level, as well as an agent's fee if subscriber billing and payment collection activities, and/or other customer services are performed by the Company's agent. Moreover, in 2007 the Company continued to pay a compensation surcharge to local and intra-regional operators occupying a "significant position" in the market for the initiation of DLD/ILD calls to subsidize provision of local telecommunications services. In accordance with the Government Decree No. 627 dated October 19, 2005, the compensation surcharge is valid until January 1, 2008.

In 2007, Rostelecom was able to optimize its costs relating to payments to Russian operators, which decreased by 5% year on year to RUB 27,860 million primarily due to the improved efficiency of cooperation with these operators, and due to a more than 20% decrease in the aggregate amount of agent fees paid as a result of establishing direct business-to-client relationships with end-customers.

Wholesale Internet access services

Using its data network based on multi-protocol label switching (IP/MPLS) technology, in 2007 the Company started actively rendering Internet access services both for operators and corporates. In order to satisfy its clients' needs, the Company set up more than 350 points of access to the worldwide Internet network during 2007. Rostelecom's 2007 revenues from data transmission services increased by more than 5 times year on year, with the greatest contribution made by Internet access services for Russian operators.

Due to the large number of points of presence in all regions of the country, Rostelecom as a backbone provider is capable of ensuring the highest service quality and reliability and providing skilled technical support to its clients all over the Russian Federation.

In 2007, the Company received a certificate from the Federal Service for Technical and Export Control of Russia. The certificate confirms the high security of information transmitted via Rostelecom's IP/MPLS network due to implementation of the information security system, including antivirus protection, protection against unauthorized access, system for detection of attacks and analysis of network security.

Leased line services

The Company's primary competitive advantage is the strength of its backbone telecommunications network, as a direct result of the strength of its network, in 2007 Rostelecom continued to be one of the leaders in the Russian leased line market.

The Company has been able to maintain a strong market position by offering its clients channels for rent on high-speed fiber-optic trunk lines, with an opportunity to choose flexible tariff plans, alongside the guarantee of high quality and reliability of its services. In 2007 revenues from leased line services grew by 8.6%.

In addition, in 2007, the Company focused on the promotion of Europe-Asia Transit (TEA) services, offering them to international telecommunications providers at major traffic exchange points. The TEA project ensures traffic transmission by the shortest route and, therefore, with the minimal Round Trip Delay compared to competitors, and allows for the allocation of a considerable quantity of channels in the long term. In addition, Rostelecom is one of the first operators for which Service Level Agreements guarantee the quality of not only its own network but also the networks of its TEA project partners.

Cooperation with international operators

In 2007, the Company continued to actively foster its cooperation with foreign telecommunications operators and telecommunications services providers to ensure the continued growth of international incoming long-distance traffic to Rostelecom's network.

Within this business line, the Company signed agreements for direct inter-operator connection and the bilateral exchange of voice traffic with a number of foreign telecommunications operators, including WIND Telecomunicazioni S.p.A. (Italy), Telecom New Zealand International (New Zealand), Bharti AirTel Ltd. (India), and others. The signed agreements stipulate the bilateral exchange of voice traffic between operators, which would facilitate the increase of throughput capacity of direct routes yielding the exchange of traffic between these countries and Russia. In addition, to ensure an increase of throughput capacity of high-speed ring channel linking at Rostelecom's points of presence at major European traffic exchange centers in Frankfurt, Stockholm and London, in 2007 the Company signed a contract with a European telecommunications company, Interoute. This provided a backup system for the Company's European traffic transit routes and expanded access to the Company's telecommunications network, and as a result reinforced Rostelecom's position in the international traffic transit market.

Governmental Authorities

Rostelecom has traditionally been a supplier of telecommunications services for government entities, including the army, militia, security services, the RF Government and Presidential Administration, to administrations of territories and regions, colleges and universities, as well as other entities financed by federal and regional budgets. In 2007, the Company took active part in and won tenders staged by government authorities and state-run companies to provide long-distance telecommunications and communication channel lease services. Furthermore, Rostelecom started to render to government authorities its new and value-added telecommunications services, such as high-speed Internet access, VPN services, videoconferencing and intelligent network services.

Rostelecom once again demonstrated its high quality of telecommunications services arranging a toll-free hot-line with the President of Russia, which has become a tradition for the Company. To secure reliable telecommunications with the Head of the State within the framework of this nationwide event, Rostelecom provides technological capacity of its network, as well as an intelligent telephone number to enable free calls for the public from all regions of Russia.

Rostelecom recognizes the importance of providing telecommunications to government authorities and highly appreciates the government's confidence in the quality of the Company's services and its unique, advanced telecommunications network.

SECURING A SUSTAINABLE POSITION IN THE LONG-DISTANCE MARKET

Since 2006, the liberalization of the Russian long-distance sector has materially changed the competitive environment in this market as it became possible for other telecommunications operators to render domestic and international long-distance services which previously, pursuant to industry legislation, had been provided exclusively by Rostelecom. As of the end of 2007, the Russian Ministry of Information Technologies and Communications issued more than 30 licenses for providing DLD and ILD services, and as of the end of 2007, as many as five operators had complied with terms and conditions of their licenses and started to render long-distance services.

Furthermore, within the framework of long-distance sector liberalization, end-customers were given an opportunity not only to pre-select their long-distance operator ("pre-select"), but also to choose their operator at every domestic or international long-distance connection ("hot-choice"), thus intensifying operators' competition for every subscriber call.

In 2007, Rostelecom successfully maintained its leadership in the Company's traditional long-distance services market, despite increased competition on the part of new operators entering the market, thus confirming its status as Russia's national long-distance operator.

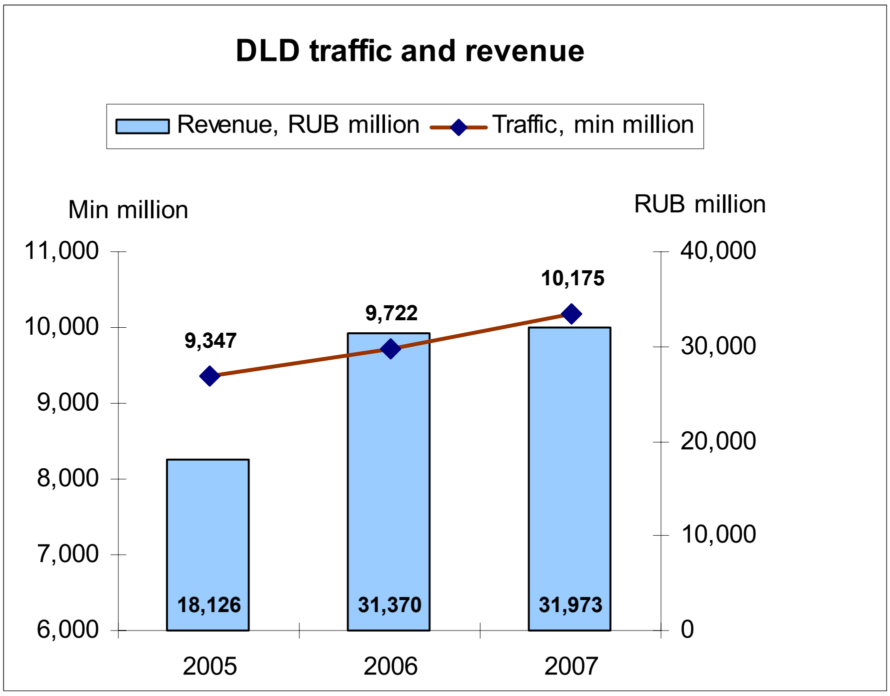
In 2007 Rostelecom's revenues from domestic and international long-distance services amounted to RUB 50,000.0 million, with its share of the Company's consolidated revenue at 77,4%.

Domestic long-distance (DLD) services

Increase in traffic and revenue from Russian clients in 2007 underscores the Company's solid position in the DLD market despite growing competition.

In order to maintain its market leadership and increasing volumes of DLD traffic through Rostelecom's network, in 2007 the Company focused on the effective cooperation with regional and local operators, engaged as Rostelecom's agents, alongside the development of direct business-to-client relationships with end-customers by the expansion of Rostelecom's own nationwide network of Customer Care Centers. By January 1, 2008 the Company had launched 88 regional Customer Care Centers.

In 2007, domestic long-distance traffic (from both end-customers and operators) amounted to 10,174.8 million minutes – a year-on-year increase of 4.7%. Rostelecom's 2007 DLD revenues increased by 1.9% to RUB 31,973.0 million. The growth rate in DLD revenue was influenced by changes in the traffic mix and by a decrease in tariffs.

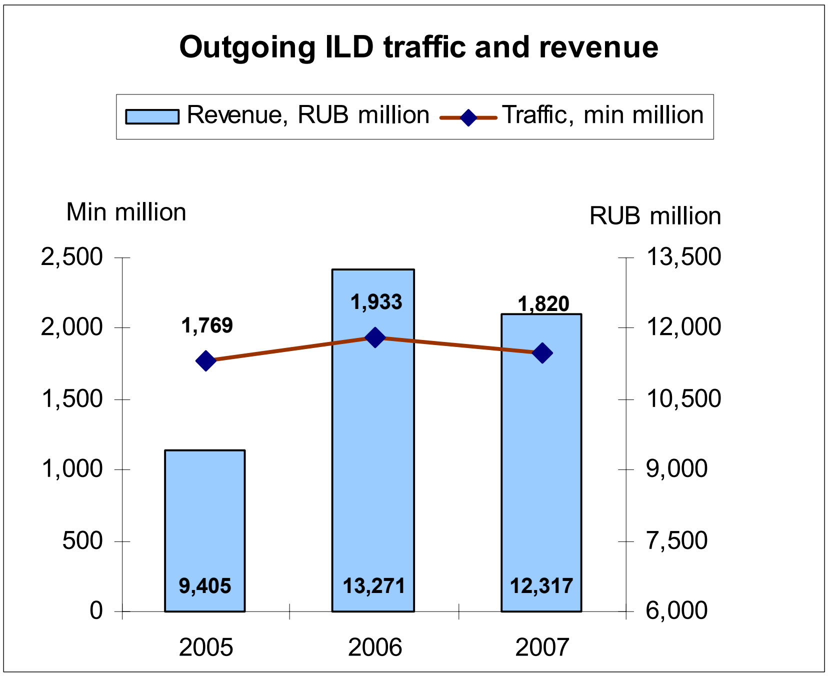


DLD traffic and revenue
Revenue, RUB million
Traffic, min million
Min million
RUB million
11,000
10,000
9,000
8,000
7,000
6,000
40,000
30,000
20,000
10,000
0
9,347
9,722
10,175
18,126
31,370
31,973
2005
2006
2007

International long-distance (ILD) services to Russian end-customers and operators

Outgoing ILD traffic for the full year 2007 totaled 1,820.1 million minutes – a year-on-year decrease of 5.8%, while revenue from ILD services to Russian subscribers and operators amounted to RUB 12,317.0 million, down 7.2% compared to 2006.

The decrease in traffic and revenue was primarily attributable to the increased competition for the most profitable destinations, mainly in the operators' market, as well as the changes in the OILD traffic mix.

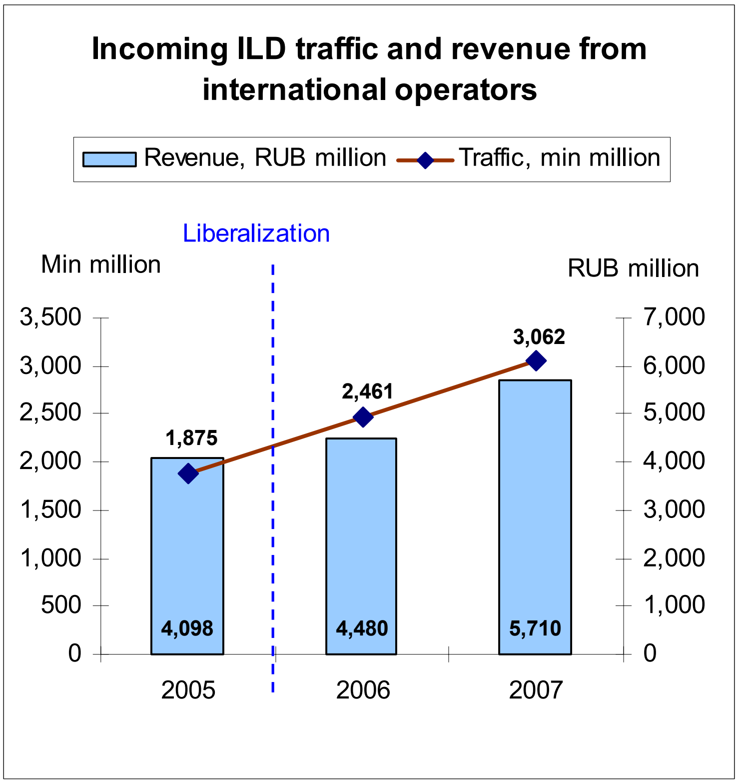


Incoming ILD traffic transit and termination services to international operators

Expanding partnerships with international operators and changes in the tariff structure allowed the Company to benefit from substantial growth in incoming international traffic and revenue from international operators.

In 2007, incoming traffic from international operators rose 24.4% compared to 2006 to 3,062.2 million minutes including both incoming ILD traffic terminated in Russia and transit traffic from international operators, which saw a two-fold increase.

Full year 2007 revenue from international operators for incoming ILD traffic transit and termination grew by 27.5% year on year to RUB 5,710.0 million as Rostelecom continued to leverage its strong market position.



DEVELOPMENT OF NEW AND VALUE-ADDED SERVICES

Active development and promotion of new, unregulated services boosts Rostelecom's revenue growth and drives diversification efforts.

Data transmission services on the base of Rostelecom's IP/MPLS network

The high quality of its data services, as well as the extensive IP/MPLS network with over 350 access points enabled the Company's successful entry into the data transmission market in 2006.

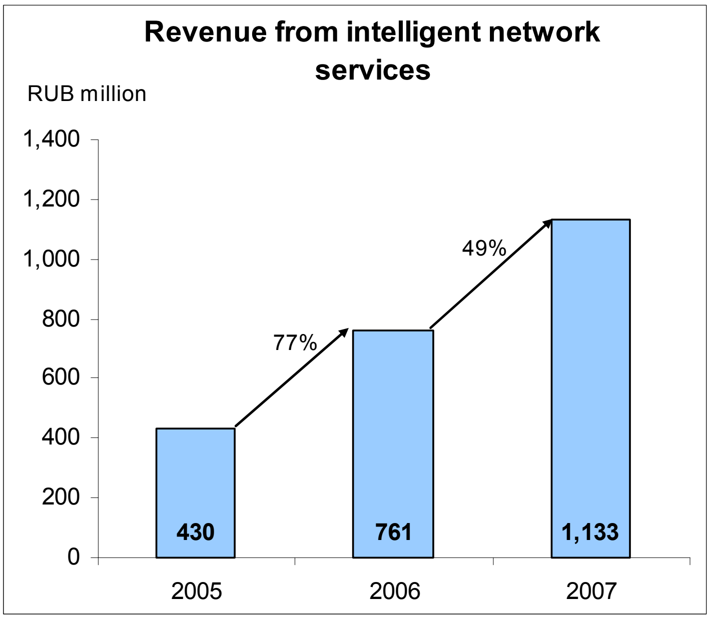
On the back of its IP/MPLS network, in 2007 Rostelecom provided Internet access services for operators and corporates as well as IP VPN services which are essential for corporates who need to connect a number of offices in different regions.

The Company's revenue from Internet access services for operators and corporates surged to RUB 1,143.0 million – a year-on-year increase of 5.3 times. By the end of 2007, Rostelecom's share in the wholesale Internet services market reached 10%.

Intelligent network services (INS)

In 2007, the Company concentrated its efforts on enhancing quality of the existing intelligent network services, such as Freephone, International Freephone, Televoting, Premium Rate, Home Country Direct.

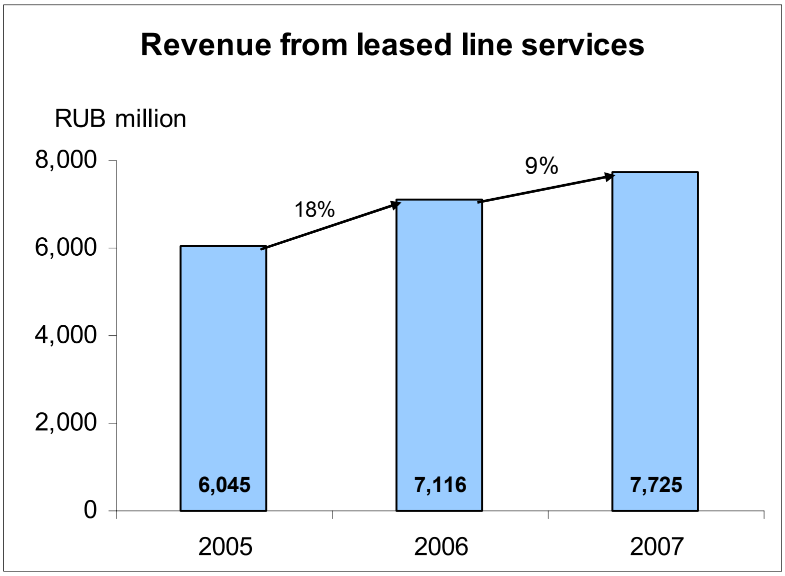
Rostelecom's active promotion of intelligent network services (INS) alongside growing demand from businesses made it possible for the Company to achieve dynamic revenue growth from INS for the fourth year in a row. In 2007, the Company's revenue from intelligent network services rose by 48.9% year on year to RUB 1,133.0 million.



Leased line services

Further development and geographic expansion of its own high-speed backbone telecommunications network based on advanced technologies and equipment enabled the Company to provide high-quality services and reinforce its competitive position in the leased line market.

Rostelecom’s 2007 revenue from leased line services rose 8.6% year on year and totaled RUB 7,725.0 million on the back of an optimized tariff policy and growing demand.



MODERNIZATION AND DEVELOPMENT OF ROSTELECOM'S NATIONWIDE NETWORK

Rostelecom owns and operates a unique, high-capacity fiber-optic telecommunications network stretching nearly 150,000 kilometers throughout Russia and interconnecting all regional and local operators' networks into a single national telecommunications network.

Rostelecom's nationwide state-of-the-art telecommunications network is a key success factor for the Company. It is the basis for its status as a universal operator as it ensures quality services and gives the Company the ability to develop new innovative services and products to meet the growing needs of end-customers and telecom operators.

In 2007, Rostelecom continued to invest in the modernization and expansion of its nationwide network and in the development of technical and IT infrastructure for the provision of new services. Full year capital expenditures decreased by 1.4% year-on-year to USD 280 million. Investments are expected to increase to approximately USD 300 million in 2008. The key objective of Rostelecom's investment program is to enable the Company to further diversify its business, pursuing new avenues for growth while sustaining solid positions in major markets and in traditional segments.

Modernization and development of Rostelecom's backbone network

By investing in the development of its backbone network, the Company maintains the technological platform that drives its competitive advantages.

Key projects 2007 to early 2008

Modernization of Moscow to Smolensk to Gusino FOL
Last year the Company constructed its Moscow – Smolensk – Gusino fiber-optic line and the second international cross-border link between Russia and Belorus to increase the throughput capacity of Rostelecom's telecommunications network to accommodate growing traffic exchange volume between the countries and enhanced the reliability of traffic transmission.
In addition, with the construction of this the new FOL, the Company set up two ring backup systems in the North-Western and Central regions, as well as an additional digital access line to Moscow.

Construction of Russia – Japan UFOL
The new Russia – Japan international undersea fiber-optic line (the Russia-Japan Cable System) will link Russia and Japan by a direct high-speed path along two distinct routes with full ring protection and two digital extensions to Vladivostok and Nakhodka.
Implementation of the project will expand the throughput capacity of the Company's network to Japan, ensure additional capabilities for greater traffic transit between European and Asian operators, and create redundancy for the existing cross-border links to Japan.

Construction of Kingisepp – Luga – Pskov – Smolensk – Moscow FOL
The Kingisepp –Luga – Pskov – Smolensk – Moscow fiber-optic line creates a ring backup system for existing lines in the North-Western region and sets up a digital extension to Pskov Automatic Trunk Exchange for transmission of additional traffic volumes resulting from the growth in demand for telecommunications services in the region.

Construction of Petrozavodsk – Murmansk FOL
While constructing a fiber-optic line from Petrozavodsk to Murmansk with digital access to Murmansk Automatic Trunk Exchange, the Company suspended a fiber optic cable embedded into OPGW (overhead power ground wire) on power transmission lines. The new line enables the Company to increase its revenue from traffic transit and the provision of telecom services in the region due to higher network throughput capacity. It also ensures additional backup route and decommissioning of the existing analog lines.

Creating of Russia – Ukraine International Cross-Border Link
To ensure the increase of network throughput capacity for greater traffic exchange with Ukrainian telecom operators, the Company arranged an additional digital cross-border link between Russia and Ukraine.

Construction of Surgut – Noyabrsk and Surgut – Nizhnevartovsk FOL
Through the construction of Surgut – Noyabrsk and Surgut – Nizhnevartovsk fiber-optic lines using suspension of a fiber optic cable embedded into OPGW (overhead power ground wire) on power transmission lines, the Company enhances its network capabilities for transmitting domestic and international long-distance traffic, rendering leased line and Internet access services. The project also ensures ring protection for the existing lines, thus enhancing reliability of the Company's network.

Increasing the Reliability of the Company's Backbone Network
In 2007, the Company continued to work on increasing the reliability of its backbone network by arranging backup systems for existing digital lines. The Company successfully created ring protection systems using DWDM technology in the Central, Central Black Earth, Volga and Urals, North-Western and Southern Regions, and similar projects were launched in the Siberian and Far Eastern Regions.
Setting up ring backup systems enables the Company to enhance network reliability, throughput capacity and efficiency, and provide advances telecommunications services to Rostelecom's customers across the entire Russian Federation.

Modernization of the Company's Backbone Network and Telecommunications Nodes
In addition to implementation of projects aimed at expanding the geography of the network by constructing new lines, the Company is modernizing its trunk channels and network equipment in order to ensure network throughput capacity is in line with growing traffic volumes.
In particular, in 2007 the Kingisepp – Belogorsk FOL, Kingisepp – Khabarovsk FOL sections were modernized, additional equipping of systems in Central, Volga and Urals regions were performed, and a number of other projects were implemented, which made it possible to increase the capacity of Rostelecom's trunk lines, and ensure high-quality telecommunications services.

Modernization of Rostelecom's secondary network is primarily aimed at increasing its switching capacity and improving quality of services. In 2007, Rostelecom's Automatic Trunk exchanges, Switching Nodes and International Switching Centers were expanded by 50,000 channels.

Development of Flexible Multiplexers Network

In order to strengthen the Company's position in the leased line market, Rostelecom continued to develop its network of modern flexible multiplexers. As of December 31, 2007, flexible multiplexers equipment was installed in 160 cities in Russia.

Development of Rostelecom's IP/MPLS network and intelligent platform

Development of data transmission network on the base of IP/MPLS technology

Using its extensive transport telecommunications network as the foundation, Rostelecom continued the development of its data network created on the basis of multi-protocol label switching technology (IP/MPLS network) forming the technological base for rendering high-speed Internet access services, IP VPN services, dedicated, virtual and web hosting services, services relating to server placement ("Co-Location"), as well as for development and promotion of new telecommunications services.

To increase the capacity of its data network, in 2007 the Company implemented a number of high capacity trunk transit nodes as well as regional nodes, satisfying steadily growing demand for Internet access services, IP VPN and other data services in all regions of the Russian Federation.

As part of the development of Rostelecom's IP/MPLS network, the Data Center was launched in Moscow. This began development of content-related services on Rostelecom's network, ensuring customer satisfaction with our Internet access services and attracting additional data traffic volume.

Upgrade of Rostelecom's Intelligent Network

In 2007, the Company continued to develop its intelligent network, including the installation of a platform manufactured by Alcatel. The new platform expanded the functionality of Rostelecom's intelligent network, improving its reliability and security levels against unauthorized use of telecommunications services. It also enabled the optimization of traffic routes.

Furthermore, the functional capabilities of the new intelligent platform form the basis for launching new services, such as phone number portability for subscribers of mobile and fixed-line telecommunications networks or universal access numbers.

Key investment priorities for 2008

Within the framework of its investment strategy, the Company is carrying out the construction of new fiber-optic trunk lines using modern technologies, upgrading existing lines and switching equipment, developing its data network and improving its intelligent platform. Expanding the geography of its own telecommunications network, increasing its reliability, throughput capacity and efficiency, the Company can better satisfy its clients' growing need for high-quality telecommunications services.

- Construction of new and modernization of existing fiber-optic lines using advanced technologies; setting up extensions linking cities and towns across the country to Rostelecom's network; creating additional and expanding existing cross-border links to CIS, European and Asian countries including the launch of the Russia-Japan Cable System to connect two countries by a direct high-speed route.
- Further expansion of ring protection systems to improve throughput capacity and reliability of Rostelecom's network, while decreasing operating costs and enhancing service quality (in the Far East and Siberian regions).
- Expanding and increasing the capacity and reliability of Rostelecom's IP/MPLS network including the launch of new Data Centers across the country, additional regional nodes and access points in Russia and expanding presence in key international traffic exchange points. The planned launch of Rostelecom's own network of Data Centers in the largest Russian cities will enable the Company to improve the quality of data services, expand cooperation with telecom services providers and bring additional traffic volume to Rostelecom's network.
- Beginning implementation of the expansion of Rostelecom's transit telephone network to improve interaction with interconnected operators and to flexibly introduce high value-added informational and convergent services

EFFICIENCY ENHANCEMENT

In order to secure its strong position in the various telecommunications market segments, Rostelecom offers its clients high quality, competitive services and exceptional customer service.

The Company has once again passed an inspection of its quality management system by an external controlling authority, confirming compliance with the GOST R ISO 9001-2001 Standard. Additional evidence of the high quality of Rostelecom's services was its nomination for the RF Ministry of Information Technologies and Telecommunications Quality Award for Telephone Telecommunications Operators.

Pursuant to the standards of the Telecommunications Quality Voluntary Certification System, the Company received certificates certifying the quality of Internet access services, VPN services, Freephone services and Audioconferencing services, among others. The Company's receipt of Compliance Certificates assures that the Company renders these services with a guaranteed level of quality, and that these services meet users' requirements and conform to relevant technical norms and standards.

In addition, the Company obtained a compliance certificate from the Federal Service for Technical and Export Control, confirming the high level of information security on its IP/MPLS network.

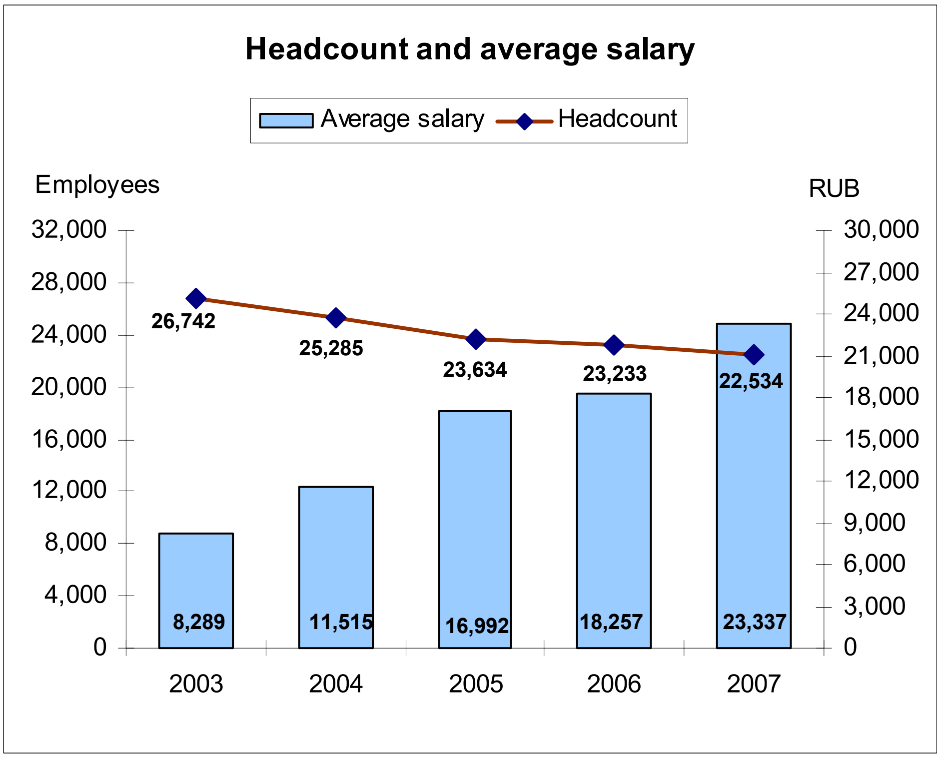
The Company continued to expand its nationwide network of Customer Care Centers, enhancing the efficiency of its service units and ensuring that Rostelecom's clients in the various regions for Russia are guaranteed consistent high standards of service quality. Further development of direct business-to-client relationships with end-customers through Rostelecom's expanding network of Customer Care Centers across the country enabled the Company to save on agent fees and increase profitability in 2007.

Organizational structure improvements and headcount optimization

To improve the overall efficiency of the business, in 2007 the Company carried out an optimization of its administrative, managerial and support personnel, gradually consolidating its territorial offices and establishing operation and maintenance centers.

Similar to 2006, overall headcount reduction in network maintenance was partly offset by the staff retained to further support the marketing, sales and customer service functions.

The Company's continued focus on business process improvements and streamlining of the organizational structure resulted in a 3.0% reduction in the headcount of Rostelecom and its subsidiaries compared to the previous year. As of December 31, 2007, headcount amounted to 22 534 employees. Average (monthly) salary of Rostelecom's employees grew by 27.8% compared to 2006 and amounted to RUB 23,337.


Headcount and average salary
Average salary
Headcount
Employees
RUB
32,000
28,000
24,000
20,000
16,000
12,000
8,000
4,000
0
30,000
27,000
24,000
21,000
18,000
15,000
12,000
9,000
6,000
3,000
0
26,742
25,285
23,634
23,233
22,534
8,289
11,515
16,992
18,257
23,337
2003
2004
2005
2006
2007

SOCIAL RESPONSIBILITY

Company Personnel

An additional competitive advantage for Rostelecom is its top-notch personnel, a team built to achieve ambitious objectives and help the Company realize its full potential.

Rostelecom focuses on staff education and training to yield a team of professionals capable of managing the Company efficiently, regardless of market conditions. In 2007, employee education programmes, including technical, commercial and administrative programmes, were held consistently. Additionally, the Company offered employee training via distant learning programmes at all Rostelecom's branches. Approximately 7,000 employees attended refresher and re-training courses, including those in a distant learning format. Over the last year, the number of employees seeking higher and specialized secondary education constituted 69.2% of the total employees working with the Company.

Within the framework of Rostelecom's Corporate University, an In-House Training Institute was set up, leveraging internal resources and knowledge in order to educate client-facing employees. Special emphasis was placed on the training of senior managers, specifically advancing their skills under Master of Business Administration programmes, and with their participation in a Managerial Skills Development Programme. The high qualifications of Rostelecom's employees were also recognized through departmental awards given by the RF Ministry for Information Technologies and Telecommunications: 36 employees were given a title of Telecommunications Master, and 15 employees were awarded Honorary Radio Operator badges. Moreover, 13 employees were given the highest award – Rostelecom's Golden Badge.

Rostelecom's non-state pension insurance system for its employees is an additional motivating factor enabling the Company to retain both entry level employees and executives of middle and top-level management. Moreover, the Company implemented a Voluntary Medical Insurance program and insurance against accidents at its facilities for all employees.

In 2007, Rostelecom allocated a portion of the salary fund to the trade union's accounts in order to carry out popular cultural and sporting events as well as other recreational events for the Company's employees and their families. Rostelecom also held trade competitions for experts in mounting and measuring fiber-optic cables, drivers and commercial units. Creative contests were also held for employees and their children, and employees were given the opportunity to take part in industry-wide sports events.

Social projects

Recognizing its social responsibility, Rostelecom places high importance on participation in social improvement and charity programs.

For several years, Rostelecom has granted personal scholarships to the best students and graduates of a number of Russian Federation institutions that provide education in the telecommunications field.

In 2007, Rostelecom continued providing quality telecommunications services to government authorities. One significant social project was Rostelecom's arrangement of a Hot Line with the President of Russia in October 2007. Rostelecom used its nationwide telecommunications network, a multi-channel federal telephone number, as well as organized TV-bridges to connect local communities across Russia to this event.

PLANS AND GOALS FOR 2008

In 2008, Rostelecom's primary objective is to further diversify its business to speed Rostelecom's transformation into a universal telecommunications operator by expanding the range of services and significantly increasing its presence in new promising markets. The Company will also strive to maintain its position in traditional telecom segments while further improving overall efficiency.

Corporate market

The combination of Rostelecom's network's high capacity and reliability, modern telecommunications services in accordance with global quality standards, extensive operating experience and professionalism make it the provider of choice for corporate users.

To strengthen its competitive advantage, the Company plans to secure its market positions in the traditional segment of domestic and international long-distance services while aggressively promoting data transmission and intelligent network services to make Rostelecom a single-source provider of telecom services.

High-quality long-distance services

Providing a wide range of tariff plans allows Rostelecom to satisfy the telecommunications needs of companies of various sizes – from nationwide and international corporations to small-size firms. The Company plans to solidify its market position in the corporate segment.

Two of the Company's key priorities are the further development of direct corporate client servicing and securing pre-selection contracts with Rostelecom as the long-distance operator of choice. Direct interaction between clients and Rostelecom will improve servicing efficiency, and allow Rostelecom's clients to take advantage of special offers.

Entire range of telecommunications services from a single operator

Another one of Rostelecom's priorities is the further development of bundled services to better satisfy corporate customers' various demands. Rostelecom's bundled packages will allow its clients to receive a broad range of modern telecommunications products and services from a single operator, making customers feel more secure and improving servicing efficiency.

Depending on the size of the Company's business, bundled packages may include traditional long-distance and local telephone services, Internet access, IP VPN, videoconferencing, intelligent network services, and others. Bundled packages are implemented through partnerships with other telecommunications operators, enabling Rostelecom's clients to use these services in all regions of the country.

In December 2007, the Company secured number capacity for 10,000 Moscow numbers, and in 2008 plans to start rendering local telephone services to corporate clients in Moscow.

Development and promotion of new services

Answering the growing demand from Russian businesses for modern telecommunications services, the Company plans to continue the aggressive promotion of new and existing state-of-the-art services provided via Rostelecom's intelligent platform and its IP/MPLS network – primarily, IP VPN and Internet access services. In addition, in the short term, the Company plans to launch its Contact Center and Data Center services.

Customer service focus

Rostelecom plans to further build its customer support network in order to provide high-level customer service. The Company will also explore partnerships with other operators and agents to expand the scope of its customer support network.

In addition, the Company plans to enable clients to actively manage the services it receives from Rostelecom. In order to secure customer loyalty, the Company will also increase the efficiency of the sales process and further promote its telecommunications products and services. Services such as the Personal Account, will allow customers to receive up-to-date information on calls made and received, learn their account balance, print invoices and to ensure prompt replenishment of accounts via Internet payment systems.

Residential subscribers' market

Despite the emergence of new providers of long-distance telecommunications services, Rostelecom retained a leading position and remains the operator selected by individual subscribers all over Russia. The Company provides high-quality, reliable telephone telecommunications without interference and noise, guaranteeing a high level of servicing and confirming its motto "Always Online" for each and every subscriber call.

The Company's short-range plans include, in addition to the development of traditional long-distance services, the rendering of new telecommunications products to its individual clients, and increased efficiency of customer service.

Convenient domestic and international long-distance services

To retain its positions in the long-distance services segment and maintain growth in domestic and outgoing international long-distance traffic from Russian residential customers, the Company plans to focus on clients signing pre-select contracts.

By entering into a contract directly with Rostelecom, these clients will benefit from differentiated tariff plans depending on time and quantity of domestic and international long-distance calls, servicing directly from the operator, friendly client service and the opportunity to take part in bonus programs and special offerings from the Company.

Promotion of new services

The Company intends to offer individual subscribers new intelligent network services, such as Freephone and Universal access numbers with the option to use a convenient web interface for ordering and managing these services, as well as content services based on Rostelecom's IP/MPLS network.

Development of customer services

To get closer to end users and expand access to Company services, Rostelecom will continue to develop and extend its own network of Customer Care Centers, and build its network of agents. Increasing the efficiency of communication with individual subscribers, the Company plans to introduce a number of information services and service management opportunities for management of services, specifically known as a Personal Account.

In addition, Rostelecom will further increase the number of points of payment for telecommunications services, and implement new means for paying invoices.

In 2008, the Company will continue to promote brand awareness and build Rostelecom's image as a state-of-the-art single-source provider of telecom services. The Company launched a nationwide advertising campaign aimed at increasing brand awareness and promoting Rostelecom's services.

Operators' market

Rostelecom's nationwide, powerful fiber-optic telecommunications network is a significant competitive advantage for the Company and Rostelecom remains a leading "operator for operators" in the Russian telecommunications market. Furthermore, the Company's up-to-date IP/MPLS network with connections to the largest Russian and foreign operators in the Russian Federation, CIS, Europe and Asia, guarantees quality at all stages of service rendering, and ensures additional advantages to telecommunications operators and telecommunications service providers selecting Rostelecom as a business partner.

In order to strengthen the Company's position in the inter-operator market, Rostelecom's key priorities are to make its cooperation with Russian operators more efficient, expand cooperation with foreign telecommunications services providers and support Rostelecom's reputation in the international market.

National "operator for operators"

The Company will continue to develop partnerships with fixed-line and mobile telecommunications operators in the Russian market, providing traffic transit services with the ability to interconnect to Rostelecom's network, which boasts direct connections with more than 150 international operators and has flexible tariff policies.

As it continues its development into a universal operator, Rostelecom plans to start selling bundled packages to telecommunications services providers. The Company will also continue strengthening positions in the leased line market, leveraging its high throughput capacity and high-speed network. Furthermore, Rostelecom intends to actively promote its wholesale Internet services and other innovative services based on its IP/MPLS network.

Development cooperation with international operators

The Company will continue to solidify its partnership with foreign operators to increase international long-distance traffic incoming to its network. Rostelecom will provide international operators with high-quality termination services, while introducing flexible pricing and expanding the geographic scope of its services. By entering into new inter-operator agreements, expanding its foreign infrastructure network and cross-border links with the countries in CIS, Europe and Asia, the Company will further strengthen of its position in the international market.

As part of its strategy for the promotion of Europe-Asia transit (TEA) services, in 2008 the Company plans to further increase the throughput capacity of its high-speed telecom lines and to put into operation a cable system linking Russia and Japan, ensuring the shortest and most efficient traffic route between European and Asian operators.

Offering new telecom services

As part of its plan to diversify its service offering, the Company is focused on the development and provision of advanced products and services for telecommunications operators. In particular, the Company intends to actively promote wholesale Internet access services and Data Center services while attracting major hosting and content providers. To this end, in 2008 the Company plans to launch four Data Centers in Moscow, Novosibirsk, Khabarovsk and Yekaterinburg.

Moreover, the Company’s current priorities include the expansion of relationships with international operators, to enhance the quality of Internet access services and further develop Internet traffic transit services. In order to strengthen the Company’s position in the data transmission services market, connections with IP/MPLS networks of foreign operators to provide international IP VPN services are planned.

IMPROVING CORPORATE GOVERNANCE PRACTICES

Rostelecom's corporate governance activities are aimed at forming and enhancing the system of corporate practices and procedures to create an optimal balance of the interests of shareholders, managing bodies and other stakeholders of the Company based on recognized Russian and global standards.

The high corporate governance and information disclosure standards adopted by Rostelecom ensure its shareholders and investors that their legitimate rights and interests will be observed. They also help to create transparent internal mechanisms designed to improve the process of managerial decision-making aimed at preserving assets, maximizing profit and market capitalization.

Corporate governance standards

To ensure transparent and understandable mechanisms for managing the Company, as well as to comply with high ethical norms in the course of carrying out the Company's business, the Corporate Governance Code and Ethics Code are in place to contain internationally recognized high standards of corporate practices, as well as to regulate such matters as conflicts of interests, prohibition to abuse official powers and insider information, and procedures for preparing and disclosing information on results of activities.

The Corporate Governance Code and Ethics Code were developed by the Company in accordance with requirements and recommendations of New York Stock Exchange, US Securities and Exchange Commission and recommendations of the Federal Service for Financial Markets of Russia. Compliance with the norms set out in the Codes is a pre-condition for maintaining the listings of Company's securities on Russian and foreign stock exchanges.

Rostelecom's Codes are based on the following corporate governance principles which are recognized in Russia and globally:

– observing shareholders' rights and interests defined by applicable legislation, norms and requirements, as well as ensuring long-term growth of share value by improving corporate practices and enhancing information-related openness and transparency;

– ensuring a transparent and efficient mechanism of interaction between managing bodies by the Company, as well as the execution of their duties in good faith and with competence, in accordance with high corporate governance and business ethics standards;

– maintaining efficient internal controls and audit system;

– active cooperation with persons interested in ensuring the long-term sustainable development of Rostelecom.

Corporate governance rating

On July 17, 2007 upon the results of its assessment of the Company's corporate governance system, RID-Expert RA Consortium (consisting of the Russian Directors Institute and Expert RA Rating Agency) confirmed the Company's rating at category "7+" within the National Corporate Governance Rating. The "7+" rating is currently the highest one for Russian companies, and it means that extensive corporate governance practices exist within Rostelecom, and that its transparency is high.

RID-Expert RA Consortium believes that falling within “7+” category means that the Company has low corporate governance risks, complies with the Russian legislation, as well as substantially follows, in its practice, recommendations contained in the Corporate Conduct Code and individual recommendations of advanced international corporate governance practice.

Confirmation of “NRKU 7+” rating is important for the Company, since it implies a high degree of cooperation between shareholders of the Company, Rostelecom’s Board of Directors, management and other stakeholders.

2007 FINANCIAL PERFORMANCE

- *Consolidated revenue for the full year 2007 increased by 4.9% to RUB 64,602.0 million;*
- *Domestic long-distance traffic rose 4.7% compared to 2006. Outgoing international traffic decreased by 5.8% year on year while incoming international traffic increased by 24.4%;*
- *Full year 2007 OIBDA increased by 7.6% to RUB 11,110.0 million, representing an OIBDA margin of 17.2%;*
- *2007 FY net profit amounted to RUB 2,806.0 million, representing a year-on-year increase of 92.7%.*

Revenue

Rostelecom's consolidated revenue for the full year 2007 increased by 4.9% to RUB 64,602.0 million.

Operating Expenses

Total operating expenses for the full year 2007 amounted to RUB 61,573.0 million, representing a year-on-year increase of 2.2% primarily attributable to the scheduled growth in staff costs, higher costs for implementation of marketing initiatives as well as other administration costs. However, the reduction in payments to Russian operators alongside lower depreciation charges and loss on the sale of PP&E slowed growth in Rostelecom's operating expenses that contributed to improved operating efficiency and higher margins compared to the previous year.

Payments to Russian operators decreased by 5.1% year on year to RUB 27,860.0 million mainly due to the expansion of the Company's own Customer Care Centers to support direct business-to-client relationships with end-customers, which enabled Rostelecom to save on agent fees. Payments to international operators rose 7.0% to RUB 7,817.0 million as a result of increase in volume of transit traffic.

Staff costs for the full year 2007 totaled RUB 8,763.0 million, a 22.6% increase year on year. This was a result of a scheduled increase in the salary budget as the Company retained the staff necessary to further support marketing, sales and customer service. This was partially offset by a staffing reduction in network maintenance. As mentioned, due to continuing business process optimization and streamlining of the organizational structure, the Company and its subsidiaries' headcount was reduced by 3.0% to 22.5 thousand employees as of December 31, 2007.

In 2007 the Company's expenses for bad debt provision amounted to RUB 815.0 million, up by two times year on year. In addition, the Company recognized in the statement of income a RUB 271.0 million loss from the impairment of goodwill and other intangible assets.

OIBDA increased by 7.6% year on year to RUB 11,110.0 million, representing the OIBDA margin of 17.2%.

Depreciation charges for the full year 2007 amounted to RUB 7,613.0 million – down 9.6% year on year.

Thus, full year 2007 operating profit grew by 2.3 times to RUB 3,029.0 million from RUB 1,305.0 million in 2006. Operating margin improved to 4.7%.

Other Income/Loss

Other income for the full year 2007 amounted to RUB 815.0 million, down 27.2% year on year. The decrease is due to higher interest expense in comparison with the previous year.

Income Tax

Income tax expense grew by 21.0% and amounted to RUB 1,194.0 million in 2007.

Consolidation

Full year 2007 consolidated financial statements include the results of operations of Rostelecom and its subsidiaries – Westelcom, GlobalTel, Globus-Telecom, Zebra Telecom MTs NTT and others.

Net profit

In 2007 Rostelecom's consolidated net profit increased by 92.7% and totaled RUB 2,806.0 million. Net margin amounted to 4.3%.

Condensed consolidated balance sheets as of December 31, 2007 and December 31, 2006 in RUB

RUB million	Dec. 31, 2007	Dec. 31, 2006	*% change, y-o-y*
ASSETS			
Non-current Assets, incl.	**53,586**	**48,110**	***11.4%***
Property, plant and equipment	38,480	39,186	*-1.8%*
Current Assets, incl.	**19,858**	**20,388**	***-2.6%***
Accounts receivable, net	8,429	8,821	*-4.4%*
Short-term investments	6,920	8,496	*-18.5%*
Cash and cash equivalents	3,284	2,353	*39.6%*
Total Assets	**73,444**	**68,498**	***7.2%***
EQUITY AND LIABILITIES			
Shareholders' equity, incl.	**56,153**	**50,945**	***10.2%***
Minority interest	26	25	*4.0%*
Current liabilities, incl.	***12,335***	***12,696***	***-2.8%***
Current portion of long-term loans	2,585	3,005	*-14.0%*
Non-current liabilities, incl.	***4,956***	***4,857***	***2.0%***
Long-term loans - net of current portion	172	298	*-42.3%*
Deferred tax liabilities	4,119	3,444	*19.6%*
Total Liabilities	**17,291**	**17,553**	***-1.5%***
Total Equity and Liabilities	**73,444**	**68,498**	***7.2%***
Net debt[1]	**-7,447**	**-7,546**	***-1.3%***

[1] Net debt is calculated as the sum of long-term loans and short-term borrowings minus cash and cash equivalents and short-term investments.

Condensed Consolidated Profit and Loss Statements for the full year ended December 31, 2007 and December 31, 2006 in RUB

RUB million	2007	2006	*% change, y-o-y*
Revenue from telephone traffic transmission	***50,000.0***	***49,121.0***	***1.8%***
DLD	31,973.0	31,370.0	*1.9%*
Outgoing ILD	12,317.0	13,271.0	*-7.2%*
Incoming ILD (termination and transit)	5,710.0	4,480.0	*27.5%*
Revenue from leased line services	***7,725.0***	***7,116.0***	***8.6%***
Other revenue	***6,877.0***	***5,322.0***	***29.2%***
Total revenue	**64,602.0**	**61,559.0**	***4.9%***
Payments to Russian operators	(27,860.0)	(29,355.0)	*-5.1%*
Payments to international operators	(7,817.0)	(7,304.0)	*7.0%*
Wages, salaries, etc.	(8,763.0)	(7,147.0)	*22.6%*
Taxes other than on income	(703.0)	(621.0)	*13.2%*
Bad debt expense	(815.0)	(389.0)	*109.5%*
Other operating expenses	(7,534.0)	(6,419.0)	*17.4%*
Total operating expenses before depreciation, loss on disposal of PP&E and impairment of goodwill & other intangible assets	**(53,492.0)**	**(51,235.0)**	***4.4%***
OIBDA	**11,110.0**	**10,324.0**	***7.6%***
OIBDA margin, %	***17.2%***	***16.8%***	***n.a.***
Depreciation	(7,613.0)	(8,418.0)	*-9.6%*
Loss on disposal of property, plant and equipment	(197.0)	(601.0)	*-67.2%*
Impairment of goodwill and other intangible assets	(271.0)	-	*n.a.*
Total operating expenses	**(61,573.0)**	**(60,254.0)**	***2.2%***
Operating profit	**3,029.0**	**1,305.0**	***132.1%***
Operating margin, %	***4.7%***	***2.1%***	***n.a.***
Gain /(loss) from associates	***156.0***	***19.0***	***721.1%***
Other income /(loss), incl.	***815.0***	***1,119.0***	***-27.2%***
Interest expense	*(238.0)*	*(133.0)*	*78.9%*
Interest income	*907.0*	*900.0*	*0.8%*
Income from sale of investments	-	*52.0*	*n.a.*
Foreign exchange gain /(loss), net	*183.0*	*219.0*	*-16.4%*
Other non-operating income /(loss), net	*(37.0)*	*81.0*	*-145.7%*
Income before tax and minority interest	***4,000.0***	***2,443.0***	***63.7%***
Current tax charge	(1,854.0)	(2,411.0)	*-23.1%*
Deferred tax benefit	660.0	1,424.0	*-53.7%*
Income tax expense	***(1,194.0)***	***(987.0)***	***21.0%***
Net income, attributable to:	**2,806.0**	**1,456.0**	***92.7%***
Equity holders of the parent	2,805.0	1,458.0	*92.4%*
Minority interest	1.0	(2.0)	*n.a.*
Net margin, %	***4.3%***	***2.4%***	***n.a.***

ROSTELECOM'S LONG-TERM CREDIT RATING DEVELOPMENTS

In April 2007 Standard & Poor's affirmed long-term credit rating on Rostelecom stands at "BB-" with a stable outlook.

In March 2008 Standard & Poor's (S&P) has revised its outlook on Rostelecom to "positive" from "stable". At the same time, the Company's "BB-" long-term credit rating was affirmed.

Standard & Poor's commented in its report that the outlook revision reflects Rostelecom's increasing financial flexibility, providing an opportunity for the Company to strengthen its overall business profile.

According to S&P, Rostelecom's current financial risk profile features minimal debt, ample liquidity, continuing production of positive free operating cash flow and limited capital expenditures, and will be further supported by the additional cash Rostelecom will receive from the sale of its 11% stake in Golden Telecom Inc.

In its report, S&P also noted that Rostelecom's active expansion into non-regulated telecom market segments, intended to mitigate the decrease in revenues from traditional long-distance services in the competitive environment, could strengthen the Company's market position.

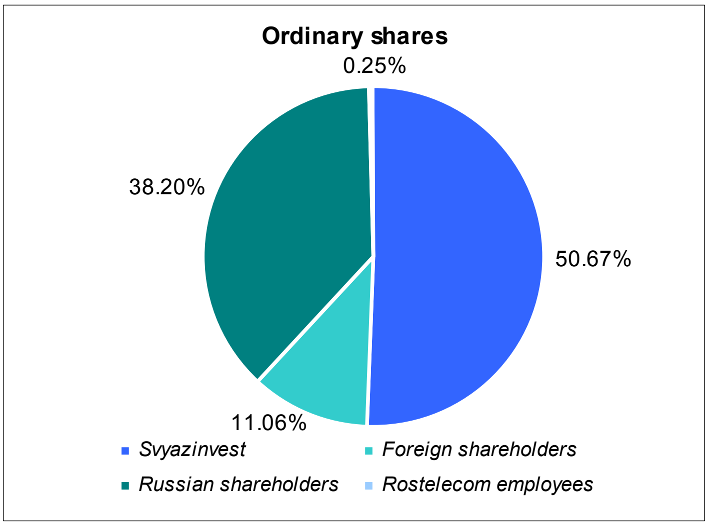
Additional factors underpinning the outlook revision, according to S&P, include the Company's increasing focus on efficiency and cost control.

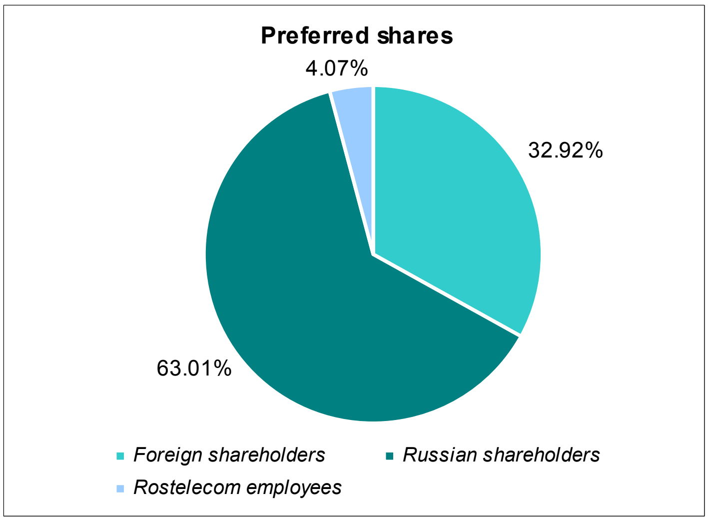
The positive outlook reflects the possibility that S&P could raise the Company's rating if Rostelecom continues to strengthen its business risk profile. This would require the Company to maintain its leading position in the long-distance market, increase revenue diversification and continue improving profitability. Rostelecom must also sustain limited debt leverage and sound credit protection in order to warrant a corporate credit rating upgrade.

SHARECAPITAL AND CORPORATE GOVERNANCE

Today, Rostelecom's charter capital amounts to RUB 2,428,819.4725, divided into 728,696,320 ordinary and 242,831,469 preferred shares, each with a par value of RUB 0.0025.

Ownership structure as of December 31, 2007





The Company's largest shareholders as of December 31, 2006

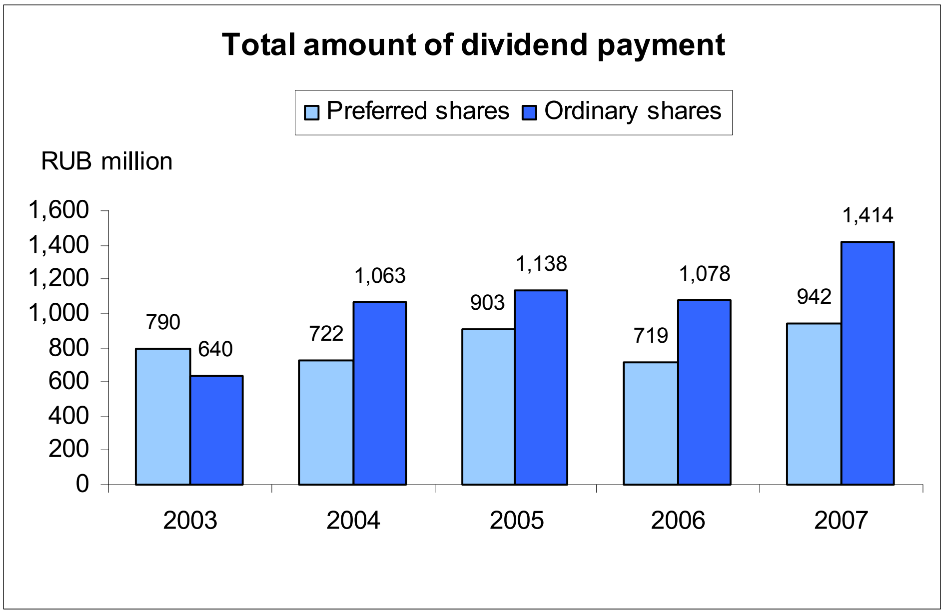
	% of charter capital	% of ordinary (voting) shares
OJSC Svyazinvest	38.00	50.67
NP National Depositary Center[1]	41.93	33.69
CJSC Depositary & Clearing Company	7.60	6.11
CJSC ING Bank (Eurasia)[1] including:	5.91	7.73
JPMorgan Chase Bank as a depositary bank	5.40	7.20

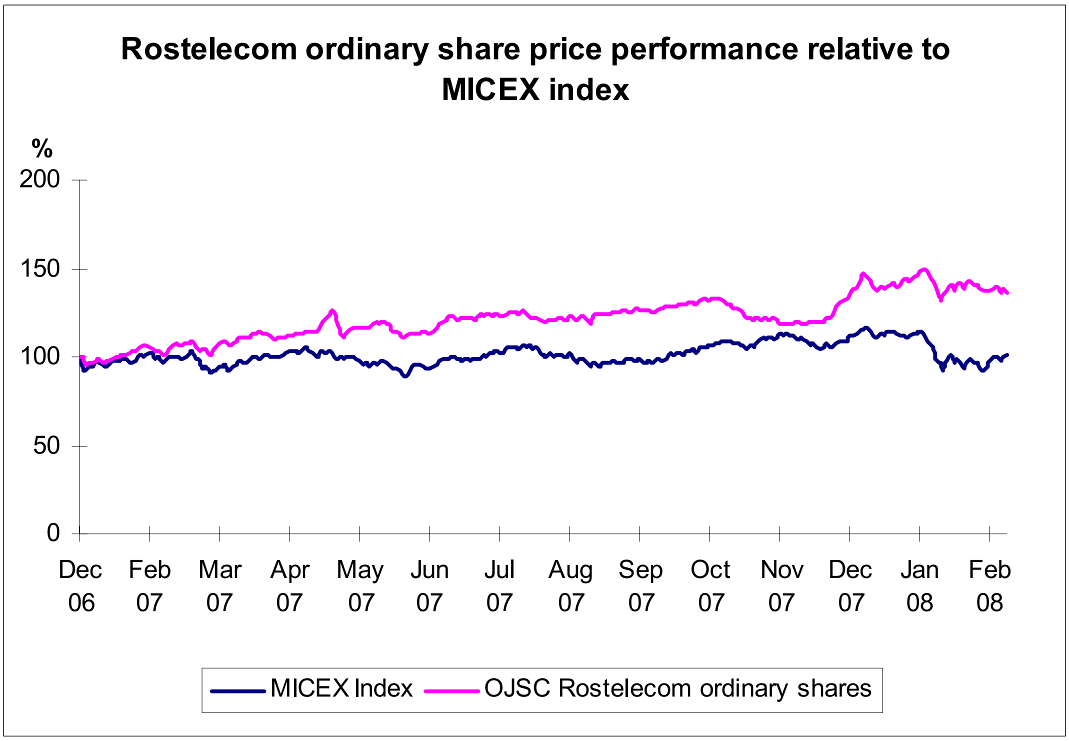
[1] *Nominal holder*

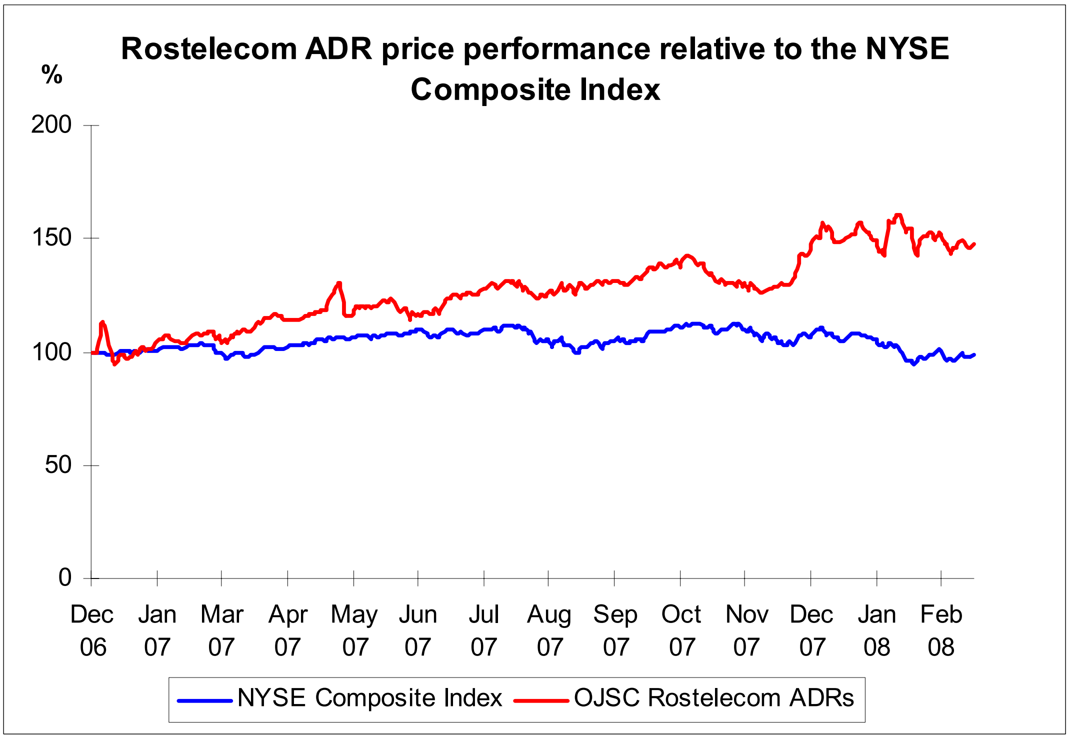
Dividend history

	2004	2005	2006	2007
Total amount of dividends, RUB	1,785,518,762.29	2,040,803,878.39	1,796,255,890.91	2,356,002,639.21
Per one preferred share, RUR	2.9738	3.7178	2.9589	3.8809
% of net profit[1] *paid to preferred shareholders*	*10.0*	*10.0*	*10.0*	*10.0*
Per one ordinary share, RUR	1.4593	1.5617	1.4790	1.9399
% of net profit[1] *paid to ordinary shareholders*	*14.7*	*12.6*	*15.0*	*15.0*

[1] *According to Russian Accounting Standards*




Rostelecom ordinary share price performance relative to MICEX index
%
200
150
100
50
0
Dec 06
Feb 07
Mar 07
Apr 07
May 07
Jun 07
Jul 07
Aug 07
Sep 07
Oct 07
Nov 07
Dec 07
Jan 08
Feb 08
MICEX Index
OJSC Rostelecom ordinary shares


Rostelecom ADR price performance relative to the NYSE Composite Index
%
200
150
100
50
0
Dec 06
Jan 07
Mar 07
Apr 07
May 07
Jun 07
Jul 07
Aug 07
Sep 07
Oct 07
Nov 07
Dec 07
Jan 08
Feb 08
NYSE Composite Index
OJSC Rostelecom ADRs

Board of Directors[1]

Chairman of the Board:

Alexander N. Kiselev – General Director of Svyazinvest

Members of the Board:

1. Mikhail A. Alekseyev;
2. Yekaterina O. Vasilyeva, Director, Corporate Finance Department, CIT Finance Investment Bank (OJSC);
3. Anatoly A. Gavrilenko, General Director, CJSC Leader (a pension fund assets management company);
4. Valery V. Degtyarev, General Director, CJSC Professional Telecommunications;
5. Alexander N. Kiselev, General Director, OJSC Svyazinvest;
6. Sergei I. Kuznetsov;
7. Yevgeny I. Logovinsky, Deputy Chairman of the Management Board, OJSC Gas Industry Insurance Company;
8. Nikolai L. Mylnikov, Director, Legal Department, CIT Finance Investment Bank (OJSC);
9. Yelena P. Selvich, Executive Director – Director of Economics and Finance Department, OJSC Svyazinvest;
10. Yevgeny A. Chechelnitsky, Deputy General Director, OJSC Svyazinvest;
11. Maxim Yu. Tsyganov, Managing Director, Moscow Branch, CIT Finance Investment Bank (OJSC).

[1] *The Board of Directors as elected at the Annual General Shareholders' Meeting on June 16, 2007*

Committees Reporting to the Board of Directors

Strategic Planning Committee

In 2007, this Committee focused on the development of forecasts and preparation of Rostelecom's medium-term strategies of operations both on the liberalized long-distance telecommunications market, and on new markets having opened for the Company due to the telecommunications sector reform. Moreover, the Committee considered issues pertaining to strategies for long-term financial investment management.

Members of the Strategic Planning Committee:

1. Yevgeny A. Chechelnitsky, Chairman of the Committee, Non-Executive Director;
2. Yekaterina O. Vasilyeva, Independent Director;
3. Anatoly A. Gavrilenko, Independent Director;
4. Andrei A. Gaiduk, First Deputy General Director – Finance Director;
5. Sergei I. Kuznetsov, Non-Executive Director;
6. Yelena P. Selvich, Non-Executive Director.

Nominations and Remuneration Committee

The basic tasks of this Committee in 2007 were to consider and analyze candidates to the Board of Directors, the Management Board and managerial positions; to refine remuneration policies for the Board of Directors and the Management Board and to approve material terms and conditions of employment contracts with members of the Management Board.

Members of the Nominations and Remuneration Committee:

1. Mikhail A. Alekseyev, Chairman of the Committee, Independent Director;
2. Valery V. Degtyarev, Independent Director;
3. Nikolai L. Mylnikov, Independent Director.

Audit Committee

In 2007, this Committee, aimed at controlling quality and completeness of information included in the Company's financial statements regularly reviewed and evaluated opinions of the Audit Commission and the independent auditor, monitored the audit of the Company and examined draft agreements in respect of audit services.

Last year, the Committee focused on issues pertaining to the evaluation of the efficiency of the Company's internal control system in accordance with the Sarbanes-Oxley Act and further optimization of the system.

Members of the Audit Committee:

1. Valery V. Degtyarev, Chairman of the Committee, Independent Director;
2. Yekaterina O. Vasilyeva, Independent Director;
3. Yevgeny I. Logovinsky, Financial Expert, Independent Director;
4. Yelena P. Selvich (as a non-voting observer), Non-Executive Director.

Corporate Governance Committee

In late 2007, the Board of Directors approved the Statute of the OJSC Rostelecom Corporate Governance Committee, the principal task of which is to prepare recommendations to the Board of Directors on enhancing corporate procedures of the Company, ensuring legitimate rights and interests of OJSC Rostelecom shareholders and recommendations relating to social responsibility.

Strategic management of the Company is carried out by the Board of Directors, and high corporate governance standards ensure protection of shareholders' rights and interests in the execution of these activities.

Management Board (as of May 1, 2008)

Chairman of the Management Board:

Konstantin Solodukhin – General Director of Rostelecom

Members of the Management Board:

1. Konstantin Y. Solodukhin, General Director of OJSC Rostelecom, Chairman of the Management Board, Member of the Management Board;
2. Sergei L. Akopov, Director of Administrative Department, OJSC Rostelecom;
3. Andrei Yu. Baklykov, Director, Information Technologies Department, OJSC Rostelecom;
4. Andrei A. Gaiduk, First Deputy General Director – Finance Director, OJSC Rostelecom ;
5. Yevgeny V. Gerasimov, Deputy General Director – Director of North-Western Branch, OJSC Rostelecom;
6. Rodion S. Lyovochka, Director, Products and Marketing Department, OJSC Rostelecom;
7. Vladimir K. Mironov, Deputy General Director, OJSC Rostelecom;
8. Olga N. Rumyantseva, Director, Sales and Client Services Department, OJSC Rostelecom;
9. Galina V. Rysakova, Director of Department of Organizational Development and Human Resources, OJSC Rostelecom;
10. Dmitry V. Sigalov, Director of Legal Affair Department, OJSC Rostelecom;
11. Vladimir V. Terekhov, First Deputy General Director, OJSC Rostelecom;
12. Roman A. Frolov, Chief Accountant, OJSC Rostelecom.

Committees Reporting to the Management Board

Tariff Committee

The principal goal of the Tariff Committee is to ensure effective decisions are made by the Management Board in respect to the Company's tariff policy. In 2007, the Tariff Committee focused on ways to optimize existing tariffs with a view to increasing the Company's revenue and expand market share.

Budget & Investment Committee

In 2007, the Budget & Investment Committee analyzed and assessed Company's projects and programs planned for 2007 and 2008 and made investment decisions. In addition, the Committee examined Rostelecom's 2008 budget, including budgets of units and branches within the framework of the OJSC Rostelecom Consolidated Budget for 2008 project.

Tender Committee

In 2007, to efficiently select the Company's suppliers and contractors, the Committee reviewed commercial offers submitted by participants and determined winners of tenders for selection for construction of communication lines and facilities, as well as for other Company projects. In addition, the Committee controlled and provided guidance in the course of arranging the purchase of goods, works and services on a tender basis.

Compensations Committee

This Committee focused on forming a highly skilled team to increase the Company's efficiency and implement compensation and incentive packages for the Company's employees.

Information Disclosure Committee

This Committee discussed material information prior its disclosure to ensure consistency and coherency of publicly disseminated information by Rostelecom in 2007.

Internal Control Committee

Last year, the Internal control Committee concentrated on the introduction and assessment of the efficiency of the Company's internal control system in accordance with Sarbanes-Oxley Act, as well as the introduction and optimization of the Risk Management System.

Audit Commission

The Company's Audit Commission was elected at the Annual General Shareholders' Meeting on June 16, 2007, and is composed of the following members:

1. Natalia Yu. Belyakova, Deputy Director, Economics and Finance Department, OJSC Svyazinvest;
2. Yekaterina S. Yerofteyeva, Deputy Director, Strategic Development Department, OJSC Svyazinvest;
3. Gennady I. Kovalenko, Representative, OJSC Svyazinvest;
4. Olga G. Koroleva, Chief Accountant, OJSC Svyazinvest, Chairman of the Commission;
5. Kirill V. Frolov, Head of Internal Audit Board, OJSC Svyazinvest.

CONTACT INFORMATION

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Fax: +7 499 972 8222
E-mail: rostelecom@rostelecom.ru

Corporate Secretary
Pavel Nezhutin
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Fax: +7 495 973 1055
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Registrar
OJSC United Registration Company (OJSC URC)

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www.ork-reestr.ru

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www.ey.com

OAO ROSTELECOM

CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

FOR THE YEAR ENDED DECEMBER 31, 2007

CONTENT

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STATEMENT OF DIRECTORS' RESPONSIBILITIES

To the Shareholders of OAO Rostelecom

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

2. Management considers that, in preparing the consolidated financial statements set out on pages 5 to 67, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates, and that appropriate International Financial Reporting Standards as issued by the International Accounting Standards Board have been followed.

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

For and on behalf of the Board of Directors:

K.Yu.Solodukhin
General Director

OAO Rostelecom
1st Tverskaya-Yamskaya, 14,
Moscow
Russian Federation

June 30, 2008

Report of Independent Registered Public Accounting Firm

To Board of Directors and Shareholders of OAO Rostelecom

We have audited the accompanying consolidated balance sheets of OAO Rostelecom, an open joint stock company, and subsidiaries, (hereinafter referred to as the “Group”) as of December 31, 2007, 2006 and 2005 and the related consolidated statements of income, consolidated statements of cash flows and consolidated statements of changes in equity for each of the three years in the period ended December 31, 2007. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group at December 31, 2007, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated June 30, 2008 expressed an adverse opinion thereon.

Ernst & Young LLC

ERNST & YOUNG LLC

Moscow, Russia
June 30, 2008

(In millions of Russian Rubles)

	Notes	December 31, 2007	December 31, 2006	December 31, 2005
ASSETS				
Non-current assets				
Property, plant and equipment	6	38,480	39,186	40,628
Goodwill and other intangible assets	7	2,745	2,795	-
Investments in associates	9	494	330	331
Long-term investments	10	11,847	5,728	3,343
Other non-current assets		20	71	13
Total non-current assets		**53,586**	**48,110**	**44,315**
Current assets				
Inventory		447	564	761
Accounts receivable	11	8,429	8,821	5,232
Prepaid income tax		778	154	373
Short-term investments	12	6,920	8,496	12,238
Cash and cash equivalents	13	3,284	2,353	2,398
Total current assets		**19,858**	**20,388**	**21,002**
Total assets		**73,444**	**68,498**	**65,317**
EQUITY AND LIABILITIES				
Equity attributable to equity holders of the parent				
Share capital	14	100	100	100
Retained earnings including other reserves		56,027	50,820	49,597
Total equity attributable to equity holders of the parent		**56,127**	**50,920**	**49,697**
Minority interest		26	25	-
Total equity		**56,153**	**50,945**	**49,697**
Non-current liabilities				
Borrowings, net of current portion	18	172	298	3,232
Finance lease payable	16	396	427	369
Accounts payable, provisions and accrued expenses	15	269	326	378
Vendor financing payable	17	-	362	-
Deferred tax liability	19	4,119	3,444	4,171
Total non-current liabilities		**4,956**	**4,857**	**8,150**
Current liabilities				
Accounts payable, provisions and accrued expenses	15	7,445	7,372	4,056
Finance lease payable	16	108	78	52
Taxes payable		533	426	830
Vendor financing payable	17	1,637	1,640	1,677
Current portion of long-term borrowings	18	2,585	3,005	851
Short-term borrowings		27	175	4
Total current liabilities		**12,335**	**12,696**	**7,470**
Total liabilities		**17,291**	**17,553**	**15,620**
Total equity and liabilities		**73,444**	**68,498**	**65,317**

OAO Rostelecom
CONSOLIDATED STATEMENTS OF INCOME
(In millions of Russian Rubles unless otherwise stated)

		Year ended December 31,		
	Notes	**2007**	**2006**	**2005**
Revenue				
Telephone traffic		50,000	49,121	31,629
Rent of channels		7,725	7,116	6,045
Other revenue		6,877	5,322	3,281
Total revenue	20	**64,602**	**61,559**	**40,955**
Operating expenses				
Wages, salaries, other benefits and payroll taxes		(8,763)	(7,147)	(6,242)
Depreciation and amortization	6, 7	(7,613)	(8,418)	(7,136)
Impairment of property, plant and equipment, goodwill and other intangible assets	6, 7	(271)	-	(4,970)
Charges by network operators – international		(7,817)	(7,304)	(7,059)
Charges by network operators – national		(27,860)	(29,355)	(8,741)
Administration and other costs	22	(6,670)	(5,553)	(3,877)
Taxes other than on income		(703)	(621)	(492)
Repairs and maintenance		(864)	(866)	(822)
Bad debt (expense)/ recovery	11	(815)	(389)	140
Loss on sale of property, plant and equipment		(197)	(601)	(1,356)
Total operating expenses		**(61,573)**	**(60,254)**	**(40,555)**
Operating profit		**3,029**	**1,305**	**400**
Income from associates		156	19	169
Interest expense		(238)	(133)	(77)
Interest income		907	900	886
Income from sale of investments		-	52	408
Other non-operating (loss)/ income		(37)	81	55
Foreign exchange gain/(loss), net		183	219	(168)
Profit before income tax		**4,000**	**2,443**	**1,673**
Current tax charge	19	(1,854)	(2,411)	(2,829)
Deferred tax benefit	19	660	1,424	2,134
Income tax expense	19	**(1,194)**	**(987)**	**(695)**
Profit after tax		**2,806**	**1,456**	**978**
Attributable to:				
Equity holders of the parent		2,805	1,458	978
Minority interest		1	(2)	-
		Rubles	**Rubles**	**Rubles**
Earnings per share attributable to equity holders of the parent – basic and diluted (not in million of Russian Rubles)	24	**2.89**	**1.50**	**1.01**

OAO Rostelecom
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions of Russian Rubles)

	Note	Year ended December 31, 2007	2006	2005
Cash flows from operating activities				
Profit before income tax		4,000	2,443	1,673
Adjustments to reconcile net income before tax to cash generated from operating activities:				
Depreciation and amortization	6, 7	7,613	8,418	7,136
Impairment losses	6, 7	271	-	4,970
Bad debt expense/ (recovery)	11	815	389	(140)
Income from associates		(156)	(19)	(169)
Loss on sale of property, plant and equipment		197	601	1,356
Gain from sale of investments		-	(52)	(408)
Net interest and other non-operating income		(632)	(848)	(864)
Foreign exchange (gain)/ loss, net		(183)	(219)	168
Changes in net working capital:				
Increase in accounts receivable		(487)	(4,242)	(421)
Decrease in inventories		117	198	44
(Decrease)/ increase in payables and accruals		(116)	2,449	49
Cash generated from operations		**11,439**	**9,118**	**13,394**
Interest paid		(257)	(426)	(193)
Interest received		1,059	778	766
Income tax paid		(2,454)	(2,049)	(3,024)
Net cash provided by operating activities		**9,787**	**7,421**	**10,943**
Cash flows from investing activities				
Purchase of property, plant and equipment and intangible assets		(7,157)	(7,177)	(7,788)
Proceeds from sale of property, plant and equipment		231	414	183
Purchase of available-for-sale investments		(570)	-	(59)
Purchase of financial assets, other than available-for-sale investments		(20,279)	(14,594)	(32,174)
Proceeds from sale of available-for-sale investments, net of direct costs		38	67	699
Proceeds from sale of investment other than available-for-sale, net of direct costs		21,518	18,218	28,824
Dividends received from associates		4	97	99
Cash acquired as a result of obtaining control over ZAO GlobalTel		-	-	140
Purchase of subsidiaries, net of cash acquired		-	(1,481)	-
Purchase of minority interest	8	(25)	-	-
Net cash used in investing activities		**(6,240)**	**(4,456)**	**(10,076)**
Cash flows from financing activities				
Drawdown of interest bearing loans		415	898	3,082
Repayment of interest bearing loans and loan facilities		(927)	(1,297)	(1,137)
Repayment of lease obligations		(105)	(55)	(33)
Repayment of vendor financing payable		(362)	(711)	-
Dividends paid to equity holders of the parent		(1,630)	(1,839)	(1,637)
Net cash (used in)/received from financing activities		**(2,609)**	**(3,004)**	**275**
Effect of exchange rate changes on cash and cash equivalents		**(7)**	**(6)**	**1**
Net increase/(decrease) in cash and cash equivalents		**931**	**(45)**	**1,143**
Cash and cash equivalents at beginning of year		**2,353**	**2,398**	**1,255**
Cash and cash equivalents at the end of year		**3,284**	**2,353**	**2,398**
Non-monetary transactions:				
Non-cash additions to property, plant and equipment and intangible assets		49	962	412

(In millions of Russian Rubles)

		Attributable to equity holders of the parent				Minority interest	Total equity
	Note	Share capital	Unrealized gain on available-for-sale investments	Retained earnings	Total		
Balance at December 31, 2004		**100**	**395**	**50,343**	**50,838**	**-**	**50,838**
Effect of obtaining control over ZAO GlobalTel	5	-	-	(826)	(826)	-	(826)
Available-for-sale investments							
Valuation gain on available-for-sale investments, net of tax		-	736	-	736	-	736
Transferred to profit on sale		-	(243)	-	(243)	-	(243)
Total income and expense for the period recognized directly in equity		**-**	**493**	**-**	**493**	**-**	**493**
Profit for the period		-	-	978	978	-	978
Total income and expense		**-**	**493**	**978**	**1,471**	**-**	**1,471**
Dividends	14	-	-	(1,786)	(1,786)	-	(1,786)
Balance at December 31, 2005		**100**	**888**	**48,709**	**49,697**	**-**	**49,697**
Acquisition of minority interest		-	-	-	-	27	27
Available-for-sale investments							
Valuation gain on available-for-sale investments, net of tax		-	1,806	-	1,806	-	1,806
Total income and expense for the period recognized directly in equity		**-**	**1,806**	**-**	**1,806**	**-**	**1,806**
Profit for the period		-	-	1,458	1,458	(2)	1,456
Total income and expense		**-**	**1,806**	**1,458**	**3,264**	**(2)**	**3,262**
Dividends	14	-	-	(2,041)	(2,041)	-	(2,041)
Balance at December 31, 2006		**100**	**2,694**	**48,126**	**50,920**	**25**	**50,945**
Acquisition of minority interest		-	-	(25)	(25)	-	(25)
Available-for-sale investments							
Valuation gain on available-for-sale investments, net of tax		-	4,223	-	4,223	-	4,223
Total income and expense for the period recognized directly in equity		**-**	**4,223**	**(25)**	**4,198**	**-**	**4,198**
Profit for the period		-	-	2,805	2,805	1	2,806
Total income and expense		**-**	**4,223**	**2,780**	**7,003**	**1**	**7,004**
Dividends	14	-	-	(1,796)	(1,796)	-	(1,796)
Balance at December 31, 2007		**100**	**6,917**	**49,110**	**56,127**	**26**	**56,153**

1. REPORTING ENTITY

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

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

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

Rostelecom was established as an open joint stock company on September 23, 1993 in accordance with the Directive of the State Committee on the Management of State Property of Russia No. 1507-r, dated August 27, 1993. As of December 31, 2007, the Government of the Russian Federation controlled indirectly 50.67% of the voting share capital of the Company, by virtue of its 75% less one share direct holding in OAO Svyazinvest ("Svyazinvest"), the main shareholder of Rostelecom.

2. BASIS OF PRESENTATION

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

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

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

3. OPERATING ENVIRONMENT OF THE GROUP

General

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

3. OPERATING ENVIRONMENT OF THE GROUP (Continued)

New scheme of settlements with regional subscribers and operators

In 2005 a set of new rules and regulations in the national telecommunication sector was enacted by the Ministry of Information Technologies and Communications as part of the regulatory reform and restructuring of the national telecommunications sector aimed to facilitate competition and make the industry more attractive for investors. New rules and regulations resulted in change of the Group's status as a monopoly supplier of long-distance and international telecommunication services, effective January 1, 2006. The new regulations allowed telecommunication operators to apply for long-distance telecommunication licenses, two alternative operators received the respective licenses and started providing long-distance and international communication services during 2006.

Before January 1, 2006 the Group provided long-distance traffic transit services to Svyazinvest inter-regional telecommunications companies (IRCs) and to other Russian operators. In Moscow the Group provided long-distance services to subscribers directly. In every region of the Russian Federation, Svyazinvest IRCs and other operators independently billed for long-distance services provided to their local network subscribers (except for subscribers in Moscow). The operators settled with the Group for long-distance call transit and termination services, and the Group, in turn, paid the respective operator for call termination services. In Moscow the Group billed subscribers for long-distance services directly. Starting January 1, 2006, in accordance with the new regulations, the Group bills end users for long-distance services directly charging them the full tariffs, previously charged by the IRCs and other operators. This led to a significant increase in Revenue from telecommunication services starting 2006 and subsequent years and a material increase in accounts receivable as of December 31, 2006, as compared to the revenues for the year ended December 31, 2005 and accounts receivable as of December 31, 2005 due to the gross presentation of the revenue and receivables in the consolidated financial statements (refer to Notes 11 and 20).

Currently, the Group does not have at its disposal sufficient staff and other resources to process, prepare and analyze source documents, maintain information systems, issue bills, and collect payments to the full extent necessary. In order to perform these activities and ensure the corresponding infrastructure to conform to the new regulatory requirements, effective January 1, 2006, the Group entered into service contracts with Svyazinvest IRCs and other operators of local and intra-regional networks to act as the Company's regional agents (contracted service providers). Contracted services include customer services to end users, invoicing, and collection of payments for long-distance services provided by the Group. While relying on resources and data supplied by contracted service providers in calculating charges for long-distance services, the Group bears responsibility for calculating charges in compliance with applicable regulations.

As a result, starting from the year ended December 31, 2006 in addition to the fees paid for call termination services, the Group also incurred Agent fees in connection with the service contracts which are included in charges by national network operators in the consolidated statements of income. In addition, the new legislation introduced compensation payments which are to be made by the Group to IRC´s as reimbursement for the expected reduction in their profitability. Charges by national network operators in the consolidated statements of income include such compensation payments of 3,612 (2006: 4,397). The above compensation payments were ended as of January 1, 2008.

The new scheme of settlements significantly changed the income and expense structure as well as receivables and payables structure. The tables below summarize the effect of changes in telecommunication legislation on the Group's assets, liabilities, revenues and related expenses:

(In millions of Russian Rubles unless otherwise stated)

3. OPERATING ENVIRONMENT OF THE GROUP (Continued)

	December 31, 2006	December 31, 2005
Accounts receivable		
Local operators	729	331
Subscribers	2,756	-
Accounts payable, provisions and accrued expenses		
Local operators	(1,970)	(48)
Subscribers	(348)	(15)
Net effect	**1,167**	**268**

	Year ended December 31, 2006	Year ended December 31, 2005
Revenue from telecommunication services		
Local operators	520	17,618
Subscribers	34,985	164
Charges by network operators – national		
Agent fees	(6,647)	-
Interconnection fees	(18,111)	(5,990)
Bad debt expense	**(369)**	-
Net effect	**10,378**	**11,792**

During the second half of 2006 and 2007 the Group started performing subscribers' billing and collection activities directly in relation to the largest subscribers located outside Moscow. The share of direct subscriber billing is constantly growing. Starting from September 1, 2007 the Group also significantly changed its scheme of settlements with subscribers in the Urals region. Before that date the Group had contracted OAO Uralsvyazinform (Svyazinvest IRC) as an agent for concluding contracts, billing subscribers, printing and delivery of invoices, collecting cash and claiming procedures for individuals and legal entities which were not direct subscribers. After September 1, 2007 the Group started billing all subscribers in the Urals region using its own billing system, but printing and delivery of invoices as well as collecting cash are still performed by other agents contracted by the Group. Revenues from servicing such subscribers for September - December 2007 amounted to 1,407.

Inflation

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

For the year ended December 31,	Annual inflation
2007	11.9%
2006	9.0%
2005	10.9%

Source: Federal Service of Public Statistics

4. PRINCIPAL ACCOUNTING POLICIES

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

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2007. The changes in accounting policies result from adoption of the following new or revised standards:

- IAS 1 *Amendment - Presentation of Financial Statements*;
- IFRS 7 *Financial Instruments: Disclosures*;
- IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*;
- IFRIC 8 *Scope of IFRS 2*;
- IFRIC 9 *Reassessment of Embedded Derivatives*;
- IFRIC 10 *Interim Financial Reporting and Impairment.*

The impact of the adoption of IFRS 7 and the changes to IAS 1 is to expand the disclosures provided in these financial statements regarding the Group's financial instruments, risk management policy and management of capital (see Notes 25, 26, 29, 30, 31, 32).

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

Significant Accounting Judgments and Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to the recoverability and depreciable lives of property, plant and equipment, fair values of assets and liabilities acquired in business combinations, post employment benefits, allowance for doubtful accounts, and deferred taxation. Actual results could differ from these estimates.

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

Changes in estimate of useful lives

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

In March 2006 the Company formalized a plan to gradually discontinue using analog trunk lines and equipment beginning from January 2006 and through the end of 2010. The Company has accordingly revised its estimate of the remaining period of use of the analog lines and equipment prospectively effective January 1, 2006. The net effect of change in useful lives of analog trunk lines for the year ended December 31, 2007 was to increase depreciation by 243 (2006: 1,393). The change in useful lives is expected to result in an increase of depreciation for the year ended December 31, 2008 by 163. Management believes this difference will be decreasing in the later years.

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

Fair Values of Assets and Liabilities Acquired in Business Combinations

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

Site Restoration Provisions

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

Post-Employment Benefits

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

Allowances

The Group makes allowances for doubtful accounts receivable. Significant judgment is used to estimate doubtful accounts. In estimating doubtful accounts historical and anticipated customer performance are considered. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements. As of December 31, 2007, 2006 and 2005, allowances for doubtful accounts have been created in the amount of 2,187, 1,594 and 1,371, respectively (refer to Note 11).

Goodwill

The Group determines whether goodwill is impaired on an annual basis. This requires an estimation of the value in use of the cash-generating unit(s) to which goodwill is allocated. Estimating the value in use requires the Group to make an estimate of expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate present value of those cash flows. As at the reporting date the Group estimated the value in use of each cash-generating unit to be higher than the carrying amount of each unit´s respective net assets including goodwill, except for ZAO Zebra Telecom. The carrying amount of consolidated goodwill as of December 31, 2007 is 702 (refer to Note 7).

Litigations

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

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

Principles of consolidation

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

A subsidiary is an entity that is controlled by the Company, either through ownership, directly or indirectly, of more than 50% of the voting share capital of the entity. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases.

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

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

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

Associates in which the Group has significant influence but not a controlling interest are accounted for using the equity method of accounting. Significant influence is usually demonstrated by the Group owning, directly or indirectly, between 20% and 50% of the voting ownership interest or by power to participate in the financial and operating policy decisions of associates. The Group's share of the net income or losses of associates is included in the consolidated statement of income, the Group's share of movement in reserves is recognized in equity and the Group's share of the net assets of associates is included in the consolidated balance sheet.
An assessment of investments in associates for possible impairment or reversal of impairment recognized previously is performed when there is an indication that the asset has been impaired or the impairment losses recognized in prior years no longer exist. When the Group's share of losses exceeds the carrying amount of the investment, the investment is reported at nil value and recognition of losses is discontinued except to the extent of the Group's commitment to fund future losses. Unrealized profits and losses that arise from transactions between the Group and its associates are eliminated in the proportion to the Group's share in such associates.

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

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

Goodwill is not amortized. Instead it is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. For the purposes of impairment testing, goodwill acquired in a business combination is, from the acquisition date allocated to each of the cash-generating units or groups of cash-generating units expected to benefit from the combination's synergies,

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

irrespective of whether other assets and liabilities of the Group are assigned to those units or group of units. Each unit or group of units to which goodwill is so allocated:

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

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

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

In case of excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost of business combination the Group:
(a) reassesses the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination:
(b) recognizes in profit or loss any excess remaining after that reassessment immediately.

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

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value. The cost of the network comprises all qualifying expenditures up to and including the cabling and wiring to the local telephone operator's intercity exchange, and includes contractors' charges and payments on account, materials, direct labor, and interest costs on specific project financing up to the date of commissioning of the relevant assets. Dismantling costs are included in cost of property, plant and equipment.
Subsequent expenditures are capitalized if it can be clearly demonstrated that they extend the life of the asset or significantly increase its revenue generating capacity beyond its originally assessed standard of performance. Expenditure for continuing repairs and maintenance are charged to the statement of income as incurred.
Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation. Any difference between the net disposal proceeds and carrying amount of the item is reported as a gain or loss on derecognition. The gain or loss resulting from such retirement or disposal is included in the determination of net income.

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

(In millions of Russian Rubles unless otherwise stated)

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

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

The useful life of assets encompasses the entire time they are available for use, regardless of whether during that time they are in use or idle. The useful lives and residual value of assets and methods are reviewed at each financial year-end or more frequently if events occur that suggest a change is necessary and, if expectations differ from previous estimates, the changes are accounted for prospectively (refer to Note 6). Depreciation of an asset ceases at the earlier of the date the asset is classified as held for sale and the date the asset is derecognized.
At each balance sheet date or more frequently if events occur that suggest a change is necessary an assessment is made as to whether there is any indication that the Group's assets may be impaired. If any such indication exists, an assessment is made to establish whether the recoverable amount of the assets has declined below the carrying amount of those assets as disclosed in the financial statements. When such a decline has occurred, the carrying amount of the assets is reduced to the recoverable amount. The amount of any such reduction is recognized immediately as a loss in the statement of income. Any subsequent increase in the recoverable amount of the assets is reversed when the circumstances that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. Increase of the recoverable amount is limited to the lower of its recoverable amount and carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. The recoverable amount is determined as the higher of the assets' fair value less cost to sell, or value in use. The value in use of the asset is estimated based on forecast of future cash inflows and outflows to be derived from continued use of the asset and from the estimated net proceeds on disposal, discounted to present value using an appropriate discount rate. In 2005, the Group recognized an impairment loss of 4,970 (refer to Notes 6 and 7) related to the impact of the new rules and regulations of the regulatory reform and restructuring of the national telecommunication sector as discussed in detail in Note 3. Based on management's analysis there were no indicators of impairment of property, plant and equipment or release of impairment losses of the previous year as of December 31, 2007 and 2006.

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

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

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

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

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

Leases

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

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the commencement of lease term at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income. Capitalized leased assets are depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term unless there is a reasonable certainty that the Group will obtain ownership by the end of the lease term, in which case the assets are depreciated over their estimated useful lives.

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

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

Intangible assets

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

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment when there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end and, if expectations differ from pervious estimates, the changes are accounted for as changes in accounting

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

estimates. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The Group assesses whether there is any indication that a finite lived intangible asset may be impaired at each reporting date. The Group also performs annual impairment tests for finite lived assets not yet placed in use. The amortization expense on intangible assets with finite lives is included in depreciation and amortization expenses in the consolidated statements of income.

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

Inventory

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

Accounts receivable

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

Financial instruments

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

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

Financial assets and liabilities at fair value through profit and loss are financial assets or liabilities which are either classified as held for trading or derivatives or are designated by the Group as at fair value through profit or loss upon initial recognition. Financial assets are classified as held for trading if they are

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

acquired for the purposes of selling in the near term. Gains and losses on investments held for trading are recognized in income.

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

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

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

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

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

Borrowings

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

Cash and cash equivalents

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

Deferred income taxes

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

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

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

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

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

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

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Any such previously recognized reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

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

Revenue and operating costs recognition

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

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

Prior to 2006, the Group charged and paid to regional local telephone operators and other telecommunication service providers in Russia either an agreed proportion of the amounts they billed to their subscribers or an agreed settlement rate based on traffic minutes. For outgoing telephone traffic originating in Moscow, subscribers were charged directly by the Group based on pre-set per minute tariffs regulated by the Ministry of Information Technologies and Communications.

As referred to in Note 3 above, effective January 1, 2006, as a result of regulatory reform in the telecommunication industry, new regulations and rules were put in force that changed principles of

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

interaction between the Group, local operators and end users in providing long-distance services. The introduction of the new settlement system represents a change in business practice resulting in new accounting for changed practice. Therefore, starting from January 1, 2006, the Group charges all its subscribers throughout Russia for outgoing telephone traffic based on pre-set per minute tariffs regulated by the Ministry of Telecommunications. The Group is charged by regional local operators for originating and terminating calls. The Group also incurs agent fees in connection with the service contracts concluded with regional local operators.

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

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

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

Provisions

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

Employee benefits

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

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

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

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

Under provision of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Group by the application of a regressive rate (from 26% to 2%) to the annual gross remuneration of each employee. The Group allocates the UST to three social funds (state pension

(In millions of Russian Rubles unless otherwise stated)

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

fund, social and medical insurance funds), where the rate of contributions to the pension funds varies from 20% to 2% depending on the annual gross salary of each employee. The Group's contributions relating to UST are expensed in the year to which they relate.

Borrowing costs

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

Foreign currency transactions

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

As at December 31, 2007, 2006 and 2005, the rates of exchange used for translating foreign currency balances were (in Russian Rubles for one unit of foreign currency):

	2007	2006	2005
US Dollar	24.55	26.33	28.78
Japanese Yen (100)	21.84	22.16	24.53
Special Drawing Rights (SDR)	38.75	39.58	41.13
EURO	35.93	34.70	34.18

Source: the Central Bank of Russia

Dividends

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

Minority interest

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

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

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

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

Earnings per share

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

Segment information

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

IFRSs and IFRIC Interpretations not yet effective

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

- IAS 1 *Presentation of Financial Statements (Revised)*;
- IAS 23 *Borrowing Costs (Revised)*;
- IAS 27 *Consolidated and Separate Financial Statements (Revised);*
- IAS 32 *Financial Instruments: Presentation (Revised);*
- IFRS 3 *Business Combinations (Revised);*
- IFRS 8 *Operating Segments*;
- IFRIC 11 *IFRS 2 - Group and Treasury Shares Transactions*;
- IFRIC 12 *Service Concession Arrangements*;
- IFRIC 13 *Customer Loyalty Programmes*;
- IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

The revised IAS 1 *Presentation of Financial Statements* is effective for annual periods beginning on or after 1 January 2009. The changes require information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. The revised standard gives preparers of financial statements the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The Group is still evaluating whether it will have one or two statements.

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

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

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

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

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

IFRS 8 *Operating Segments* requires disclosure of information about the Group's operating segments and replaces the requirements to determine primary (business) and secondary (geographical) reporting segments of the Group. The Standard is effective for periods beginning on or after 1 January 2009. The Group has only one operating segment. There is no impact of IFRS 8 *Operating Segments* on the Group's results of operations and financial position.

IFRIC No. 11 *IFRS 2 - Group and Treasury Shares Transactions* addresses the issues whether certain transactions should be accounted for as equity-settled or as cash-settled under the requirements of IFRS 2 *Group and Treasury Shares Transactions*, and concerns the accounting treatment for share-based payment arrangements that involve two or more entities within the same group. An entity shall apply this interpretation for annual periods beginning on or after March 1, 2007. The Group expects that this Interpretation will have no impact the on the Group's results of operations and financial positions.

IFRIC 12 *Service Concession Arrangements* applies to service concession operators. Service concession operators are government or the public sector entities which grant contracts for supply of public services to private operators. This interpretation explains how to account for the obligations undertaken and rights received in service concession arrangements. The interpretation shall be applied for annual periods beginning on or after January 1, 2008. As the Company and its subsidiaries are not service concession operators, this Interpretation will have no impact on the Group's results of operations and financial position.

4. PRINCIPAL ACCOUNTING POLICIES (Continued)

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

IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* was issued in July 2007 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 *Employee Benefits*. The Group expects that this Interpretation will have no impact on the Group's results of operations and financial positions as all current defined benefit plans are unfunded.

(In millions of Russian Rubles unless otherwise stated)

5. BUSINESS COMBINATIONS

The Group did not make any acquisitions during 2007. However, the Group acquired two subsidiaries in 2006.

ZAO Globus-Telecom

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

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

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

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

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

(In millions of Russian Rubles unless otherwise stated)

5. BUSINESS COMBINATIONS (Continued)

ZAO Zebra Telecom

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

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

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

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

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

ZAO GlobalTel

The Group owns 51% of the ordinary shares of ZAO GlobalTel, a Russian closed joint stock company since inception of ZAO GlobalTel. ZAO GlobalTel was created in 1996 to provide access to a US-based global mobile satellite telephone network. Since the time of its launch, the global satellite network has experienced technical problems and low subscriber interest, as the result of which ZAO GlobalTel has only recently developed its operations beyond the development stage. The US owner of the satellite network also owns the remaining 49 per cent of ZAO GlobalTel. The charter of ZAO GlobalTel, its by-laws and the way ZAO GlobalTel historically conducted its operations provided for substantive participation of both shareholders in the economic activities of ZAO GlobalTel. The minority shareholder had effective veto rights that would prevent the Group from causing ZAO GlobalTel to take an action that is significant in the ordinary course of its business. Because effective control of ZAO GlobalTel did not rest with the Group, management accounted for the investment in ZAO GlobalTel

5. BUSINESS COMBINATIONS (Continued)

under the equity method. The Group did not recognize its share in losses of ZAO GlobalTel as the accumulated share in losses of ZAO GlobalTel exceeded the investment of the Group in ZAO GlobalTel.

From the date of acquisition till December 31, 2005 ZAO GlobalTel has contributed 37 to the reduction of the net profit of the Group. If the combination had taken place at the beginning of the year, the profit for the Group would have been 976 and revenue would have been 41,178.

Loans and other accounts receivable from ZAO GlobalTel were fully provided for as a loss from ZAO GlobalTel. Any receipts from ZAO GlobalTel in respect of the loans and receivable were recognized as gain from associates in the period they were received.

On April 25, 2005 the shareholders' meeting of ZAO GlobalTel approved a new charter which abolished the other shareholder's veto and substantive participation rights. The Group assessed that these changes resulted in it obtaining control over ZAO GlobalTel, thus, converting it from jointly controlled entity to a subsidiary of the Group. Consequently, the results of operations and financial position of ZAO GlobalTel were consolidated in the financial statements of the Group prospectively beginning from April 25, 2005.

The results of operations and financial position of ZAO GlobalTel were consolidated by the Group beginning from April 25, 2005. Upon obtaining control on that date, the accumulated losses were recognized in retained earnings.

(In millions of Russian Rubles unless otherwise stated)

6. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2007, 2006 and 2005 was as follows:

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

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

(In millions of Russian Rubles unless otherwise stated)

6. PROPERTY, PLANT AND EQUIPMENT (Continued)

	Buildings and site services	Cable and transmission devices	Other	Construction in progress	Total
Cost					
At January 1, 2005	23,039	124,724	24,597	4,313	176,673
Additions	-	-	-	7,944	7,944
Additions with acquired subsidiaries	-	328	28	79	435
Disposals	(1,076)	(11,699)	(2,214)	(8)	(14,997)
Transfer	228	1,886	3,425	(5,539)	-
Reclassification	3,952	(2,423)	(1,529)	-	-
At December 31, 2005	26,143	112,816	24,307	6,789	170,055
Accumulated Depreciation and Impairment Losses					
At January 1, 2005	(15,774)	(97,071)	(17,841)	-	(130,686)
Depreciation expense	(757)	(4,761)	(1,618)	-	(7,136)
Impairment losses	(1,112)	(2,687)	(1,026)	(136)	(4,961)
Disposals	700	10,632	2,024	-	13,356
Reclassification	(1,506)	228	1,278		-
At December 31, 2005	(18,449)	(93,659)	(17,183)	(136)	(129,427)
Net book value at December 31, 2005	**7,694**	**19,157**	**7,124**	**6,653**	**40,628**

As of December 31, 2007 the balance of construction in progress includes advances given to suppliers of property, plant and equipment in amount of 4,278 (2006: 2,508, 2005: 1,954).

At December 31, 2007 the cost of fully depreciated property, plant and equipment was 69,222 (2006: 68,212, 2005: 51,777).

Interest capitalization

Interest amounting to 239, 273 and 118 was capitalized in property, plant and equipment for the years ended December 31, 2007, 2006 and 2005. The capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 9.1%, 7.8% and 5.4%, respectively.

Pledged property, plant and equipment

Property, plant and equipment with a carrying value of 2,097, 3,240, and 3,837 was pledged in relation to loan agreements entered into by the Group as of December 31, 2007, 2006 and 2005, respectively. Included in pledged property, plant and equipment as of December 31, 2007, 2006 and 2005 is also the Satellite Gateway equipment with a carrying value of 102, 154 and 206, respectively, pledged in connection with vendor financing received from Globalstar L.P. (minority shareholder of ZAO GlobalTel). Currently, ZAO GlobalTel is in default on this vendor financing (see also Note 17).

(In millions of Russian Rubles unless otherwise stated)

6. PROPERTY, PLANT AND EQUIPMENT (Continued)

Impairment of property, plant and equipment

As discussed in detail in Note 3, as part of the regulatory reform and restructuring of the national telecommunications sector aimed to facilitate competition and make the industry more attractive for investors, in 2005 the Ministry of Information Technologies and Communications issued a number of new rules and regulations that resulted in change of the Group's status as a monopoly supplier of long distance and international communications effective January 1, 2006.

As of December 31, 2005 the Group performed the assessment of the impact of the new rules and regulations on its business and results of operations that resulted in a 4,970 impairment loss recognized in the statement of income for the year ended December 31, 2005 related to write-down of certain property, plant and equipment of 4,961 and goodwill of 9 to their recoverable amount. The recoverable amount of property, plant and equipment was based on value in use and was determined at the cash-generating unit level. The cash-generating unit consisted of the Company and its subsidiaries: ZAO Westelcom and MTs NTT. Impairment analysis was performed based on the value in use as fair value less cost to sell cannot be determined reliably. In determining value in use for the cash-generating unit, the cash flows were discounted at a rate of 16.65% on a pre-tax basis and cash flows beyond the 5-year period were extrapolated using a 5% growth rate.

In 2007 the Company has changed the presentation of impairment loss recognized in 1998 in the financial statement which was previously reported as a reduction of the cost of property, plant and equipment, to make it consistent with presentation of impairment loss recognized in 2005 as required by IFRS. The change in presentation affects disclosure and does not affect the numbers reported previously either in the balance sheet or in the statements of income or other statements. The effect of this change on the disclosure of information on property, plant and equipment for comparative periods is represented below.

	As previously reported	As currently reported	Difference
Cost			
at January 1, 2006			
Buildings	25,632	26,143	511
Cable and transmission	111,551	112,816	1,265
Other	24,190	24,307	117
CIP	6,789	6,789	-
Total	**168,162**	**170,055**	**1,893**

(In millions of Russian Rubles unless otherwise stated)

6. PROPERTY, PLANT AND EQUIPMENT (Continued)

(continued)	**As previously reported**	**As currently reported**	**Difference**
Accumulated depreciation at January 1, 2006			
Buildings	(17,938)	(18,449)	(511)
Cable and transmission	(92,394)	(93,659)	(1,265)
Other	(17,066)	(17,183)	(117)
CIP	(136)	(136)	-
Total	**(127,534)**	**(129,427)**	**(1,893)**
Net book value at January 1, 2006			
Buildings	7,694	7,694	-
Cable and transmission	19,157	19,157	-
Other	7,124	7,124	-
CIP	6,653	6,653	-
Total	**40,628**	**40,628**	**-**
Cost at January 1, 2007			
Buildings	23,849	24,329	480
Cable and transmission	101,916	103,039	1,123
Other	25,026	25,129	103
CIP	8,293	8,293	-
Total	**159,084**	**160,790**	**1,706**
Accumulated depreciation at January 1, 2007			
Buildings	(18,287)	(18,767)	(480)
Cable and transmission	(84,142)	(85,265)	(1,123)
Other	(17,333)	(17,436)	(103)
CIP	(136)	(136)	-
Total	**(119,898)**	**(121,604)**	**(1,706)**
Net book value at January 1, 2007			
Buildings	5,562	5,562	-
Cable and transmission	17,774	17,774	-
Other	7,693	7,693	-
CIP	8,157	8,157	-
Total	**39,186**	**39,186**	**-**

(In millions of Russian Rubles unless otherwise stated)

7. GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

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

The Other intangibles include a prepayment in amount of 151 related to certain rights to use.

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

- number capacity,
- trademarks,
- computer software

The owned number capacity and trademarks are intangible assets with indefinite useful lives and are not amortized. Both assets have no legal restrictions on the term of their use and the Group can derive

(In millions of Russian Rubles unless otherwise stated)

7. GOODWILL AND OTHER INTANGIBLE ASSEST (Continued)

economic benefits from their use during indefinite term. These assets are tested for impairment annually or more frequently if there is an indication that the intangible assets may be impaired.

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

Interest amounting to 5, 76 and 0 was capitalized primarily in computer software for the years ended December 31, 2007, 2006 and 2005.

The goodwill recognized is attributed to the acquisitions of ZAO Globus-Telecom and ZAO Zebra Telecom (refer to Note 5).

ZAO Globus-Telecom's telecommunication service was identified as separate cash-generating unit with goodwill and indefinite life intangible assets acquired through business combination allocated to it. The recoverable amount of ZAO Globus-Telecom's telecommunication service which is higher than its carrying amount at the reporting date has been determined based on value in use calculation using cash flow projection from financial budget approved by senior management for 2008 and extrapolated for the next four-year period, cash flows beyond this period are extrapolated using nil growth rate. The pre-tax discount rate applied to cash flow projection is 13.7% (2006: 10.6%). The gross margin was based on a range of 58% - 60%.

ZAO Zebra Telecom was identified as separate cash-generating unit at its acquisition date in June 2006 with goodwill and indefinite life intangible assets allocated thereto. In the last half of 2007, the Group determined that there were indications of impairment of goodwill and indefinite life intangible assets related to ZAO Zebra Telecom due to a decline in market conditions for their services. Therefore, the Group compared the recoverable amount of ZAO Zebra Telecom with its carrying amount and recognized an impairment loss of 271, of which 237 was allocated to goodwill and 34 was allocated to the respective trademark which is an indefinite lived intangible asset. Consequently, goodwill was fully written off in 2007. Concurrently, as a result of the decline in market conditions, the Group decided to change the business model where ZAO Zebra Telecom will provide termination services to the Group. This change in business model will result in ZAO Zebra Telecom producing a significant amount of internally generated cash inflows from the provision of the termination services using ZAO Zebra Telecom's zone network. Thus, ZAO Zebra Telecom ceased to be separate cash-generating unit at that time.

The recoverable amount of ZAO Zebra Telecom also has been determined based on its value in use calculated using the cash flow projection from financial budget approved by senior management for 2008 and extrapolated for the next four-year period, cash flows beyond this period are extrapolated using nil growth rate. The pre-tax discount rate applied to the cash flow projection is 15.1% (2006: 14.7%). The gross margin was based on a range of 41% - 44%.

The carrying amount of goodwill, the number capacity and trademarks as of December 31, 2007 allocated to each of the cash-generating units is as follows:

	ZAO Globus-Telecom	Rostelecom	Total
Goodwill	702	-	702
Number capacity	353	1	354
Trademarks	-	163	163
Net book value at December 31, 2007	**1,055**	**164**	**1,219**

(In millions of Russian Rubles unless otherwise stated)

7. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

Rostelecom

The recoverable amount of the Rostelecom unit to which indefinite lived intangible assets from ZAO Zebra Telecom acquisition are allocated has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management for 2008 and extrapolated for the next four-year period, cash flows beyond this period are extrapolated using nil growth rate . The discount rate applied to the cash flow projections is 14.6%.

As of December 31, 2007 and 2006 the carrying amounts of ZAO Globus-Telecom and Rostelecom units were less than their recoverable amounts, thus no impairment loss was recognized in the consolidated statement of income for the year ended December 31, 2007 and 2006.

The calculation of value in use for both ZAO Globus-Telecom and ZAO Zebra Telecom are most sensitive to the gross margin, discount rate and market share assumption. Gross margin is based on actual results for 2007. Discount rates reflect management's estimate of the risks specific to the units. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. Market share assumptions are important because management assess how the unit's position, relative to its competitors, might change over the budget period.

8. SUBSIDIARIES

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

		Effective share of the Group as of December 31,		
Subsidiary	**Main activity**	**2007**	**2006**	**2005**
ZAO MTs NTT	Fixed line telecommunication services	100%	100%	100%
ZAO Westelcom	Leasing of telecommunication equipment	100%	100%	100%
ZAO Zebra Telecom (see Note 5)	Local telecommunication services and Internet services	100%	100%	-
ZAO Globus-Telecom (see Note 5)	Local telecommunication services	94.9%	94.9%	-
ZAO GlobalTel (see Note 5)	Satellite telecommunications	51%	51%	51%
ZAO SK Kostars	Insurance services	86.7%	86.7%	60%
ZAO Incom	Local telecommunication services	84.8%	54.4%	54.4%
DP Pansionat Malakhit	Recreational services	100%	100%	100%
OAO InfoTeKS Taganrog Telecom	Local telecommunication services	100%	74%	74%

In March 2007, the Group acquired outstanding minority interest of 26% in OAO InfoTeKS Taganrog Telecom, which is the subsidiary of ZAO Westelcom, for the cash payment of 25. As of December 31, 2006 and 2005 ZAO Westelcom's interest in OAO InfoTeKS Taganrog Telecom was 74%. In 2005 and 2006 the latter had negative net assets and minority interest in accumulated loss was allocated against the Group's interest. The results of operations and financial position of OAO InfoTeKS Taganrog Telecom were consolidated by the Group in the accompanying financial statements for the years ended December 31, 2007, 2006 and 2005.

(In millions of Russian Rubles unless otherwise stated)

9. INVESTMENTS IN ASSOCIATES

Investments in associates as of December 31, 2007, 2006 and 2005 were as follows:

Associate	Main activity	Voting share capital, %	2007 Carrying amount	2006 Carrying amount	2005 Carrying amount
OAO RTComm.RU	Internet services	31	317	217	222
OAO MMTS-9	Telecommunication services	49	114	76	73
OAO Svyazintek	Implementation of integrated billing systems	19	60	36	27
Other	Various		3	1	9
Total investments in associates			**494**	**330**	**331**

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

Summarized financial information as of December 31, 2007, 2006 and 2005 and for the years then ended of the associates disclosed above is presented below:

Aggregate amounts	2007	2006	2005
Assets	3,624	3,778	1,353
Liabilities	2,037	2,679	449
Revenue	8,539	5,729	3,401
Net income	444	255	226

All associates are registered in the Russian Federation.

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

As of December 31, 2007, 2006 and 2005, Rostelecom had significant influence on OAO RTComm.RU through ownership of 31.09% of voting shares of OAO RTComm.RU which main activity is Internet access services to enterprises and individuals. In 2008 the Group plans to obtain control over OAO RTComm.RU by acquiring additional 68% equity interest. For more details refer to Note 33.

In April 2005, according to the changed charter of ZAO GlobalTel, the Group obtained control over ZAO GlobalTel and consolidated the latter in the financial statements as of December 31, 2006 and 2005 (refer to Note 5).

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10. LONG-TERM INVESTMENTS

Long-term investments are available-for-sale investments Rbl denominated and as of December 31, 2007, 2006 and 2005 comprised the following:

	2007	2006	2005
Investment in Golden Telecom	10,945	4,963	3,017
Investment in OAO Sberbank of Russia	826	724	298
Other available-for-sale investments	76	41	28
Total long-term investments	**11,847**	**5,728**	**3,343**

Investments in OAO Sberbank of Russia stated at fair value determined based on Russian Trade System (RTS) closing bid price at the last trading date.

Prior to December 2005, investment into Golden Telecom was accounted for using equity method as the Group exercised significant influence over the financial and operating policies of Golden Telecom through representation on its Board of Directors since in accordance with the Shareholders' Agreement the Group had the right to appoint 2 out of 10 members to the Board of Directors of Golden Telecom while other shareholders appointed 1-3 Directors to the Board.

In December 2005, provisions in the Shareholders' Agreement that gave to the Group the right to appoint two directors to the Board of Golden Telecom lapsed and effective December 1, 2005, the Group's remaining rights are limited to maintaining membership of less than two directors in the Board of Golden Telecom, depending on the current effective voting power in the latter. The above change brought to cessation the Group's significant influence over Golden Telecom effective December 1, 2005. Consequently, effective December 1, 2005, the Group discontinued applying equity method of accounting for its investment in Golden Telecom and reclassified this investment as an available-for-sale financial asset with initial cost equal to carrying value of equity investment in Golden Telecom at the date of the reclassification. As of December 31, 2007, 2006 and 2005 investment in Golden Telecom is measured at its fair value determined based on NASDAQ closing bid price at the last trading day.

The Group did not make any material disposals of its investments in 2007. During 2006 the Group sold its interests in ZAO Telecross, OOO RTC-Sibir, OOO Artelecom-Service, OAO A-Svyaz, ZAO Rostelecomimport and ZAO AKB Promsvyazbank with a carrying value of 11 for a cash payment of 56.

In February 2008 the Group sold its interest in Golden Telecom, Inc at the amount of USD 464 million (11,385 at the exchange rate as of that date). For additional information refer to Note 33.

(In millions of Russian Rubles unless otherwise stated)

11. ACCOUNTS RECEIVABLE

Accounts receivable as of December 31, 2007, 2006 and 2005 comprised the following:

	2007	2006	2005
Local operators	1,067	1,679	1,849
Subscribers	5,056	4,519	1,083
Foreign operators	1,033	696	696
Other	1,751	1,284	596
Less: allowance for doubtful trade accounts receivable	(1,994)	(1,132)	(898)
Trade accounts receivable, net	6,913	7,046	3,326
Prepayments	503	418	379
Prepaid taxes other than on income	791	1,092	1,210
Other accounts receivable	349	721	790
Less: allowance for doubtful other accounts receivable	(127)	(456)	(473)
Other accounts receivable, net	1,516	1,775	1,906
Total accounts receivable	**8,429**	**8,821**	**5,232**

The net accounts receivable balance is not past due.

The following table summarizes accounts receivables denominated in foreign currencies as of December 31, 2007, 2006 and 2005:

	2007	2006	2005
USD	716	517	347
SDR (special drawing right)	269	140	325
Other currencies	48	39	24
Accounts receivable denominated in foreign currencies, gross	**1,033**	**696**	**696**
Less: allowance for doubtful accounts receivable	(339)	(293)	(237)
Accounts receivable denominated in foreign currencies, net	**694**	**403**	**459**

As of December 31, 2007, 2006 and 2005, the carrying value of trade accounts receivable approximated their fair value.

The following table summarizes the changes in the allowance for doubtful accounts receivable for the years ended December 31, 2007, 2006 and 2005:

	2007	2006	2005
Balance, beginning of year	1,594	1,371	2,284
Provision/(recovery) for doubtful accounts receivable	815	389	(140)
Accounts receivable written-off	(222)	(166)	(773)
Balance, end of year	**2,187**	**1,594**	**1,371**

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

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12. SHORT-TERM INVESTMENTS

Short-term investments include investments available-for-sale, which are stated at fair value, and loans and receivables which are stated at amortized cost using the effective interest rate method. Short-term investments comprised the following as of December 31, 2007, 2006 and 2005:

	2007	2006	2005
Bills of exchange	343	542	5,312
Short-term deposits and deposit certificates	6,547	7,916	6,878
Other	30	38	48
Total short-term investments	**6,920**	**8,496**	**12,238**

Short-term investments include amounts totaling to 1,294 (2006: 2,182, 2005: 2,475) which are denominated in US dollars as of December 31, 2007, 2006 and 2005:

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

The bills of exchange bear interest in the range from 7% to 10% and are denominated in Rubles, as well as in foreign currencies. As of December 31, 2007, approximately 0% (2006: 26%, 2005: 33%) of the Group's total bills of exchange are denominated in foreign currencies, represented by US dollars.

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2007, 2006 and 2005 included cash on hand and at bank accounts and short-term deposits and bills of exchange with original maturities of less than three months as follows:

	2007	2006	2005
Cash at bank – Rubles	3,106	1,147	2,165
Cash at bank – Foreign currencies	105	93	58
Short term deposits – Rubles	67	6	170
Short-term bills of exchange	-	1,101	-
Other	6	6	5
Total cash and cash equivalents	**3,284**	**2,353**	**2,398**

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14. EQUITY

Share capital

The authorized share capital of the Company as of December 31, 2007, 2006 and 2005 comprised 1,634,026,541 ordinary shares and 242,832,000 non-redeemable preferred shares. The par value of both ordinary and preferred shares amounted to Rbl 0.0025 per share.

As of December 31, 2007, 2006 and 2005, the issued and outstanding share capital was as follows:

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

There were no transactions with the Company´s own shares during 2007, 2006 and 2005.

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

The nominal share capital of the Company recorded on its incorporation has been indexed, to account for the effects of inflation from that date through December 31, 2002. The share capital in the Russian statutory accounts at December 31, 2007, 2006 and 2005 amounted to 2,428,819 nominal (uninflated) Rubles.

Ordinary shares carry voting rights with no guarantee of dividends.

Preferred shares have priority over ordinary shares in the event of liquidation but carry no voting rights except on resolutions regarding liquidation or reorganization of the Company, changes to dividend levels of preferred shares, or the issuance of additional preferred stock. Such resolutions require two-thirds approval of preferred shareholders. The preferred shares have no rights of redemption or conversion.

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

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

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

Distributable earnings of all entities included in the Group are limited to their respective retained earnings, as mandated by statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2007, 2006 and 2005 amounted to 43,645, 35,171 and 28,972, respectively.

(In millions of Russian Rubles unless otherwise stated)

14. EQUITY (Continued)

Reserve capital

In accordance with the Company's Charter, Rostelecom has to maintain a reserve fund through a mandatory annual transfer of at least 5% of its statutory net profits up to the maximum amount of 15% of its statutory share capital. As of December 31, 2007, 2006 and 2005 the statutory reserve fund amounted to 364,323 nominal (uninflated) Rubles. These amounts are prohibited for distribution by current Russian legislation except for some limited cases.

Dividends

Dividends declared to holders of preferred and ordinary shares for the years ending December 31, 2006, 2005 and 2004 were accrued in the following years:

	2007	2006	2005
Dividend – preferred shares	718	903	722
Dividend – ordinary shares	1,078	1,138	1,064
Total dividends	**1,796**	**2,041**	**1,786**

	Rbl	Rbl	Rbl
Dividend per preferred share	2.96	3.72	2.97
Dividend per ordinary share	1.48	1.56	1.46

15. ACCOUNTS PAYABLE, PROVISIONS AND ACCRUED EXPENSES

Accounts payable, provisions and accrued expenses consisted of the following as of December 31, 2007, 2006 and 2005:

	2007	2006	2005
Trade accounts payable	4,601	6,100	3,064
Short-term portion of pension obligations (refer to Note 23)	55	63	49
Short-term portion of site restoration provisions	41	26	8
Compensation related accruals	1,324	741	540
Other accrued expenses	1,349	375	339
Dividends payable	75	67	56
Current accounts payable, provisions and accrued expenses	**7,445**	**7,372**	**4,056**
Long-term portion of pension obligations (refer to Note 23)	98	112	123
Long-term portion of site restoration provisions	57	78	17
Long-term advances received	59	69	87
Other long-term accounts payable	55	67	151
Non-current accounts payable, provisions and accrued expenses	**269**	**326**	**378**
Total accounts payable, provisions and accrued expenses	**7,714**	**7,698**	**4,434**

(In millions of Russian Rubles unless otherwise stated)

15. ACCOUNTS PAYABLE, PROVISIONS AND ACCRUED EXPENSES (Continued)

The following table summarizes trade accounts payable denominated in foreign currencies as of December 31, 2007, 2006 and 2005:

	2007	**2006**	**2005**
USD	463	932	696
SDR	181	314	684
Other currencies	241	177	215
Accounts payable denominated in foreign currencies	**885**	**1,423**	**1,595**

Site restoration provisions represent present value of the expenditures the Company expects to incur in connection with phasing out of analog trunk lines during 2007-2010 in accordance with the formalized plan of the Company (refer also to Note 6). The discount rate of 14.50% was used based on the weighted average cost of capital. As of December 31, 2007 total amounts of site restoration provisions equal to 98 (2006: 104; 2005: 25), of which 41 (2006: 26; 2005: 8) are included in accounts payable and accrued expenses and 57 (2006: 78; 2005: 17) are included in non-current accounts payable in the consolidated balance sheets as of December 31, 2007.

16. FINANCE LEASE PAYABLE

Leased assets as of December 31, 2007, 2006 and 2005, where the Group is a lessee of IRU, plants and machinery under finance lease agreements, comprised of the following:

	2007	**2006**	**2005**
Cost – capitalized finance leases	572	523	430
Impairment loss and accumulated depreciation	(160)	(108)	(54)
Net book value	**412**	**415**	**376**

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

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

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

Future minimum lease payments together with the present value of the net minimum lease payments as of December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
Finance lease liabilities – minimum lease payments			
Current portion of finance lease liability	135	111	53
Between one to two years	106	83	44
Between two to three years	54	93	44
Between three to four years	43	43	44
Between four to five years	43	43	44
Over five years	307	349	438
Total minimum lease payments	**688**	**722**	**667**
Less interest	(184)	(217)	(246)
Present value of minimum lease payments	**504**	**505**	**421**

(In millions of Russian Rubles unless otherwise stated)

16. FINANCE LEASE PAYABLE (Continued)

Present value of minimum lease payments			
Not later than 1 year	108	78	52
Later than 1 year and not later than 5 years	157	163	144
Later than 5 years	239	264	225
Total non-current lease payable	396	427	369
Total lease payable	**504**	**505**	**421**

Depreciation of property, plant and equipment under the finance lease contracts for 2007 amounted to 52 (2006: 54; 2005: 10; refer to Note 6). Finance charges for the year ended December 31, 2007 amounted to 82 (2006: 44; 2005: 14) and included in interest expense in the consolidated statement of income.

17. VENDOR FINANCING PAYABLE

Vendor financing payable includes the following as of December 31, 2007, 2006 and 2005:

	2007	**2006**	**2005**
Globalstar L.P.	1,246	1,249	1,289
IBM Corporation	-	-	388
Peter Service	391	391	-
Vendor financing payable – current portion	1,637	1,640	1,677
Peter Service	-	362	-
Vendor financing payable – non-current portion	-	362	-
Total vendor financing payable	**1,637**	**2,002**	**1,677**

As of December 31, 2007, the Group had the following outstanding vendor financing payable:

- 1,246 (US$ 51 million) payable by ZAO GlobalTel to Globalstar L.P., which is the minority shareholder of ZAO GlobalTel, for the purchase of three gateways and associated equipment and services (refer Note 6). Globalstar L.P. has a lien over this equipment until the liability is fully paid. ZAO GlobalTel is in default in respect of payments in 2004, 2005, 2006 and 2007 and has not obtained a waiver from Globalstar L.P. As a result, the whole balance of 1,008 (2006: 1,082, 2005: 1,182) (US$ 41 million) is classified as current in these consolidated balance sheets as of December 31, 2007, 2006 and 2005. Penalty interest in amount of 238, 167 and 107, accrued for each day of delay at the rate of 10% p.a., is included in vendor financing payable in these balance sheets as of December 31, 2007, 2006 and 2005, respectively. In 2006 Loral, which is the legal successor of Globalstar L.P., brought an action against ZAO GlobalTel claiming immediate repayment of 1,246. Management believes that if immediate repayment of the defaulted vendor financing and loans is demanded, it would not have a material adverse effect on the Group's results of operations, financial position and operating plans.

- 391 payable by the Company to ZAO Peter-Service for the purchase of billing system. The liability is repayable in equal quarterly installments up to December 31, 2008. Notes payable bear an interest of 7.73% p.a.

(In millions of Russian Rubles unless otherwise stated)

18. LONG-TERM BORROWINGS

Long-term borrowings as of December 31, 2007, 2006 and 2005 were as follows:

Maturity	2007	2006	2005
Current portion of interest bearing loans	2,585	3,005	851
Between one to two years	136	198	621
Between two to three years	36	63	587
Between three to four years	-	37	544
Between four to five years	-	-	520
Over five years	-	-	960
Non-current portion of interest bearing loans	172	298	3,232
Total interest bearing loans	**2,757**	**3,303**	**4,083**

As of December 31, 2007, 2006 and 2005, interest bearing loans, which are mostly denominated in foreign currencies, were as follows:

	2007	2006	2005
US Dollars (US$)	2,397	3,055	3,812
Japanese Yen (JPY)	-	32	103
EURO	77	123	168
Foreign currency denominated loans	**2,474**	**3,210**	**4,083**
Russian Ruble denominated loans	283	93	-
Total interest bearing loans	**2,757**	**3,303**	**4,083**

As of December 31, 2007, the Group entered in loan agreements with 9 banks and other financial institutions. The loans denominated in US Dollars are made at fixed rates of 4 – 6.5% and floating rates of LIBOR + 0.5 – 3.25%. The Russian Rouble denominated loans are made at approximately 10% p.a. Effective interest rates of interest bearing loans approximate their nominal rates.

Included in long-term loans is the amount of 2,047 on a credit agreement between Rostelecom and Vnesheconombank (VEB) entered into in December 2005. The loan is repayable annually up to the end of 2012. Under the existing credit agreement with Vnesheconombank and CSFB the Group is required to meet at the end of each quarter various financial covenants applied to the statutory financial statements of the Company, including maintaining certain level of debt to equity and debt to income ratios. As of December 31, 2006 and December 31, 2007 the Group was not in compliance with some of the covenants, stipulated in the loan agreement and no waiver had been obtained from the banks. The Group received waivers from the bank only after the reporting dates (in June 2008 and in June 2007 respectively), hence the whole amount of the loan is included in current portion of long-term loans in the consolidated balance sheet as of December 31, 2007 and December 31, 2006. The Group was in compliance with the covenants as of March 31, 2008 as well as of March 31, June 30 and September 30, 2007 and 2006.

In connection with the $100 million loan from Vnesheconombank and CSFB, on June 28, 2006, the Group entered into interest rate swap agreement with CSFB. In accordance with the interest rate swap agreement each June 28 and December 28, commencing on December 28, 2006 and ending on December 28, 2012, the Group undertakes an obligation to CSFB calculated at a fixed interest rate and CSFB undertakes an obligation to the Group in the amount calculated at floating rate payable by the Group on its loan. The Group did not designate the above interest rate swap derivative as hedging instrument. Therefore, this financial instrument was classified as financial liability at fair value through profit and loss amounted to 73 (2006:15) (refer to Note 15). Fair value of the derivative is calculated by discounting

18. LONG-TERM BORROWINGS (Continued)

of future cash flows determined by condition and payments schedule of the agreement using forward rates of similar instruments at the reporting date. The net loss of 58 related to the change in the fair value of the interest rate swap contract was included in the non-operating loss in the consolidated statement of income for the year ended December 31, 2007 (2006: 15).

225 on a credit agreement between ZAO GlobalTel and Loral Space and Communications Corporation ("Loral"). ZAO GlobalTel is in default in respect of these loans. A penalty in the amount of 55 is included in the outstanding balance. As no waiver has been obtained from Loral, these loans are classified as current in the consolidated balance sheet as of December 31, 2007. The loan does not provide for any collateral. . In 2006 Loral brought an action against ZAO GlobalTel claiming immediate repayment of 225.

(In millions of Russian Rubles unless otherwise stated)

19. INCOME TAXES

The components of net deferred tax assets and liabilities at December 31, 2007, 2006 and 2005, and the respective movements during 2007, 2006 and 2005, were as follows:

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

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

(In millions of Russian Rubles unless otherwise stated)

19. INCOME TAXES (Continued)

	December 31, 2004	**Movement during 2005 recognized in**		**December 31, 2005**
		Equity	**Profit for the period**	
Tax effects of future tax deductible items				
Investment valuation difference	34	(34)	-	-
Accounts receivable	474	-	(303)	171
Other	9	-	18	27
Gross deferred tax asset	**517**	**(34)**	**(285)**	**198**
Tax effects of future taxable items:				
Investments valuation difference	-	317	132	449
Property, plant and equipment	6,203	-	(2,485)	3,718
Accounts payable, provisions and accrued expenses	268	-	(66)	202
Gross deferred tax liability	**6,471**	**317**	**(2,419)**	**4,369**
Net deferred tax liability	**5,954**	**351**	**(2,134)**	**4,171**

Differences between IFRS and statutory taxation and reporting regulations give rise to temporary differences between the carrying value of certain assets and liabilities for financial reporting and profits tax purposes. The tax effect of these temporary differences is recorded at the rate of 24%.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and the deferred income tax assets and deferred income tax liabilities relate to the income taxes levied by the same fiscal authority on the same taxable entity.
The Company has not recorded deferred tax liabilities with respect to deductible temporary differences associated with investments in subsidiaries and jointly controlled entities as it does not intend to cause such differences to reverse in the foreseeable future.

The components of income tax expense for the years ended December 31, 2007, 2006 and 2005 were as follows:

	2007	**2006**	**2005**
Current tax charge	1,854	2,411	2,829
Deferred tax benefit	(660)	(1,424)	(2,134)
Income tax expense	**1,194**	**987**	**695**

The reconciliation of the theoretical amount that would arise using the Russian statutory rate of 24% to the total actual income tax was as follows for the years ending December 31, 2007, 2006 and 2005:

	2007	**2006**	**2005**
Income tax expense at statutory rate (24%)	960	586	401
Change in assessment for current tax of prior periods	-	2	28
Effect of share in income taxes of associates	-	-	(156)
Permanent differences	234	399	422
Income tax expense	**1,194**	**987**	**695**

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

(In millions of Russian Rubles unless otherwise stated)

20. REVENUE

Revenue comprised the following for the years ending December 31, 2007, 2006 and 2005:

	2007	2006	2005
Telephone traffic			
Domestic long-distance traffic	31,973	31,370	18,126
Outgoing international long-distance traffic	12,317	13,271	9,405
Incoming and transit international long-distance traffic	5,710	4,480	4,098
	50,000	**49,121**	**31,629**
Rent of channels	**7,725**	**7,116**	**6,045**
Other revenue			
Television and radio transmission	448	528	574
Satellite services	699	559	548
Internet access	1,143	217	44
Intelligent network services (INS)	1,133	761	430
Interconnection services	519	597	27
Technical support services	464	364	414
Equipment maintenance services	696	537	281
Miscellaneous revenue	1,775	1,759	963
	6,877	**5,322**	**3,281**
Total revenue	**64,602**	**61,559**	**40,955**

The Group rendered DLD services, incoming and outgoing ILD services of 10,175, 3,062 and 1,820 million minutes respectively (2006: 9,722; 2,461; 1,932; 2005: 9,347; 1,874; 1,769). Although the traffic is growing the Group is diversifying its activities through the development of other services such as Internet, INS, Satellite and Network maintenance services.

As described in Note 3 above, effective January 1, 2006, as a result of regulatory reform in the telecommunication industry, new regulations and rules were put in force that changed principles of interaction between the Group, local operators and end users in providing long-distance services. The introduction of the new settlement system represents a change in business practice resulting in new accounting for changed practice. Refer to Note 3 for the summary of impact of the new settlement system on the Groups revenues and related expenses.

21. SEGMENT INFORMATION

The Group operates in one industry segment, being the provision of domestic and international long-distance telecommunication services in the Russian Federation. The results of this segment and assets and liabilities as of December 31, 2007, 2006 and 2005 are presented in the consolidated statements of income and the consolidated balances sheets, respectively.
An analysis of revenue by service type is disclosed in Note 20. A geographical analysis of revenue by the country or region of the customer for the years ending December 31, 2007, 2006 and 2005 is as follows:

	Russia	CIS	USA	Western Europe	Eastern Europe	Others	Total
2007	58,024	2,406	848	2,068	400	856	64,602
2006	56,360	2,227	475	1,515	241	741	61,559
2005	36,249	2,626	233	1,049	194	604	40,955

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

(In millions of Russian Rubles unless otherwise stated)

22. ADMINISTRATION AND OTHER COSTS

Administration and other costs consisted of the following for the years ended December 31, 2007, 2006 and 2005:

	2007	2006	2005
Administration costs	1,548	1,648	952
Advertising and similar costs	1,403	748	231
Office maintenance	1,903	1,543	1,287
Utilities and similar services	700	655	613
Consulting and similar services	450	312	220
Insurance	201	321	367
Other	465	326	207
Total administration and other costs	**6,670**	**5,553**	**3,877**

23. EMPLOYEE BENEFITS

The numbers of employees of the Group was equal to 22,534 as at December 31, 2007 (2006: 23,233, 2005: 23,634).

The Group makes payments to the Government pension fund for its employees. Such contributions are included in the unified social tax ("UST") calculated by the Group using regressive scale and are charged to expense when incurred during the employee's service period. Total contributions for UST amounted to 1,426 during the year ended December 31, 2007 (2006: 1,272, 2005: 1,171).

The Company participates in the private Joint Participation Program, which is a pension plan with defined contributions. To participate in the program, individuals should be full-time employees of the Company and should enter into non-state pension insurance agreement with NPF "Telecom-Soyuz", which is the successor of NPF Rostelecom-Garantiya. Total expenses of the Group under this program amounted to 9 during the year ended December 31, 2007 (2006: 6, 2005: 14) and are included in wages, salaries, other benefits and payroll taxes in the consolidated statements of income.

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

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

	2007	2006	2005
Opening defined benefit obligation	277	290	258
Interest cost on benefit obligation	19	20	13
Current service cost	13	15	17
Past service cost	-	-	84
Actuarial losses/(gains) on obligation	8	38	(23)
Benefits paid	(78)	(86)	(59)
Closing defined benefit obligation	239	277	290
Unrecognized past service cost	(86)	(102)	(118)
Liability recognized in balance sheet	**153**	**175**	**172**

(In millions of Russian Rubles unless otherwise stated)

23. EMPLOYEE BENEFITS (Continued)

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

	2007	2006	2005
Interest cost on benefit obligation	19	20	13
Current service cost	13	15	17
Amortization of past service cost	16	16	40
Actuarial losses/ (gains) on obligation	8	38	(23)
Total net benefit expense	**56**	**89**	**47**

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

	2007	2006	2005
Discount rate	7.9%	7.9%	7.7%
Employee turnover rate	10.9%	10.5%	8.4%
Expected inflation rate	6.9%	7%	6%

The amounts of experience adjustments is as follows:

	2007	2006
Present value of defined benefit obligation	239	277
Experience adjustments on plan liabilities	15	46

In accordance with the transitional provisions for the amendments to IAS 19 Employee Benefits in December 2004, the disclosures above are determined prospectively from the 2006 reporting period. The expected amount of benefits to be paid in 2008 is 85.

24. EARNINGS PER SHARE

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

	2007		2006		2005	
Net income attributable to equity holders of the parent	**2,805**		**1,458**		**978**	
	Preferred shares	**Ordinary shares**	**Preferred shares**	**Ordinary shares**	**Preferred shares**	**Ordinary shares**
Weighted average number of shares outstanding	**242,831,469**	**728,696,320**	**242,831,469**	**728,696,320**	**242,831,469**	**728,696,320**
Basic and diluted earnings per share, Russian Rubles	**2.89**	**2.89**	**1.50**	**1.50**	**1.01**	**1.01**

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

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

(In millions of Russian Rubles unless otherwise stated)

25. FINANCIAL INSTRUMENTS

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

Classes	Categories	December 31, 2007 Carrying amount	December 31, 2006 Carrying amount	December 31, 2005 Carrying amount
Long-term equity investments				
- at fair value	Available-for-sale	11,771	5,687	3,315
- at cost	Available-for-sale	10	9	21
Long-term debt investments				
- at amortized cost	Loans and receivables	66	32	7
Long-term receivables	Loans and receivables	16	13	-
Total Non-current financial assets		**11,863**	**5,741**	**3,343**
Short-term equity investments				
- at fair value	Available-for-sale	30	21	28
- at cost	Available-for-sale	-	-	-
Short-term debt investments				
- at fair value	Available-for-sale	-	-	-
- at amortized cost	Loans and receivables	6,890	8,475	12,210
Short-term trade receivables	Loans and receivables	6,913	7,046	3,326
Short-term other receivables	Loans and receivables	222	265	317
Cash and cash equivalents	Loans and receivables	3,284	2,353	2,398
Total Short-term financial assets		**17,339**	**18,160**	**18,279**
Long-term bank loans	Liabilities at amortized cost	172	205	3,232
Long-term non-bank loans	Liabilities at amortized cost	-	93	-
Non-current finance lease and vendor financing	Liabilities at amortized cost	396	789	369
Non-current accounts payable	Liabilities at amortized cost	153	179	274
Total Non-current financial liabilities		**721**	**1,266**	**3,875**

(In millions of Russian Rubles unless otherwise stated)

25. FINANCIAL INSTRUMENTS (Continued)

(continued)		**December 31, 2007**	**December 31, 2006**	**December 31, 2005**
Classes	**Categories**	**Carrying amount**	**Carrying amount**	**Carrying amount**
Short-term bank loans	Liabilities at amortized cost	2,286	2,891	654
Short-term non-bank loans	Liabilities at amortized cost	326	289	201
Short-term finance lease and vendor financing	Liabilities at amortized cost	1,745	1,718	1,729
Short-term accounts payable	Liabilities at amortized cost	7,331	7,331	4,048
Non-hedge derivative	Financial liabilities at fair value through profit and loss	73	15	-
Total Short-term financial liabilities		**11,761**	**12,244**	**6,632**

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

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

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

The carrying value of fixed interest rate long-term debt approximates fair value as the interest rates approximate the market rates for similar instruments.

(In millions of Russian Rubles unless otherwise stated)

26. GAIN/(LOSS) FROM FINANCIAL INSTRUMENTS

Gain/(loss) from financial instruments for 2007, 2006, 2005 are as follows:

		2007			
Classes	**Categories**	**Impairment loss and reversal of impairment loss**	**Fair Value revaluation gain/(loss)**	**Gain/(loss) from sale of financial instruments**	**Gain/(loss) from currency translation**
Long-term equity investments					
- at fair value	Available-for-sale		5,562		(1)
- at cost	Available-for-sale				
Long-term debt investments					
- at amortized cost	Loans and receivables	2			(4)
Investments in associates	N/A				
Long-term receivables	Loans and receivables	(60)			
Total Long-term financial assets		**(58)**	**5,562**	**-**	**(5)**
Short-term equity investments					
- at fair value	Available-for-sale		(1)		
Short-term debt investments					
- at fair value	Available-for-sale				
- at amortized cost	Loans and receivables				(145)
Short-term trade receivables	Loans and receivables	(863)			(103)
Short-term other receivables	Loans and receivables	107			(9)
Cash&cash equivalents	Loans and receivables				(9)
Total Short-term financial assets		**(756)**	**(1)**	**-**	**(266)**

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

(continued)		**2007**			
Classes	**Categories**	**Impairment loss and reversal of impairment loss**	**Fair Value revaluation gain/(loss)**	**Gain/(loss) from sale of financial instruments**	**Gain/(loss) from currency translation**
Long-term bank loans	Liabilities at amortized cost				(1)
Long-term accounts payable	Liabilities at amortized cost				(3)
Total Long-term financial liabilities		**-**	**-**	**-**	**(4)**
Short-term bank loans	Liabilities at amortized cost				214
Short-term non-bank loans	Liabilities at amortized cost				(10)
Short-term finance lease & vendor financing	Liabilities at amortized cost				(3)
Short-term accounts payable	Liabilities at amortized cost				236
Non-hedge derivative	Financial liabilities at fair value through profit and loss		(58)		
Total Short-term financial liabilities		**-**	**(58)**	**-**	**437**

(In millions of Russian Rubles unless otherwise stated)

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

		2006				2005			
Classes	Categories	Impairment loss and reversal of impairment loss	Fair Value revaluation gain/(loss)	Gain/(loss) from sale of financial instruments	Gain/(loss) from currency translation	Impairment loss and reversal of impairment loss	Fair Value revaluation gain/(loss)	Gain/(loss) from sale of financial instruments	Gain/(loss) from currency translation
Long-term equity investments									
- at fair value	Available-for-sale		2,372				1,012		
- at cost	Available-for-sale	(7)		52				216	
Long-term debt investments									
- at amortized cost	Loans and receivables								
Investments in associates	N/A								
Long-term receivables	Loans and receivables	(6)							
Total Long-term financial assets		**(13)**	**2,372**	**52**	**-**	**-**	**1,012**	**216**	**-**
Short-term equity investments									
- at fair value	Available-for-sale		4				2	18	
Short-term debt investments									
- at fair value	Available-for-sale						7	174	
- at amortized cost	Loans and receivables				(212)				(105)
Short-term trade receivables	Loans and receivables	(408)			(186)	181			5
Short-term other receivables	Loans and receivables	4			(44)	(41)			1
Cash&cash equivalents	Loans and receivables				(8)				
Total Short-term financial assets		**(404)**	**4**	**-**	**(450)**	**140**	**9**	**192**	**(99)**
Long-term bank loans	Liabilities at amortized cost				211				19
Long-term accounts payable	Liabilities at amortized cost								
Total Long-term financial liabilities		**-**	**-**	**-**	**211**	**-**	**-**	**-**	**19**

(In millions of Russian Rubles unless otherwise stated)

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

		2006				2005			
Classes	Categories	Impairment loss and reversal of impairment loss	Fair Value revaluation gain/(loss)	Gain/(loss) from sale of financial instruments	Gain/(loss) from currency translation	Impairment loss and reversal of impairment loss	Fair Value revaluation gain/(loss)	Gain/(loss) from sale of financial instruments	Gain/(loss) from currency translation
Short-term bank loans	Liabilities at amortized cost				111				(49)
Short-term non-bank loans	Liabilities at amortized cost				4				
Short-term finance lease & vendor financing	Liabilities at amortized cost				12				(13)
Short-term accounts payable	Liabilities at amortized cost				332				10
Non-hedge derivative	Financial liabilities at fair value through profit and lossL		(15)						
Total Short-term financial liabilities		**-**	**(15)**	**-**	**459**	**-**	**-**	**-**	**(52)**

27. RELATED PARTY TRANSACTIONS

(a) The Government and OAO Svyazinvest as a shareholder

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

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

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

(c) Transactions with the Svyazinvest Group

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

(In millions of Russian Rubles unless otherwise stated)

27. RELATED PARTY TRANSACTIONS (Continued)

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

The Group also consumes design services from certain companies of the Svyazinvest Group which are included in 2007 in additions of property, plant and equipment in amount of 21 (2006: 36, 2005: 47).

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

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

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

	2007	2006	2005
Revenue	2,308	1,460	17,475
Charges by network operators - national	(21,162)	(22,598)	(6,757)
Administration and other costs	(105)	(71)	(72)
Contributions to non-for-profit organizations (included in administration and other costs)	(1)	(1)	(125)
Contributions in pension fund included in wages, salaries, other benefit and payroll taxes	(86)	(92)	(167)
Bad debt (expense)/ recovery	(83)	(46)	(23)

Significant decrease in revenues and increase in charges by local network operators in 2006 is related to the new interconnection and settlement regulations effective January 1, 2006 (refer to Note 3 for further details).

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

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

	2007	2006	2005
Accounts receivable	670	781	1,017
Allowance for doubtful receivables	(129)	(46)	-
Accounts payable	(731)	(1,677)	(82)
Payable to non-for-profit organizations	(23)	(24)	(117)

(d) Transactions with the Government

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

(In millions of Russian Rubles unless otherwise stated)

27. RELATED PARTY TRANSACTIONS (Continued)

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

	2007	2006	2005
Revenue	5,486	4,385	2,148
Charges by network operators - national	(385)	(351)	-
Administration and other costs	(722)	(821)	(47)
Contributions to Fund of Telecommunication History (included in administration and other costs)	(51)	(16)	(23)
Bad debt (expense)/ recovery	(51)	-	118

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

	2007	2006	2005
Accounts receivable	526	530	342
Allowance for doubtful receivables	(106)	(63)	(81)
Accounts payable	(171)	(219)	(88)

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

	2007	2006	2005
Share of total revenue	1.2%	1.2%	3.9%
Share of charges by network operators - national	4.6%	5.1%	5.4%
Share of accounts receivable	2.5%	2.8%	4.4%
Share of allowance for doubtful receivables	0.8%	0.8%	0.5%
Share in intangible assets	8.0%	-	-
Share of other non-current assets	-	79.3%	-
Share of trade accounts payable	1.5%	3.8%	0.9%

The Company deposits available cash with OAO Sberbank of Russia in which Government of the Russian Federation controls 57.6%. As of December 31, 2007, 2006 and 2005 short-term deposits held in OAO Sberbank of Russia amounted to nil, nil and 1,000, respectively. As of December 31, 2007, 2006 and 2005 cash held in OAO Sberbank of Russia amounted to 250, 641 and 1,364, respectively.

e) Transactions with associates

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

	2007	2006	2005
Revenue	575	556	1,347
Charges by network operators – national	(118)	(102)	(162)
Bad debt (expense)/ recovery	(10)	22	(10)

(In millions of Russian Rubles unless otherwise stated)

27. RELATED PARTY TRANSACTIONS (Continued)

The Group also consumes design services from OAO Svyazintek which are included in 2007 in additions of property, plant and equipment in amount of 9 (2006: 442, 2005: 34).

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

	2007	**2006**	**2005**
Accounts receivable	103	67	525
Allowance for doubtful receivables	(38)	(28)	(50)
Accounts payable and accrued expenses	(23)	(18)	(23)

(f) Directors' remuneration

In 2007, the total remuneration of the directors and management board members, represented by short-term benefits, amounted to 79 (2006: 149, 2005: 131). As of December 31, 2007 12 employees of the Company were members of the management board (2006: 11, 2005: 13).

(g) Other related party transactions

In 2006, 2005 the Group acquired promissory notes of OAO Svyazbank for 4,700 and 5,500, respectively, and settled partially the promissory notes for 9,022 and 2,607 respectively. Net income from sale of promissory notes of OAO Svyazbank amounted to nil in 2006 and 58 in 2005 and was included in interest income in these consolidated statements of income. Also refer to Notes 12 and 13. As of December 31, 2006 and 2005 held in OAO Svyazbank amounted to 319 and 447, respectively. Certain directors and managers of the Group and OAO Svyazinvest were directors of OAO Svyazbank till June 2006.

During 4 months of 2005 and year ended December 31, 2004 the Group acquired promissory notes of OAO Russian Industrial bank (OAO RIB) for 1,271 and 795, respectively, and settled partially the promissory notes for 1,370 and nil, respectively. Gain from sale of promissory notes of OAO RIB amounted to 6 (2004: nil) and was included in interest income in these consolidated statement of income. Certain managers of the Group were directors of OAO RIB till April 29, 2005.

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

	2007	**2006**	**2005**
Revenue	23	1,087	150
Administration and other costs	(8)	(129)	(31)
Bad debt (expense)/ recovery	84	(7)	(77)

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

	2007	**2006**	**2005**
Accounts receivable	4	239	183
Allowance for doubtful receivables	-	(84)	(77)
Accounts payable and accrued expenses	-	(90)	(5)

28. COMMITMENTS AND CONTINGENCIES

a) Legal proceedings

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

b) Taxation

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

As of December 31, 2007 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained upon examination. Management of the Group believes that it has adequately provided for tax liabilities in the consolidated balance sheet as of December 31, 2007. However, the general risk remains that relevant authorities could take different position with regard to interpretative issues and the effect could be significant.

As a result the comprehensive tax inspection covering the period of 2003, the Federal Tax Service of the Russian Federation assessed the Group 3,474 in additional taxes, including fines and penalties payable by the Group.

The Group disputed the claim of the Federal Tax Service of the Russian Federation in the Arbitration Court of Moscow. In April of 2007 the Arbitration Court declared the claim of the tax authorities in the amount of 3,473 to be invalid. The court approved the claim in amount of 1. The Federal Tax Service of the Russian Federation lodged an appeal with the Court of Appeals (The Ninth Arbitration Court of Appeals). The Court of Appeals confirmed the decision of the Arbitration Court of the first instance with respect to the Group's claims. Besides, the Court of Appeals reduced the amount of the claims of the tax authorities declared valid to 0.15. In December of 2007 the Federal Tax Service of the Russian Federation appealed to the Court of Cassation. In April of 2008 the Court of Cassation confirmed the decision of the Court of Appeals. The Federal Tax Service can appeal to the Supreme Arbitration Court of the Russian Federation until August of 2008. Management believes that the Group's position will be defended successfully in the Supreme Arbitration Court. No amounts related to this issue were accrued by the Group as of December 31, 2007, 2006 and 2005 in the accompanying financial statements.

In December of 2007 the Federal Tax Service of the Russian Federation completed the comprehensive tax inspection for the period of 2004-2006 and, as a result, issued a claim in the amount of 1,812 of additional taxes, fines and penalties. More than 90% of the amount relates to assessments calculated on the basis of subjective treatment of telecommunication industry legislation by the tax authority. In February of 2008 the Group appealed the decision to a higher taxing authority. Furthermore, the Group is going to appeal to the Arbitration Court of Moscow after its appeal to the higher tax authority is considered. Management believes that, overall, taxes for 2004-2006 has been properly calculated by the Group and fairly stated in its financial statements based on the Group's analysis of the sustainability of liability. As a result of this analysis the Group has accrued additional tax liabilities of 144 as of December 31, 2007.

In April 2008 Russian Federal Tax Service completed comprehensive tax inspection of GlobalTel for the period of 2005-2006 and, as a result, issued a claim in the amount of 91 of additional taxes. Major part of this assessment relates to accrual of taxable income with respect to overdue outstanding liability under

(In millions of Russian Rubles unless otherwise stated)

28. COMMITMENTS AND CONTINGENCIES (Continued)

loan agreements with Loral Space and Communications Corporation (refer to Note 18). Currently GlobalTel litigates over the payment of accounts payable with Loral in international and Russian courts. However, in relation to the accrual of taxable income on outstanding liability under loan agreements in the total amount of 46 the Group believes that it has sufficient arguments for defending its position in Court and no further provisions are necessary based on the technical merits of the tax position taken. To provide for the tax authorities' claim on other issues, the Group has accrued additional tax liabilities of 45 as of December 31, 2007, and liabilities for potential fines and penalties of 16. The Federal Tax service has not initiated a tax inspection of GlobalTel for 2007. When such an inspection is initiated, the Group can be claimed for similar issues as of Loral ones. Management estimates the possible amount of such a claim of 49 and does not provide for this risk for the same reasons as stated above. Besides, for other issues discovered by the Federal Tax Service Management estimated similar risk for 2007 in the amount of 8 and accrued this provision in the accompanying financial statements.

The Federal Tax Service has not initiated a tax inspection of the Group entities' accounts for 2007. When such an inspection is initiated the Group can be claimed for similar reasons as the Group kept these operations in 2007. Management of the Group estimates the possible amount of such a claim of 208. However, management does not believe that it is probable that they will pay this liability.

In relation to the tax inspection claim in the amount of 1,812 as well as to the associated risk in the amount of 208 management believes that it has sufficient arguments for defending its position in Court and no further provisions are necessary based on the technical merits of the tax position taken.

c) Licenses

Substantially all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years up to 2013.
The Company has renewed all other licenses on a regular basis in the past, and believes that it will be able to renew licenses without additional cost in the normal course of business. Suspension or termination of the Company's main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Group.

d) Capital Commitments

As of December 31, 2007, contractual commitments of the Group for the acquisition of property, plant and equipment amounted to 3,298 (2006: 2,915, 2005: 6,220).

As of December 31, 2007 all lease contracts are legally cancellable. However the Group was involved in a number of operating land lease agreements on which the Group constructed certain leasehold improvements. Thus it is reasonably certain that these leases would not be cancelled. Future minimum lease payments under these operating leases as of December 31, 2007 were as follows:

Current portion	56
Between one to two years	55
Between two to three years	52
Between three to four years	49
Between four to five years	42
Over five years	1,307
Total minimum rental payables	**1,561**

(In millions of Russian Rubles unless otherwise stated)

28. COMMITMENTS AND CONTINGENCIES (Continued)

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

Future minimum rentals receivable cancellable operating leases which are merely to be cancelled as of December 31, 2007, 2006 and 2005 were as follows:

	2007	2006	2005
Current portion	83	70	35
Between one to two years	81	90	59
Between two to three years	80	88	76
Between three to four years	78	87	73
Between four to five years	78	86	80
Over five years	347	467	549
Total minimum rental receivables	**747**	**888**	**872**

29. CREDIT RISK MANAGEMENT

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

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

The Group's accounts receivable are represented by receivables from the Government and other public organizations, businesses and individuals each of them bearing different credit risk. Collection of receivables from the Government and other public organizations is mainly influenced by political and economic factors and not always under full control of the Group. However, management undertakes all possible efforts to minimize the exposure to risk of receivable from this category of subscribers. In particular, credit worthiness of such subscribers is assessed based on financing limits set by the Government. Management believes there were no significant unprovided losses relating to these or other receivables as at December 31, 2007.

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

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

(In millions of Russian Rubles unless otherwise stated)

29. CREDIT RISK MANAGEMENT (Continued)

enhanced, whenever possible, by collaterals.

To secure obligation of debtor to pay on promissory notes the Group holds collaterals amounting to 26 which are represented by property and stocks. The Group is entitled to dismiss the pledged property and stocks only in case of either non-performance or undue performance of obligations by the debtor. The settlement date under promissory notes secured by collaterals will expire in 2009.

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

The Group had no individual customers, other than the Government of the Russian Federation and its related parties (refer to Note 26), that accounted for greater than 10% of its revenue during the years ended December 31, 2007, 2006 and 2005.

30. LIQUIDITY RISK MANAGEMENT

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

Maturity analysis as of December 31, 2007, 2006 and 2005 represented below shows undiscounted cash flows.

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

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

(In millions of Russian Rubles unless otherwise stated)

30. LIQUIDITY RISK MANAGEMENT (Continued)

Financial instrument	Less than one year	Between one to two years	Between two to three years	Between three to four years	Between four to five years	Over five years
Bank loans	1,164	876	796	708	641	1,039
Financial lease and vendor financing	1,735	44	44	44	44	438
Accounts payable	4,089	50	43	36	38	207
As of December 31, 2005	**6,988**	**970**	**883**	**788**	**723**	**1,684**

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

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

31. MARKET RISK

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

Interest rate risk

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

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

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

(In millions of Russian Rubles unless otherwise stated)

31. MARKET RISK (Continued)

	Increase/decrease in percentage point	Effect on profit before tax
2006		
EUR	+ 1.0%	(2)
EUR	- 1.0%	2
USD	+ 1.0%	(94)
USD	- 1.0%	94
2005		
EUR	+ 1.0%	(3)
EUR	- 1.0%	3
USD	+ 1.0%	(126)
USD	- 1.0%	126

Foreign exchange risk

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

In 2007, approximately 10.2% (2006: 8%, 2005: 12%) of the Group's revenues and 15.0% (2006: 14%, 2005: 17%) of the Group's expenses were denominated in currencies other than the Russian ruble. Revenues generated in foreign currency represent income received from foreign operators, and foreign currency denominated expenses consist primarily of payments to foreign operators for international long-distance traffic termination. Accounts receivable from foreign operators and accounts payable to foreign operators which are denominated in foreign currencies amounted to approximately 8.2% (2006: 5%, 2005: 9%) of the Group's total accounts receivable and 11.5% (2006: 18%, 2005: 36%) of the Group's total accounts payable as of December 31, 2007, 2006 and 2005, respectively. Borrowings denominated in foreign currencies and outstanding as of December 31, 2007, 2006 and 2005 amounted to 88.9%, 94% and 100% of the Group's total borrowings as of December 31, 2007, 2006 and 2005, respectively.

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

The following table demonstrates the sensitivity to a reasonably possible change in exchange rates, with all other variables held constant, of the group profit before tax.

	Increase/decrease in percentage point	**Effect on profit before tax**
2007		
EUR	+ 3.5%	(8)
EUR	- 6.0%	13
USD	+ 4.0%	(104)
USD	- 5.5%	143
SDR	+ 4.0%	4
SDR	- 5.5%	(5)

(In millions of Russian Rubles unless otherwise stated)

31. MARKET RISK (Continued)

	Increase/decrease in percentage point	Effect on profit before tax
2006		
EUR	+ 3.5%	(6)
EUR	- 6.0%	11
USD	+ 4.0%	(138)
USD	- 5.5%	189
SDR	+ 4.0%	(7)
SDR	- 5.5%	10
2005		
EUR	+ 3.5%	(12)
EUR	- 6.0%	20
USD	+ 4.0%	(109)
USD	- 5.5%	149
SDR	+ 4.4%	(14)
SDR	- 5.5%	20

Other price risk

As of December 31, 2007 the Group's assets include investments into quoted securities subject to other price risk. To mitigate this risk the Group analyses on regular way market trends on securities and takes a decision to sale on necessity.

32. CAPITAL MANAGEMENT

The following table demonstrates the sensitivity to a reasonably possible change in market indexes on securities, with all other variables held constant, of the group profit in term of result of fair value revaluation recognized in equity.

	Increase/decrease in percentage point	Effect on revaluation result recognised in equity
2007		
MICEX	+ 30.0%	3,532
MICEX	- 30.0%	(3,532)
2006		
MICEX	+ 30.0%	1,706
MICEX	- 30.0%	(1,706)
2005		
MICEX	+ 30.0%	995
MICEX	- 30.0%	(995)

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize the return to shareholders. The Board of directors reviews the Group's performance and establishes variety of key performance indicators which are based on Russian statutory accounts. In addition, the Group is subject to externally imposed capital requirements (VEB loan covenants) which are used for capital monitoring. There were no changes in the objectives, policies and processes during 2007.

Capital includes equity attributable part to the equity holders of the parent entity. Revaluation surplus which is included in capital is not subject to capital management because of its nature. The Group manages its capital structure and makes adjustments to it by issue of new shares, dividend

(In millions of Russian Rubles unless otherwise stated)

32. CAPITAL MANAGEMENT (Continued)

payments to shareholders, purchase of treasury shares. The Group monitors the compliance of the amount of legal reserve with the statutory requirements. In addition, the Group monitors distributable profits on a regular basis and determines the amounts and timing of dividends payments.

33. SUBSEQUENT EVENTS

Investments in Golden Telecom

In February 2008 the Group accepted an offer by Lilian Asquisition, Inc., a subsidiary of Vimpelcom, to the purchase the Group´s shares of Golden Telecom, Inc. Consideration from the Group´s sale of 4,417,055 shares of Golden Telecom, Inc. amounted to USD 464 million (11,385). As of the date of issuance of these consolidated financial statements the deal was closed and cash was received at full. Profit from this transaction before tax amounted to 8,666 of which 440 relates to profit for 2008 and 8,226 was recognized in equity in 2005-2007 as a result of fair value revaluation. In 2008 the Group will pay income tax of 2,322 in connection with the sale of Golden Telecom shares from which 2,122 was recognized as deferred tax liability in 2005-2007.

Investments in OAO RTComm.RU

In March 2008 the Group‘s Board of Directors authorized the purchase of additional 68.4% equity interest in OAO RTComm.RU that will increase the Group’s equity interest in OAO RTComm.Ru up to 99.5% and result in obtaining control over it. The acquisition does not significantly influence the Group’s financial position. The expected cost of additional investments approximates 1,500. As of the date of issuance of the accompanying consolidated financial statements the deal was not completed.

Change in legislation

According to several acts of Federal Tariff Service, starting from February 2008 the Company decreased tariffs on domestic long distance telecommunication services approximately by 10%.

Dividends for the year ended December 31, 2007

In June 2008 the Group’s shareholders authorized dividends of 2,356 for the year ended December 31, 2007.

	Dividends	Dividends per share, Rbl
Ordinary Shares, Rbl 0.0025 par value	1,413.6	1.9399
Preferred Shares, Rbl 0.0025 par value	942.4	3.8809
Total	**2,356.0**	