

OJSC Tattelecom

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

31 December 2009

OJSC TATTELECOM

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INDEPENDENT AUDITOR'S REPORT

To the Shareholder and Board of Directors of OJSC Tatttelecom:

- 1 We have audited the accompanying consolidated financial statements of OJSC Tatttelecom and its subsidiaries (the "Group") which comprise the consolidated statement of financial position as at 31 December 2009 and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

- 6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit


21 May 2010
Moscow, Russian Federation

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

	Note	31 December	
		2009	2008
ASSETS			
Non-current assets			
Property, plant and equipment	12	10,415,453	10,344,765
Intangible assets	13	138,145	70,753
Financial investments	14	198,421	130,495
Other non-current assets	15	57,265	208,184
Total non-current assets		10,809,284	10,754,197
Current assets			
Inventory	16	144,282	130,759
Trade accounts receivable	17	772,549	665,160
Advances paid and prepaid expenses	18	193,086	108,392
Prepaid income tax		71,197	51,633
Prepaid taxes, other than income tax		23,823	68,220
Financial investments	14	400,725	41,396
Cash and cash equivalents	19	81,701	117,557
Total current assets		1,687,363	1,183,117
TOTAL ASSETS		12,496,647	11,937,314
EQUITY			
Ordinary shares	20	2,104,799	2,104,799
Treasury shares	20	(81,892)	(82,109)
Revaluation reserve for available-for-sale investments	14	(5,267)	(10,791)
Additional paid in capital	20	232,275	-
Retained earnings		3,792,124	3,379,703
TOTAL EQUITY		6,042,039	5,391,602
LIABILITIES			
Non-current liabilities			
Long-term borrowings	21	826,917	1,675,789
Long-term obligations under finance lease	23	12,157	30,152
Deferred income tax liability	24	459,965	261,643
Deferred revenue	25	344,999	713,444
Post-retirement benefit obligations	26	199,068	228,627
Government grants	3	-	162,139
Other long-term liabilities	28	92,955	55,811
Total non-current liabilities		1,936,061	3,127,605
Current liabilities			
Current portion of long-term borrowings	21	2,876,063	1,787,973
Short-term obligations under finance lease	23	31,379	46,827
Accounts payable and accrued liabilities	27	1,123,280	1,227,803
Taxes payable, other than income tax		201,703	160,050
Deferred revenue, current portion	25	286,122	195,454
Total current liabilities		4,518,547	3,418,107
TOTAL LIABILITIES		6,454,608	6,545,712
TOTAL EQUITY AND LIABILITIES		12,496,647	11,937,314

Approved for issue and signed on behalf of the Board of Directors on 21 May 2010.


L.N. Shafigoullin
General Director


M.N. Agafonova
Head of Finance

The accompanying notes on pages 5 to 34 are an integral part of these consolidated financial statements.

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in thousands of Russian Roubles)

	Note	For the year ended 31 December	
		2009	2008
Revenue	9	5,519,614	5,298,479
Operating expenses	10	(4,118,993)	(4,196,054)
Operating profit		1,400,621	1,102,425
Finance income		24,012	29,171
Finance cost	11	(497,752)	(268,970)
Foreign exchange loss		(55,242)	(118,694)
Profit before income tax		871,639	743,932
Income tax expense	24	(194,107)	(178,278)
Profit for the year		677,532	565,654
Other comprehensive income:			
Actuarial gain, net of deferred tax charge of RR 2,962 (2008: RR 11,168)	26	11,848	44,661
Gain (loss) on revaluation of available-for-sale investments, net of deferred tax charge of RR 1,381 (2008: deferred tax credit of RR 8,509)	14	5,524	(34,038)
Total comprehensive income for the year attributable to the owners of the Company		694,904	576,277
Weighted average number of outstanding ordinary shares		20,419,338,080	20,421,581,719
Earnings per ordinary share, basic and diluted, in roubles per share		0.034	0.028

The accompanying notes on pages 5 to 34 are an integral part of these consolidated financial statements.

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

	Note	Ordinary shares	Additional paid in capital	Revaluation reserve for available for sale investments	Treasury shares	Retained earnings	Total
Balance at 31 December 2007		2,104,799	–	23,247	(81,064)	3,026,643	5,073,625
Total comprehensive income for the year	14, 26	–	–	(34,038)	–	610,315	576,277
Dividends declared		–	–	–	–	(257,255)	(257,255)
Purchase of treasury shares		–	–	–	(1,045)	–	(1,045)
Balance at 31 December 2008		2,104,799	–	(10,791)	(82,109)	3,379,703	5,391,602
Adjustment to property, plant and equipment contributed by ultimate parent	3	–	232,275	–	–	(70,136)	162,139
Total comprehensive income for the year	14, 26	–	–	5,524	–	689,380	694,904
Dividends declared		–	–	–	–	(206,823)	(206,823)
Sale of treasury shares		–	–	–	217	–	217
Balance at 31 December 2009		2,104,799	232,275	(5,267)	(81,892)	3,792,124	6,042,039

The accompanying notes on pages 5 to 34 are an integral part of these consolidated financial statements.

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

	Note	For the year ended 31 December	
		2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		871,639	743,932
Adjustments for:			
Depreciation of property, plant and equipment	12	1,000,376	720,144
Amortization of intangible assets	13	95,895	62,405
Loss on disposal of property, plant and equipment		86,583	89,949
Finance income		(24,012)	(29,171)
Finance costs	11	497,752	268,970
(Gain) loss on impairment of trade accounts receivable		(142,040)	28,215
Loss on write off of financial investments	14	-	109,300
Foreign exchange loss		55,242	118,694
Other non-cash operating expenses		8,298	24,819
Operating cash flows before changes in working capital:		2,449,733	2,137,257
Decrease (increase) in trade accounts receivable		34,651	(76,405)
Increase in inventory		(9,874)	(3,927)
(Increase) decrease in advances paid and prepaid expenses		(72,379)	13,273
Decrease in prepaid taxes, other than income tax		44,397	15,211
Decrease in accounts payable and accrued liabilities		(258,803)	(76,008)
Increase in taxes payable, other than income tax		41,653	111,526
Decrease in deferred revenue		(277,777)	(77,275)
Changes in working capital		1,951,601	2,038,830
Income taxes paid		(19,692)	(231,527)
Interest paid		(504,003)	(288,694)
Net cash from operating activities		1,427,906	1,523,431
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property, plant and equipment		(886,712)	(1,525,745)
Purchases of intangible assets		(118,232)	(25,303)
Proceeds from sale of property, plant and equipment		82,328	-
Interest received		11,743	8,152
Purchases of investments		(525,587)	(371,636)
Acquisition of subsidiaries, net of cash acquired		(16,970)	-
Proceeds from repayment of investments		30,000	240,003
Net cash used in investing activities		(1,423,430)	(1,674,529)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from bonds issue		1,620,131	-
Repayment of bonds		(219,187)	(1,481,590)
Proceeds from borrowings		1,111,620	3,567,169
Repayment of borrowings		(2,332,388)	(1,709,259)
Finance lease payments		(33,443)	(94,500)
Dividends paid		(187,065)	(143,390)
Net cash (used in) from financing activities		(40,332)	138,430
NET DECREASE IN CASH AND CASH EQUIVALENTS		(35,856)	(12,668)
CASH AND CASH EQUIVALENTS, beginning of the year		117,557	130,225
CASH AND CASH EQUIVALENTS, end of the year		81,701	117,557

The accompanying notes on pages 5 to 34 are an integral part of these consolidated financial statements.

1. OJSC TATTELECOM AND ITS OPERATIONS

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") for the year ended 31 December 2009 for OJSC Tatttelecom ("Tatttelecom" or the "Company") and its subsidiaries (together referred to as the "Group").

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

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

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

As of 31 December 2009 and 2008, the Company's major shareholders were as follows:

	<u>% of ownership</u>
OJSC Svyazinvestneftekhim	87.2%
Other	12.8%
Total	<u>100.0%</u>

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

The Group consists of the Company and the following subsidiaries. All Group companies are incorporated in the Russian federation.

Subsidiary	% of ownership as at 31 December			Immediate parent
	2009	2008		
LLC Kamatel-K	100	–		OJSC Tatttelecom
LLC Kamatel K	100	–		OJSC Tatttelecom
LLC LiNet	100	–		OJSC Tatttelecom
LLC Elemte Invest	100	100		OJSC Tatttelecom
LLC StroiRemKompania	89	–		LLC Elemte Invest

2. OPERATING ENVIRONMENT OF THE GROUP

The Russian Federation displays certain characteristics of an emerging market, including relatively high inflation and high interest rates. The global financial crisis has had a severe effect on the Russian economy since mid-2008:

- Lower commodity prices have resulted in lower income from exports and thus lower domestic demand. Russia's economy contracted in 2009.
- The rise in Russian and emerging market risk premia resulted in a steep increase in foreign financing costs.
- The depreciation of the Russian Rouble against hard currencies (compared to RR 25.3718 for 1 US Dollar at 1 October 2008) increased the burden of foreign currency corporate debt, which has risen considerably in recent years.
- As part of preventive steps to ease the effects of the situation in financial markets on the economy, the government incurred a large fiscal deficit in 2009.

The volume of financing available has significantly reduced since 2008. Such circumstances may affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

2. OPERATING ENVIRONMENT OF THE GROUP (CONTINUED)

The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations and frequent changes, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

Management is unable to predict all developments in the economic environment which could have an impact on the Group's operations and consequently what effect, if any, they could have on the future financial position of the Group.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

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

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

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

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

Revised accounting and changes in presentation

In 2009 the Company revised its accounting for contributions of property, plant and equipment received from the Company's ultimate parent to treat them as capital contributions. Previously, these contributions were credited to the government grants caption of the consolidated statement of financial position and accreted into income over the life of the respective assets, in accordance with IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance". The effect of this revision as of 31 December 2009 resulted in retained earnings being reduced by RR 70,136; government grants balance reduced by RR 162,139 and additional paid in capital increased by RR 232,275.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revised accounting and changes in presentation (continued)

At 31 December 2009, the Company revised the presentation of its investment in NPF Volga Capital, a pension fund. Previously, the investment was offset against employee pension obligations and shown net on the face of the consolidated statement of financial position. At 31 December 2009, the Company classified the investment as a non-current available-for-sale investment (Note 14). As a result of this revision, the Company's non-current liabilities and non-current assets as of 31 December 2008 increased by RR 110,609.

Functional and presentation currency

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

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

The exchange rates of the Russian Rouble to the US Dollar ("USD") as of 31 December 2009 and 2008 were RR 30.2442 and RR 29.3804 to USD 1, respectively. The exchange rates of the Russian Rouble to Euro as of 31 December 2009 and 2008 were RR 43.3883 and RR 41.4411 to 1 Euro, respectively.

At 31 December 2009, the Company changed its presentation currency from USD to RR. All comparatives were restated accordingly.

Consolidated financial statements

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Consolidated financial statements (continued)

Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Company. Minority interest forms a separate component of the Group's equity.

Property, plant and equipment

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

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

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in profit or loss. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

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

Depreciation

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

	<u>Useful life in years</u>
Land	Not depreciated
Buildings	40
Telecommunication equipment	10
Transmission devices	15
Vehicles	7
Office equipment and other	3-5

The residual value of an asset is the estimated amount that the Group would currently obtain from a disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Assets under construction are not depreciated. Depreciation of these assets will begin when the related assets are ready to be placed in service.

Leases

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Leases (continued)

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

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

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

Intangible assets

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

	<u>Useful life in years</u>
Licenses	1-7
Software	1-10
Subscribers' base	5

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

Financial instruments – key measurement terms

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments – key measurement terms (continued)

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

Initial recognition of financial assets

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

Derecognition of financial assets

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

Classification of financial assets

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

Available-for-sale investments

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

Classification of financial liabilities

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

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

Impairment of financial assets carried at amortized cost

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

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

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

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

Inventories

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

Prepayments

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pension plan and post-employment benefits

The Group operates a defined benefit pension scheme. The scheme is funded through payments to a non-governmental pension fund, NPF Volga-Capital, determined by periodic actuarial calculations. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the consolidated statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise. Past-service costs are recognized immediately in profit or loss.

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

Value added taxes

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

Income taxes

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

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

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilized.

