



MEGAFON

Consolidated Financial Statements

*Years ended December 31, 2009 and 2008
With Report of Independent Auditors*

Report of Independent Auditors

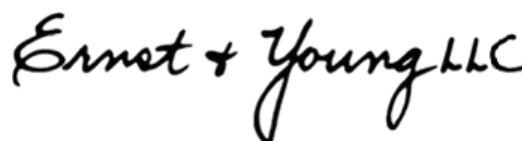
The Board of Directors and Shareholders
OJSC MegaFon -

We have audited the accompanying consolidated balance sheets of OJSC MegaFon and subsidiaries ("the Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 OJSC MegaFon and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

March 9, 2010



Contents

Consolidated Financial Statements

Consolidated Balance Sheets.....	3
Consolidated Statements of Operations.....	5
Consolidated Statements of Cash Flows	6
Consolidated Statements of Shareholders' Equity	7
Notes to Consolidated Financial Statements	8

MegaFon
Consolidated Balance Sheets

(In millions of Rubles)

	As of December 31,	
	2008	2009
Assets		
Current assets:		
Cash and cash equivalents	6,465	12,550
Short-term investments	33,738	49,114
Accounts receivable, net of allowance for doubtful accounts of 511 and 861 at December 31, 2008 and December 31, 2009, respectively <i>(Note 15)</i>	5,617	4,050
Accounts receivable, related parties <i>(Note 16)</i>	81	35
Inventory	2,352	1,219
VAT receivable	2,640	2,037
Deferred tax assets <i>(Note 14)</i>	1,167	772
Prepaid expenses <i>(Note 17)</i>	4,942	8,589
Other current assets	1,227	1,784
Total current assets	58,229	80,150
Property, plant and equipment, net of accumulated depreciation of 75,515 and 99,993 at December 31, 2008 and December 31, 2009, respectively <i>(Note 4)</i>	128,691	147,231
Goodwill and intangible assets:		
Goodwill <i>(Note 3)</i>	363	498
Intangible assets, net of accumulated amortization of 14,411 and 17,101 at December 31, 2008 and December 31, 2009, respectively <i>(Note 5)</i>	13,149	16,869
Other non-current assets	2,317	1,893
Total assets	202,749	246,641

The accompanying notes are an integral part of these consolidated financial statements.

MegaFon

Consolidated Balance Sheets (continued)

(In millions of Rubles)

	As of December 31,	
	2008	2009
Liabilities		
Current liabilities:		
Accounts payable	5,713	4,530
Accounts payable to equipment suppliers	5,633	6,864
Accounts payable, related parties (Note 16)	365	502
Current portion of liability for marketing related licenses (Note 5)	—	287
Accrued compensation and social contributions	2,031	3,435
Subscribers' prepayments	6,462	7,083
Taxes payable (Note 14)	1,012	1,880
VAT payable	2,187	1,240
Deferred revenue	247	358
Loans from shareholders (Note 7)	97	—
Current portion of long-term debt (Note 6)	15,660	7,811
Other current liabilities	516	645
Total current liabilities	39,923	34,635
Debt, less current portion (Note 6)	16,223	19,335
Loans from shareholders, less current portion (Note 7)	3,647	—
Deferred tax liabilities, less current portion (Note 14)	2,159	2,531
Asset retirement obligations (Note 4)	2,349	3,303
Liability for marketing related licenses, less current portion (Note 5)	—	1,054
Deferred revenue, less current portion (Note 5)	64	1,568
Other non-current liabilities	258	301
Total liabilities	64,623	62,727
Equity		
MegaFon shareholders' equity:		
Common stock (par value of 10 Rubles, 6,200,002 shares authorized, issued and outstanding)	581	581
Reserve fund	17	17
Additional paid-in capital	13,875	13,870
Retained earnings	123,910	169,199
Accumulated other comprehensive loss	(257)	(255)
Total MegaFon shareholders' equity	138,126	183,412
Noncontrolling interests	—	502
Total equity	138,126	183,914
Total liabilities and equity	202,749	246,641

The accompanying notes are an integral part of these consolidated financial statements.

MegaFon

Consolidated Statements of Operations

(In millions of Rubles)

	Years ended December 31,	
	2008	2009
Revenue (including related party amounts) (Notes 10, 16)	175,451	181,883
Cost of services (excluding depreciation and amortization and including related party amounts) (Notes 11, 16)	35,427	36,865
Gross margin	140,024	145,018
Sales and marketing expenses (excluding depreciation and amortization and including related party amounts) (Note 12, 16)	16,455	17,361
Operating expenses (excluding depreciation and amortization and including related party amounts) (Notes 13, 16)	35,323	39,465
Depreciation and amortization (Notes 4, 5)	28,125	31,344
Operating income	60,121	56,848
Other income/(expense):		
Interest expense	(1,831)	(1,657)
Interest income	2,840	3,255
Other gain/(loss), net	18	(89)
Gain/(loss) on derivatives, net (Note 8)	2,322	(300)
Foreign currency exchange loss	(3,700)	(2,192)
Total other income/(expense), net	(351)	(983)
Income before income taxes and noncontrolling interest	59,770	55,865
Provision for income taxes (Note 14)	15,474	10,565
Net income	44,296	45,300
Net loss/(income) attributable to noncontrolling interests	23	(11)
Net income attributable to MegaFon	44,319	45,289

The accompanying notes are an integral part of these consolidated financial statements.

MegaFon

Consolidated Statements of Cash Flows

(In millions of Rubles)

	Years ended December 31,	
	2008	2009
Cash flows from operating activities:		
Net income attributable to MegaFon	44,319	45,289
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,125	31,344
(Gain)/loss on derivatives	(2,322)	300
Net foreign exchange loss	3,700	2,192
Net income/(loss) attributable to noncontrolling interests	(23)	11
Bad debt expense	321	1,122
Provision for deferred income taxes	144	10
Amortization of deferred finance charges	649	617
Changes in assets and liabilities:		
Accounts receivable	290	484
Inventory	(1,837)	1,156
Prepayments and other current assets	(1,570)	(4,770)
Accounts payable and accrued expenses	(267)	1,331
Subscribers' prepayments	658	609
VAT, net	1,313	(345)
Net cash provided by operating activities	73,500	79,350
Cash flows from investing activities:		
Purchases of property, plant and equipment and intangible assets	(50,200)	(46,443)
Proceeds from sale of property, plant and equipment	351	639
Acquisitions of subsidiaries, net of cash acquired	(1,169)	(833)
Increase in short-term investments	(10,304)	(14,073)
Other investing activities	(16)	—
Net cash used in investing activities	(61,338)	(60,710)
Cash flows from financing activities:		
Proceeds from long-term debt	2,570	9,856
Repayments of long-term debt	(12,798)	(19,640)
Deferred finance charges paid	(13)	(333)
Other financing activities	—	(59)
Net cash used in financing activities	(10,241)	(10,176)
Effect of exchange rate changes on cash and cash equivalents	285	(2,379)
Net increase in cash and cash equivalents	2,206	6,085
Cash and cash equivalents at the beginning of the period	4,259	6,465
Cash and cash equivalents at the end of the period	6,465	12,550
Supplemental cash flow information:		
Cash paid during the year for income taxes	15,388	10,897
Cash paid during the year for interest	2,071	2,636
Non-cash activities:		
Revenue from in-kind services (Note 5)	—	18

The accompanying notes are an integral part of these consolidated financial statements.

MegaFon

Consolidated Statements of Shareholders' Equity

(In millions of Rubles, except share amounts)

	MegaFon's shareholders' equity								
	Common Stock		Reserve fund	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total attributable to MegaFon	Non-controlling interest	Total
	Shares	Amount							
Balances as of December 31, 2007	6,200,002	581	17	13,875	79,591	(264)	93,800	35	93,835
Comprehensive income:									
Net income	–	–	–	–	44,319	–	44,319	(23)	44,296
Foreign currency translation adjustment	–	–	–	–	–	(6)	(6)	(12)	(18)
Pensions costs (net of tax effect of zero)	–	–	–	–	–	13	13	–	13
Total comprehensive income							44,326	(35)	44,291
Balances as of December 31, 2008	6,200,002	581	17	13,875	123,910	(257)	138,126	–	138,126
Comprehensive income:									
Net income	–	–	–	–	45,289	–	45,289	11	45,300
Foreign currency translation adjustment	–	–	–	–	–	(25)	(25)	(8)	(33)
Pensions costs (net of tax effect of zero)	–	–	–	–	–	27	27	–	27
Total comprehensive income							45,291	3	45,294
Acquisitions (Note 3)	–	–	–	–	–	–	–	583	583
Purchase of noncontrolling interest (Note 3)	–	–	–	(5)	–	–	(5)	(25)	(30)
Dividends paid to noncontrolling interest	–	–	–	–	–	–	–	(59)	(59)
Balances as of December 31, 2009	6,200,002	581	17	13,870	169,199	(255)	183,412	502	183,914

The accompanying notes are an integral part of these consolidated financial statements.

MegaFon

Notes to Consolidated Financial Statements

(In millions of Rubles, unless otherwise indicated)

1. Description of Business

Open Joint Stock Company (“OJSC”) MegaFon (the “Company” or “MegaFon”) was formed in the Russian Federation (“Russia”) on May 22, 2002 as a result of the renaming and reorganizing of OJSC North-West GSM and its integration under one brand with Closed Joint Stock Company (“CJSC”) Sonic Duo, CJSC Mobicom-Kavkaz, CJSC Mobicom-Centre, CJSC Mobicom-Novosibirsk, CJSC Mobicom-Khabarovsk, CJSC Mobicom-Kirov, OJSC MSS-Povolzhie, CJSC Volzhsky GSM and CJSC Uralsky GSM. On July 1, 2009, the Company merged all of its wholly-owned major operating Russian subsidiaries with and into the Company, so that its principal telecommunications operations are now conducted through a single legal entity throughout Russia.

MegaFon is a leading mobile operator in Russia and provides a broad range of voice, data and other telecommunication services to businesses, other telecommunications service providers and retail subscribers, with licenses to operate in all regions of Russia, covering a population of approximately 142 million. The Company intends, wherever possible, to offer its integrated telecommunication services under the “MegaFon” brand, although some services still carry local brand names because of recent acquisitions. In addition to its operations in Russia, the Company provides mobile services through its subsidiaries in Republic of Tajikistan (“Tajikistan”), Republic of Abkhazia (“Abkhazia”) and Republic of South Ossetia (“South Ossetia”).

In Russia, MegaFon has constructed and continues to expand a nationwide mobile communications network that operates on the dual band GSM 900/1800 standard. In May 2007, the Company was awarded a license that expires on May 21, 2017, for the provision of 3G mobile telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. As of December 31, 2009 the Company is providing 3G services in almost all of its regions throughout Russia.

The following table sets forth operating subsidiaries and branches of the Company as of December 31, 2009:

Subsidiary/Branch	Area of Operation	Ownership Interest	Date Operations Commenced/ Acquired
OJSC MegaFon:	Russia	100%	
Northwest branch	Northwest Region		December 1994
Povolzhye branch	Povolzhsky Region		August 1999
Caucasus branch	Southern Region		January 2001
Stolichny branch	Moscow and Moscow Region		November 2001
Ural branch	Ural Region		June 2002
Central branch	Central Region		December 2002
Siberian branch	Siberian Region		December 2003
Far East branch	Far East Region		March 2004
TT-Mobile	Tajikistan	75%	October 2001
CJSC In-Tone <i>(Note 3)</i>	Russia	100%	August 2008
OJSC VideoFon <i>(Note 3)</i>	Russia	100%	September 2008

MegaFon

Notes to Consolidated Financial Statements (continued)

1. Description of Business (continued)

Subsidiary/Branch	Area of Operation	Ownership Interest	Date Operations Commenced/ Acquired
LLC T-Pay (<i>Note 3</i>)	Russia	100%	September 2008
CJSC CC Absolut (<i>Note 3</i>)	Moscow	100%	December 2008
CJSC Aquafon GSM (<i>Note 3</i>)	Abkhazia	51%	March 2009
CJSC Ostelecom (<i>Note 3</i>)	South Ossetia	75%	March 2009

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Basis of Presentation

The statutory accounting records of the Company and its subsidiaries, except TT-Mobile, are maintained in Russian Rubles (“RUR”) and except TT-Mobile, Aquafon and Ostelecom are prepared in accordance with the accounting requirements provided for under Russian accounting and tax legislation. Foreign subsidiaries of the Company maintain their accounting records in accordance with their local accounting and tax legislation. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The accompanying consolidated financial statements differ from statutory financial statements used in Russia, Tajikistan, Abkhazia and Ossetia as they reflect certain adjustments, recorded in the entities’ accounts, which are necessary to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments are related to (1) revenue recognition; (2) recognition of interest expense and other operating expenses; (3) deferred income taxes; (4) valuation and depreciation of property, plant and equipment and intangible assets; (5) business combinations; (6) consolidation and accounting for subsidiaries; (7) accounting for derivatives; (8) foreign currency translation; and (9) valuation allowances for unrecoverable assets.

The Company evaluated subsequent events up to March 9, 2010, the date these financial statements were issued.

The accompanying consolidated financial statements are presented in millions of Rubles, except for share amounts or unless otherwise indicated.

Use of Estimates in Preparation of Financial Statements

The preparation of consolidated financial statements, in conformity with US GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reported period. Significant estimates, among others, include the allocation of purchase price to the fair value of net assets acquired in connection with business combinations, useful lives related to tangible and intangible assets, impairment tests of long-lived assets, deferred revenue, asset retirement obligations, fair value of derivative financial instruments, recoverability of

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

deferred tax assets, income tax provision and allowance for doubtful accounts. Actual results could differ from these estimates.

Principles of Consolidation

Wholly-owned and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Consolidation is also required when the Company is subject to a majority of the risk of loss or is entitled to receive a majority of the residual returns or both from a variable interest entity's activities.

All significant inter-company accounts and transactions are eliminated upon consolidation and net earnings/(losses) are reduced or increased by the portion of the net earnings/(losses) of subsidiaries applicable to any noncontrolling interests. Results of subsidiaries acquired and accounted for by the acquisition method have been included in operations from the relevant date of acquisition.

Business Combinations

The Company applies the acquisition method of accounting and recognizes the assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, license and other asset lives and market multiples, among other items.

Foreign Currency Translation

The functional currency of the Company's subsidiaries domiciled in Russia, Abkhazia and South Ossetia is the RUR as a majority of their revenues, costs, property and equipment purchased, debt and trade liabilities is either priced, incurred, payable or otherwise measured in RUR.

The functional currency of TT-Mobile, the Company's 75% owned subsidiary in Tajikistan, is the US dollar as a majority of its revenues, costs, property and equipment purchased, debt and trade liabilities is either priced, incurred, payable or otherwise measured in US dollars.

Cash and Cash Equivalents

From time to time, the Company may hold cash on hand and deposits in banks with an original maturity of three months or less which are classified as cash and cash equivalents. Cash equivalents are carried at cost, which approximates fair value.

Short-Term Investments

The Company classifies investments and time deposits with an original maturity of more than three months but less than twelve months from the date of purchase, that the Company may

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

hold from time to time, as short-term investments. Short-term investments are shown at cost which approximates fair value. The carrying amount of short-term investments is reduced to recognize any decline in value which is other than temporary.

Accounts Receivable

Accounts receivable are shown at their net realizable value which approximates fair value. The Company makes judgments as to the collectability of accounts receivable based on historical trends and future expectations. To determine the allowance for doubtful accounts, management reviews specific customer risks and the Company's accounts receivable aging.

Inventories

Inventories, which primarily consist of telephone handsets, accessories for resale, SIM-cards and prepaid phone cards, are stated at the lower of cost or market. Cost is determined using the first in, first-out method.

Value-Added Tax

Value Added Tax ("VAT") related to revenues is generally payable to the tax authorities on an accrual basis when invoices are issued to customers or cash received. VAT incurred on purchases may be offset, subject to certain restrictions, against VAT related to revenues, or can be reclaimed in cash from the tax authorities under certain circumstances.

Management periodically reviews the recoverability of VAT receivable and believes the amount reflected in the consolidated financial statements is fully recoverable within one year except for 33 and 60, which is classified as part of other non-current assets as of December 31, 2009 and 2008, respectively.

Deferred Finance Charges

Commissions, arrangement and commitment fees and related legal fees paid to secure a firm commitment from lenders, premiums paid to secure vendor financing, and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the terms of the related loans, using the effective-interest method. Costs capitalized in connection with revolving credit facilities are amortized on a straight-line basis over the period the revolving line of credit is active.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation and impairments, if any. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Interest expense incurred during the construction phase of a project is capitalized as part of property, plant and equipment until the project is completed and the asset is placed into service. Depreciation is recorded on a straight-line basis over the estimated useful life of the asset.

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The estimated useful lives are as follows:

Buildings and structures	7 to 45 years
Switching equipment, including billing systems	3 to 7 years
Base stations, including software	7 years
Fiber-optic equipment	20 years
Other network equipment	5 to 7 years
Vehicles and office equipment	3 to 5 years

Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the assets. The lease term includes renewals when such renewals are reasonably assured.

Repair and maintenance costs are expensed as incurred, while updates and improvements are capitalized.

At the time of retirement or other disposition of property, plant, and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain and loss is recorded in the consolidated statement of operations.

Asset Retirement Obligations

The Company has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located.

The Company records the fair value of a legal liability for an asset retirement obligation in the period it is incurred. This cost is initially capitalized and amortized over the estimated retirement period of 25 years. Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as a gain or loss on disposition. The Company annually evaluates whether there are any indicators which suggest that the estimated cash flows underlying the liability have changed materially. If such indicators exist the Company re-estimates the timing and amount of the cash flows and accounts for the effect of such.

Goodwill

Goodwill represents the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired and is not amortized.

Intangible Assets

Intangible assets, which are stated at cost, consist principally of operating licenses, frequencies, numbering capacity, customer base and marketing related licenses. These assets are generally amortized on a straight-line basis, except for marketing related licenses (*see Note 5*), over their estimated useful lives, generally four to seventeen years.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Operating licenses and frequencies provide the Company with the exclusive right to utilize certain radio frequency spectrum to provide mobile communications services. These licenses and frequencies are amortized on a straight-line basis within the estimated useful lives determined based on the management estimation of future economic benefits from these assets. The Company capitalizes payments made to third party suppliers to acquire access to and for use of telephone numbering capacity. Customer base is amortized reflecting the pattern in which the economic benefits are consumed or otherwise used up. Other intangible assets, such as software and trademarks are amortized on a straight-line basis over their estimated useful lives.

The Company continues to evaluate the amortization period to determine whether events or circumstances warrant revised amortization periods. Additionally, the Company considers whether the carrying value of such assets should be impaired based on the expected future benefits.

Long-lived Assets Impairment

Long-lived assets to be held and used by the Company are reviewed to determine whether an event or change in circumstances indicates that the carrying amount of the asset may not be recoverable. For long-lived assets to be held and used, the Company bases its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, the Company determines whether impairment has occurred through the use of an undiscounted cash flows analysis of assets at the lowest level for which identifiable cash flows exist. If impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the fair value of the asset. No such losses were recognized in the years ended December 31, 2009 and 2008.

Goodwill Impairment Assessment

Goodwill is reviewed annually, as of the beginning of the fourth quarter, for impairment or whenever it is determined that impairment indicators exist. The Company determines whether impairment has occurred by assigning goodwill to the reporting units identified and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If goodwill impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. No such losses were recognized during the years ended December 31, 2009 and 2008.

Interest Free Loans from Shareholders

Interest free loans from noncontrolling shareholders are recorded at their estimated present values based on the Company's incremental borrowing rate. The related imputed interest is recorded as additional paid-in capital in the consolidated statements of shareholders' equity.

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The accretion of imputed interest is included as interest expense in the accompanying consolidated statements of operations.

Revenue Recognition

The Company earns service revenues for usage of its cellular system, which include airtime charges from contract and prepaid subscribers, monthly contract fees, interconnect fees from other mobile and fixed-line operators, roaming charges and charges for Value Added Services (“VAS”). Interconnect revenue includes revenues from mobile and fixed-line operators that was earned from the services rendered for traffic termination from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers in the network of the Company. VAS include SMS, MMS, GPRS, WAP, Ring Back Tone (“RBT”) and other services. The cost of content revenue relating to VAS is presented net of related costs when the Company acts as an agent of the content providers. Generally, these services generate additional revenues through monthly subscription fees or increased mobile usage. Service revenue is generally recognized when the services (including value added services and roaming revenue) are rendered. Prepaid cards, used as a method of cash collection, are accounted as customer advances for future services. Prepaid cards do not have expiration dates but are subject to statutory expiration periods, and unused balances are recognized as revenue when cards expire. Payments from customers for equipment are not recognized as revenue until installation and testing are completed and accepted by the customer. Revenues are stated net of value-added tax and sales tax charged to customers.

The Company defers revenue resulting from fees paid by customers upon initial connection. Deferred revenues are subsequently recognized over the estimated average customer lives under tariff plans, which are periodically reassessed by management and such reassessment may impact future operating results of the Company.

The Company enters into multiple element revenue arrangements in which a customer may purchase a combination of handset, airtime traffic and other services. The consideration received from a subscriber is allocated to the separate units of accounting inherent in the contract based on their relative fair values. The allocated revenue is recognized in accordance with the type of element, limited to up-front cash received.

Advertising Costs

Advertising costs are expensed as incurred (*see Note 12*).

Government Pension Funds

The Company contributes to the local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended December 31, 2009 and 2008 were 1,084 and 1,161, respectively.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Income Taxes

Provisions are recorded in the consolidated financial statements for taxation of profits in accordance with Russian and other local legislations currently in force. The Company accounts for income taxes under the liability method. Deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement bases of assets and liabilities and are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future.

The Company accounts for uncertain tax positions and reflects liabilities for unrecognized income tax benefits together with corresponding interest and penalties in the consolidated statement of operations as income tax expense.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, short-term investments and accounts receivable. The Company deposits available cash with various banks in Russia. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within Russia. To manage the concentration of credit risk, the Company allocates available cash to domestic branches of international banks and a limited number of Russian banks. A majority of these Russian banks are either owned or controlled by the Russian Government. Management periodically reviews the credit worthiness of the banks in which it deposits cash, cash equivalents and short-term investments.

The Company extends credit to certain counterparties, principally international and national telecommunications operators, for roaming services, and to certain dealers. Management periodically reviews the history of payments and credit worthiness of the dealers. The Company generally requires its subscribers to prepay for services, except for corporate subscribers that it deems reliable. The Company generally does not require collateral to extend credit to its customers.

Fair Value Measurement

US GAAP standards establish a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value. These levels include:

Level 1: Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are non-active; inputs other than quoted prices that are observable and derived from or corroborated by observable market data.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The Company, using available market information, appropriate valuation methodologies and management's estimates determines the approximate fair values of financial instruments.

Derivative Instruments and Hedging Activities

The Company records all derivative instruments on the balance sheet at their respective fair values. On the date a derivative contract is executed, and depending on the specific facts and circumstances, the derivative may be designated as a fair value hedge, cash flow hedge or foreign currency hedge of net investment in a foreign operation. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the consolidated statement of operations. The Company does not hold or issue derivatives for trading purposes.

Stock-Based Compensation

As the stock-based awards granted by the Company to its employees are settled in cash they are accounted for as liability awards. The measurement of the liability and compensation cost of outstanding stock-based awards is based on the intrinsic value of the awards and is remeasured each period through the date of settlement. Compensation cost is recognized over the requisite service period of each separately vesting portion of the award based on the proportionate amount of the requisite service that has been rendered to date.

Comparative Information

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current year.

Recent Accounting Pronouncements

Accounting Standards Codification. In June 2009, the Financial Accounting Standards Board ("FASB") issued a standard that established the FASB Accounting Standards Codification ("ASC") as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with US GAAP. New accounting standards issued subsequent to June 30, 2009 are communicated by the FASB through Accounting Standards Updates ("ASU"). The ASC is effective for interim and annual periods ending after September 15, 2009.

Business Combinations. In December 2007, the FASB issued new guidance on business combinations (ASC 805), which significantly changed the accounting for business combinations and added new disclosure requirements. It requires the acquiring entity in a business combination to recognize all the assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition-date fair value. The guidance also requires acquisition-related transaction and restructuring costs to be expensed rather than treated as part of the cost of the acquisition. This guidance became effective for the Company

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

as of January 1, 2009, and was applied for the 2009 acquisitions (*Note 3*). The adoption of this guidance did not have a material impact on the Company's financial statements.

In April 2009, the FASB issued guidance on accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies (ASC 805). It provides guidance on initial recognition and subsequent measurement, accounting for and disclosure of such assets and liabilities. This guidance became effective for the Company as of January 1, 2009. The adoption of this guidance did not have a material impact on the Company's financial statements.

Noncontrolling Interests. In December 2007, the FASB issued guidance that establishes new accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary (ASC 810). This guidance became effective for the Company on January 1, 2009. From the date of adoption the Company is required to report its noncontrolling interests as a separate component of shareholders' equity. Among other requirements, this guidance requires consolidated net income to include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of operations, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. The guidance requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements are to be applied prospectively. The Company has adopted the guidance and the required reclassifications and disclosures have been made in its financial statements.

In January 2010, the FASB issued guidance that amends accounting and disclosure requirements for a decrease in ownership in a business under existing US GAAP standards for consolidations. It also clarifies the types of businesses that are in the scope of these consolidations. As required by this guidance, The Company applied the amendments starting with its annual consolidated financial statements as of and for the year ended December 31, 2009 retrospectively to January 1, 2009. The adoption of this guidance did not have a material impact on the Company's financial statements.

Fair Value Measurement and Disclosures. In April 2009, the FASB issued guidance that requires enhanced disclosures, including interim disclosures, on financial instruments, determination of fair value in turbulent markets, and recognition and presentation of other-than-temporary impairments (ASC 820). This guidance is effective for interim and annual reporting periods ending after June 15, 2009, and its adoption did not have a material impact on the Company's financial statements (*Note 8*).

In August 2009, the FASB issued ASU 2009-05, "*Measuring Liabilities at Fair Value*", which provides additional guidance on fair value measurement of liabilities. The new guidance provides clarification on the measurement and reporting of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. This guidance is effective for the interim and annual reporting periods beginning after August 2009, and its adoption did not have a material impact on the Company's financial statements.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

In January 2010, the FASB issued ASU 2010-06, “*Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*” that requires separate disclosure of significant transfers between Level 1 and Level 2 fair value measurement inputs and a description of the reasons for the transfers and amends existing disclosure requirements in regards of level of disaggregation and inputs and valuation techniques. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009. The Company will adopt this guidance from January 1, 2010. The Company does not expect ASU 2010-06 to have a material impact on its financial statements.

Derivatives and Hedging. In March 2008, the FASB issued new guidance that changes disclosure requirements for derivative instruments and hedging activities (ASC 815), which requires additional disclosures about an entity’s strategies and objectives for using derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The guidance is effective for the Company from January 1, 2009. The adoption of the guidance did not have a material impact on the Company’s financial statements.

Intangible assets. In April 2008, the FASB issued guidance on determining the useful life of intangible assets (ASC 350). This guidance applies to (1) intangible assets that are acquired individually or with a group of other assets and (2) intangible assets acquired in both business combinations and asset acquisitions. Under this guidance, entities estimating the useful life of a recognized intangible asset must consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension. The guidance is effective for the Company from January 1, 2009. The adoption of this guidance did not have a material impact on the Company's financial statements.

Subsequent events. In May 2009, the FASB issued an accounting standard (ASC 855) which establishes general standards of accounting for and disclosing events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard is effective on a prospective basis for interim or annual financial periods ending after June 15, 2009. The adoption of the standard did not have a material impact on the Company’s financial statements.

Variable Interest Entities (“VIE”). In June 2009, the FASB issued an accounting standard that amends the consolidation guidance for variable-interest entities (ASC 810). The amendments will significantly affect the overall consolidation analysis under the existing guidance. Accordingly, an enterprise will need to reconsider its previous conclusions, including (1) whether an entity is a VIE, (2) whether the enterprise is the VIE’s primary beneficiary, and (3) what type of financial statements disclosures are required. For the Company, this standard becomes effective January 1, 2010. The Company is currently evaluating the impact of this standard on its financial statements.

Revenue Arrangements with Multiple Deliverables. In October 2009, the FASB issued ASU 2009-13, “*Multiple-Deliverable Revenue Arrangements*”, which addresses how revenues should be allocated among all products and services included in the Company’s multiple

MegaFon

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

element sales arrangements. It establishes a selling price hierarchy for determining the selling price of each product or service included in a sale arrangement. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. It replaces “fair value” with “selling price” in revenue allocation guidance. ASU 2009-13 will be effective prospectively for sales entered into or materially modified in fiscal years beginning on or after June 15, 2010. The FASB permits early adoption of ASU 2009-13, applied retrospectively, to the beginning of the year of adoption. The Company is currently evaluating the impact of this standard on its financial statements.

3. Business Combinations and Asset Purchase

Acquisitions in 2008

InCore

In August 2008, the Company completed the acquisition of 100% ownership interest in CJSC InCore (“InCore”), a provider of ring back tone services, for approximately 1,025 cash consideration, including 2 of direct transaction costs. The primary reason for the acquisition was to provide RBT service directly to the Company’s customers. The Company has consolidated the financial position and results of operations of InCore from the date of acquisition. In 2009 InCore was renamed into CJSC In-Tone.

VideoFon

In September 2008, the Company completed the acquisition of 100% ownership interest in OJSC VideoFon (“VideoFon”), an exclusive retailer of the Company operating in St. Petersburg and the Leningrad region, for approximately 155 cash consideration, including 0.5 of direct transaction costs. The primary reason for the acquisition was to develop the Company’s own retail network. The Company has consolidated the financial position and results of operations of VideoFon from the date of acquisition.

T-Pay

In September 2008, the Company completed the acquisition of 100% ownership interest in LLC T-Pay (“T-Pay”), a producer and distributor of prepaid phone cards, for approximately 103 in cash consideration, including 0.5 of direct transaction costs. The primary reason for the acquisition was to utilize T-Pay’s large regional storage network and to reduce internal logistical and distribution costs. The Company has consolidated the financial position and the results of operations of T-Pay from the date of acquisition.

MegaFon

Notes to Consolidated Financial Statements (continued)

3. Business Combinations and Asset Purchase (continued)

Absolut

In December 2008, the Company completed the acquisition of 100% ownership interest in CJSC CC Absolut (“Absolut”) for approximately 2,347 cash consideration, including 4 of direct transaction costs. Absolut owns the building which houses the Company’s corporate office in the center of Moscow.

The table below represents the allocation of the purchase price to the net assets of the entities acquired in 2008, based on their estimated fair values and the associated estimated useful lives.

	InCore	VideoFon	T-Pay	Absolut	Total amounts	Weighted average useful life, years
Tangible assets:						
Buildings	—	—	—	3,131	3,131	45
Telecommunications equipment	239	—	—	—	239	12
Other tangible assets	63	14	34	—	111	7
Identifiable intangible assets:						
Customer base	531	—	—	—	531	3
Software	27	—	17	—	44	7
Other	—	—	—	30	30	N/A
Net working capital	107	2	(26)	(235)	(152)	N/A
Deferred tax asset/(liabilities)	(110)	3	19	(579)	(667)	N/A
Goodwill	168	136	59	—	363	N/A
Total purchase price allocation	1,025	155	103	2,347	3,630	

Acquisitions in 2009

AquaFon and Ostelecom

In March 2009, the Company completed the acquisition of 100% ownership interest in Debton Investment Limited (“Debton”) for approximately 932 cash consideration. As of the acquisition date, Debton owned 51% of CJSC AquaFon GSM (“AquaFon”), a mobile operator in Abkhazia, which owns GSM 900/1800 and UMTS licenses, frequencies and numbering capacity, and 51% of CJSC Ostelecom (“Ostelecom”), a company holding a mobile license and frequencies in South Ossetia. The Company has consolidated the financial position and the results of operations of Debton, including AquaFon and Ostelecom, from the date of acquisition.

MegaFon

Notes to Consolidated Financial Statements (continued)

3. Business Combinations and Asset Purchase (continued)

The primary reason for this acquisition was to facilitate the Company's entry into the mobile telephony market in Abkhazia and South Ossetia, where the Company did not previously have a license to conduct mobile services.

The table below represents the allocation of the purchase price to the acquired net assets of Aquafon and Ostelecom based on their estimated fair values and the associated estimated useful lives.

	Aquafon	Ostelecom	Total amounts	Weighted average useful life, years
Tangible assets:				
Buildings and structures	136	—	136	14
Telecommunications network	435	51	486	5
Identifiable intangible assets:				
Customer base	151	—	151	4
Telecommunication licenses	481	72	553	14
Trademark	67	—	67	10
Software	24	—	24	9
Net working capital	152	(29)	123	N/A
Deferred tax liabilities	(145)	(15)	(160)	N/A
Goodwill	100	35	135	N/A
Noncontrolling interest	(522)	(61)	(583)	N/A
Total estimated purchase price allocation			932	

In December 2009, the Company through Debton acquired additional 24% shares of Ostelecom for cash consideration of \$1 million (30 at the exchange rate as of the date of payment). The Company's overall indirect share stake in Ostelecom increased from 51% to 75%.

4. Property, Plant and Equipment

Property, plant and equipment as of December 31 are as follows:

	2008	2009
Cost:		
Buildings, structures and leasehold improvements	26,327	33,746
Telecommunications network	146,762	176,318
Vehicles, computers, office and other equipment	12,084	14,126
	185,173	224,190
Accumulated depreciation	(75,515)	(99,993)
Construction in-progress	19,033	23,034
Property, plant and equipment, net	128,691	147,231

MegaFon

Notes to Consolidated Financial Statements (continued)

4. Property, Plant and Equipment (continued)

Depreciation expense for the years ended December 31, 2009 and 2008 was 27,946 and 25,224, respectively.

Included in construction in-progress are advances to suppliers of network equipment of 4,174 and 3,729 as of December 31, 2009 and 2008, respectively.

Software and licenses for base stations and billing systems are included in the balances of telecommunications network assets. The net book value of such software was 6,124 and 4,357 as of December 31, 2009 and 2008, respectively.

Interest capitalized was 843 (out of the total interest expense of 2,500) and 830 (out of the total interest expense of 2,661) for the years ended December 31, 2009 and 2008, respectively.

Asset Retirement Obligations

The following table describes the changes to the Company's asset retirement obligations liability:

	<u>2008</u>	<u>2009</u>
Asset retirement obligations at the beginning of the year:	2,235	2,349
Revision in estimated cash flows	(506)	404
Net increase in liability during the year	334	227
Accretion expense	286	323
Asset retirement obligations at the end of the year	<u>2,349</u>	<u>3,303</u>

The accretion expense was included in depreciation and amortization in the consolidated statements of operations.

5. Intangible Assets

Intangible assets as of December 31 are as follows:

	Weighted average amortization period, years	Cost		Accumulated amortization	
		2008	2009	2008	2009
Operating licenses	12	19,129	19,470	(10,887)	(12,319)
Frequencies	17	3,053	3,861	(706)	(926)
Numbering capacity	10	1,503	1,685	(1,384)	(1,417)
Customer base	3	576	727	(24)	(283)
Marketing related intangible assets	5	—	3,317	—	(16)
Other intangible assets	4	3,299	4,910	(1 410)	(2,140)
Total	10	<u>27,560</u>	<u>33,970</u>	<u>(14,411)</u>	<u>(17,101)</u>

MegaFon

Notes to Consolidated Financial Statements (continued)

5. Intangible Assets (continued)

Amortization expense for the years ended December 31, 2009 and 2008 was 3,075 and 2,615, respectively.

Amortization expense for the succeeding five years is expected to be as follows: 2010 – 3,328; 2011 – 3,143; 2012 – 2,883; 2013 – 2,790 and 2014 – 2,616.

Operating licenses

Operating licenses, primarily consist of GSM 900/1800 standard licenses, are integral to operations of the Company and any inability to extend existing licenses on the same or comparable terms could materially affect the Company's business. While operating licenses are issued for a fixed period, renewals of these licenses previously had occurred routinely and at nominal cost. The Company determines that there are currently no legal, regulatory, contractual, competitive, economic or other factors that could result in delays in license renewal, or even an outright refusal to renew. The weighted average period until the next renewal date is approximately 3 years.

The terms of the 3G license require the Company to meet certain conditions, including capital commitments and coverage requirements and is amortized over the period contemplated by the license term (*Note 17*).

Marketing Related Intangible Assets

In April 2009, the Company and OJSC Rostelecom ("Rostelecom") entered into an agreement with the Organizational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi, to acquire rights and licenses to use the Olympic mascot, logos and other Olympic symbols and, in the case of the Company, to be referred to as "the General Mobile Partner of the 2014 XXII Olympic Winter Games". Under the agreement the Company committed to a payment of \$65 million (1,966 at the exchange rate as of December 31, 2009) in cash to be made in several installments from 2009 through 2014. In addition, the Company and Rostelecom are jointly responsible to provide equal amounts of services in-kind of up to a combined total of \$130 million (3,932 at the exchange rate as of December 31, 2009) from 2009 through 2014. The management of the Company believes that the risk of non-performance by Rostelecom of its responsibilities under the agreement is remote.

The Company did not obtain the rights and licenses until the third quarter of 2009, at which time the Company assumed a liability at the net present value of future cash installments of 1,334 and deferred revenue at fair value of 1,516. The recognition of the intangible asset is treated as a non-cash item to the extent of the amount of the liability and deferred revenue recorded. The intangible asset is amortized using the reverse sum-of-the-years'-digits method for approximately 5 years.

The fair value of deferred revenue recognized by the Company was estimated using the Discounted Cash Flow ("DCF") analysis (Level 3). The basis for the Company's cash flow assumptions includes forecasted amounts and timing of services to be provided under the agreement. The Company used 7% as a discount rate.

MegaFon

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans

Long-term loans as of December 31 are as follows:

	<u>2008</u>	<u>2009</u>
Eurobonds (1)	8,403	—
Sberbank loans (2)	495	127
Citibank International Plc., ING BHF-Bank Aktiengesellschaft, and ING Bank N.V. loans (3)	1,665	701
Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft, Citibank N.A. London branch, and ING Bank N.V. loans (4)	10,242	7,355
Citibank N.A. London branch and ING Bank N.V. loan (5)	5,622	3,924
China Development Bank and Bayerische Landesbank (6)	2,497	4,732
Japan Bank for International Cooperation, Citibank N.A. Tokyo branch and Calyon Tokyo branch loan (7)	1,028	756
Nordic Investment Bank loan (8)	441	1,680
BNP Paribas London branch & Nordea Bank Finland PLC (9)	71	6,472
Other loans (10)	1,419	1,399
Total long-term loans	<u>31,883</u>	<u>27,146</u>
Less current portion	15,660	7,811
Non-current portion	<u>16,223</u>	<u>19,335</u>

Loan repayments over the five year period beginning on January 1, 2010 are as follows:

2010	7,811
2011	6,794
2012	4,689
2013	3,871
2014	3,078
Thereafter	<u>903</u>
Total	<u>27,146</u>

At December 31, 2009, the Company's debt was denominated in the following currencies:

	<u>Borrowing currency</u>	<u>Millions of Rubles</u>
Rubles	127	127
US dollars (in millions)	496	14,988
Euros (in millions)	277	12,031
Total long-term loans		<u>27,146</u>

MegaFon

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans (continued)

(1) Eurobonds

In December 2004, an orphan special purpose vehicle, MegaFon S.A., issued \$375 million (10,406 at the exchange rate as of December 31, 2004) of loan participation notes (the “Eurobonds”) at face value. The Eurobonds carried interest at a rate of 8% per annum, payable semi-annually. The proceeds from the Eurobonds were used to finance a loan from MegaFon S.A. to the Company on substantially the same terms and conditions as the Eurobonds. Deferred financing costs of 178 were capitalized in connection with this loan.

During 2007 and 2008, the Company repurchased and cancelled \$89 million face value of the Eurobonds. The Eurobonds matured on December 10, 2009 and were paid in full on that date.

(2) Sberbank

The Company has entered into several credit facilities with Sberbank at various interest rates and maturities. In August 2007, the interest rate on all loans was re-set to 7.5% per annum. The credit facilities matured at dates varying from 2006 through 2010. In January 2010, the Company repaid the aggregate principal amount and related interest in respect to all outstanding credit facilities with Sberbank.

(3) Citibank International Plc., ING BHF-Bank Aktiengesellschaft and ING Bank N.V.

Citibank International Plc. and ING BHF-Bank Aktiengesellschaft and Siemens AG (“Hermes Credit Facility”); Citibank International plc. and ING Bank N.V. and Ericsson AB (“EKN Credit Facility”); Citibank International plc. and ING Bank N.V. and Nokia Corporation (“Finnvera Credit Facility”)

In October 2003, the Company entered into the Hermes Credit Facility for up to 75.4 million Euros (2,629 at the exchange rate as of October 31, 2003). The Hermes Credit Facility can only be used to purchase Siemens AG equipment. The Hermes Credit Facility carries interest at a rate of approximately 4% per annum. The Hermes Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2004 through 2011. The Hermes Credit Facility is guaranteed by Hermes, a German export credit agency. A payment of 4.8 million Euros (167 at the exchange rate as of the date of payment) was required to obtain the guarantee and was capitalized as deferred finance charges.

In May 2004, the Company entered into the EKN Credit Facility for up to \$54 million (1,549 at the exchange rate as of May 31, 2004). The EKN Credit Facility could only be used to purchase Ericsson equipment. The EKN Credit Facility carried interest at a rate of approximately 4% per annum. The EKN Credit Facility required the Company to make semi-annual payments, plus accrued interest, from 2004 through 2009. The EKN Credit Facility was guaranteed by EKN, a Swedish export credit agency. In May 2009, the Company fully repaid the EKN Credit Facility.

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans (continued)

In May 2004, the Company entered into the Finnvera Credit Facility for up to \$135 million (3,913 at the exchange rate as of May 31, 2004). The Finnvera Credit Facility could only be used to purchase Nokia Corporation equipment. The Finnvera Credit Facility carried interest at a rate of approximately 4% per annum. The Finnvera Credit Facility required the Company to make semi-annual payments, plus accrued interest, from 2004 through 2009. The Finnvera Credit Facility was guaranteed by Finnvera, a Finnish export credit agency. In May 2009, the Company fully repaid the Finnvera Credit Facility.

A payment of \$14 million (406 at the exchange rate as of the date of payment) was required to obtain the guarantees for the EKN Credit Facility and the Finnvera Credit Facility and was capitalized as deferred finance charges.

(4) Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft, Citibank N.A. London branch, and ING Bank N.V.

Bayerische Landesbank, Commerzbank Aktiengesellschaft and Siemens AG (“Hermes II Credit Facility”); Bayerische Landesbank, Commerzbank Aktiengesellschaft and Bayerische Landesbank Filiale Di Milano and Siemens Mobile Communications Spa (“SACE Credit Facility”); Citibank, N.A. London branch, ING Bank N.V. and several other financial institutions and Nokia Corporation (“Finnvera II Credit Facility”).

In June 2005, the Company entered into the Hermes II Credit Facility for up to 185 million Euros (6,387 at the exchange rate as of June 30, 2005). The Hermes II Credit Facility can only be used to purchase Siemens AG equipment. The Hermes II Credit Facility carries interest at a rate of Euribor plus 0.35% per annum. The Hermes II Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2006 through 2014. The Hermes II Credit Facility is guaranteed by Hermes, a German export credit agency.

In June 2005, the Company entered into the SACE Credit Facility for up to 74.5 million Euros (2,572 at the exchange rate as of June 30, 2005). The SACE Credit Facility can only be used to purchase Siemens Mobile Communications SpA equipment. The SACE Credit Facility carries interest at a rate of approximately 4% per annum. The SACE Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2006 through 2015. The SACE Credit Facility is guaranteed by SACE, an Italian export credit agency.

In June 2005, the Company entered into the Finnvera II Credit Facility for up to \$321.5 million (9,217 at the exchange rate as of June 30, 2005). The Finnvera II Credit Facility can only be used to purchase Nokia Corporation equipment. The Finnvera II Credit Facility carries interest at a rate of approximately 4% per annum. The Finnvera II Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2005 through 2010. The Finnvera II Credit Facility is guaranteed by Finnvera, a Finnish export credit agency.

A payment of \$45.2 million (1,288 at the exchange rate as of date of payment), in the aggregate, was required to obtain guarantees for these credit facilities and was capitalized as a deferred finance charge.

MegaFon

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans (continued)

- (5) Citibank N.A. London branch and ING Bank N.V.

In June 2006, the Company entered into the Finnvera III Credit Facility for up to 218 million Euros (7,407 at the exchange rate as of June 30, 2006). The Finnvera III Credit Facility can only be used to purchase Nokia Corporation equipment. The Finnvera III Credit Facility carries interest at a rate of approximately 4.3% per annum. The Finnvera III Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2007 through 2011. The Finnvera III Credit Facility is guaranteed by Finnvera, a Finnish export credit agency. Several payments aggregating 6.5 million Euros (225 at the exchange rate as of the dates of payment) were required to obtain the guarantee. These payments were capitalized as deferred finance charges as of each payment date.

- (6) China Development Bank and Bayerische Landesbank (“China Development Bank II Credit Facility”); China Development Bank (“China Development Bank III Credit Facility”)

In October 2007, the Company entered into the China Development Bank II Credit Facility for up to \$85 million (2,102 at the exchange rate as of October 31, 2007). The China Development Bank II Credit Facility can only be used to purchase Huawei equipment. The China Development Bank II Credit Facility carries interest at a rate of LIBOR plus 1.1% per annum. The China Development Bank II Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2009 through 2014.

In June 2009, the Company entered into the China Development Bank III Credit Facility for up to \$300 million (9,387 at the exchange rate as of June 30, 2009). The China Development Bank III Credit Facility can only be used to purchase Huawei equipment. The China Development Bank III Credit Facility carries interest at a rate of LIBOR plus 2.7% per annum. The China Development Bank III Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2011 through 2016.

As of December 31, 2009, the Company has an amount due to Huawei of \$8.3 million (251 at the exchange rate as of December 31, 2009). The Company intends to pay this amount using the proceeds from the China Development Bank III Credit Facility. In the accompanying consolidated balance sheet the Company has classified the amount due to Huawei as long-term debt according to the China Development Bank III Credit Facility repayment schedule.

- (7) Japan Bank for International Cooperation, Citibank Japan Ltd. (formerly Citibank N.A. Tokyo branch) and Calyon Tokyo branch (“JBIC Credit Facility”)

In January 2006, the Company entered into the JBIC Credit Facility for up to \$50 million (1,406 at the exchange rate as of January 31, 2006). The JBIC Credit Facility can only be used to purchase NEC Corporation equipment and limited local content. Tranche A of the JBIC Credit Facility in the amount of \$30 million carries interest at a rate of 6.87% per annum. Tranche B of the JBIC Credit Facility in the amount of \$20 million carries interest at a rate of LIBOR plus 0.45% per annum. The JBIC Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2008 through 2012.

MegaFon

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans (continued)

(8) Nordic Investment Bank (“NIB Credit Facility”)

In October 2004, the Company entered into the NIB Credit Facility for up to \$30 million (863 at the exchange rate as of October 31, 2004). In June 2006, the NIB Credit Facility was amended to increase the amount of the facility from \$30 million to \$50 million (1,354 at the exchange rate as of June 30, 2006). The NIB Credit Facility carries interest at a rate of LIBOR plus 0.85% - 2.20% per annum depending on the international corporate ratings received by the Company from Fitch, S&P and Moody’s. The NIB Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2007 through 2012.

In April 2007, the NIB Credit Facility was amended to increase the amount of the facility from \$50 million to \$100 million (2,569 at the exchange rate as of April 30, 2007). In addition, the NIB Credit Facility was converted to a revolving loan facility, and Nordea and Bayerische Landesbank were added to the lending group.

(9) BNP Paribas London branch, Nordea Bank Finland PLC, Calyon Bank Helsinki branch and KFW Impex Bank (“Finnvera IV Credit Facility”)

In November 2008, the Company entered into the Finnvera IV Credit Facility for up to the US dollar equivalent of 177.7 million Euros (6,322 at the exchange rate as of November 30, 2008). The Finnvera IV Credit Facility can only be used to purchase Nokia Siemens Networks (“NSN”) equipment. The Finnvera IV Credit Facility carries interest at a rate of 4.54% per annum. The Finnvera IV Credit Facility requires the Company to make semi-annual payments, plus accrued interest, from 2010 through 2014. The Finnvera IV Credit Facility is guaranteed by Finnvera, a Finnish export credit agency. The Company is required to make payments aggregating \$10.7 million (324 at the exchange rate as of December 31, 2009) in order to obtain this Finnvera guarantee, and these payments will be made in proportion to the amount of the draw down of the Credit Facility. These payments will be capitalized as deferred finance charges as they are made.

As of December 31, 2009, the Company drew down \$180 million under the Finnvera IV Credit Facility.

As of December 31, 2009, the Company has an amount due to NSN of 23.6 million Euros (1,024 at the exchange rate as of December 31, 2009). The Company intends to pay this amount using the proceeds from Finnvera IV Credit Facility. In accompanying consolidated balance sheet as of December 31, 2009 the Company has classified the amount due to NSN as short-term and long-term debt according to the Finnvera IV repayment schedule.

(10) Other

In addition to the above, the Company has entered into various other credit facilities with maturities from 2006 through 2012 as follows:

Svyazbank – three credit facilities with an aggregate principal amount of 321. As of December 31, 2009, these credit facilities were fully drawn. These credit facilities carry interest at rates between 11% and 12% per annum.

MegaFon

Notes to Consolidated Financial Statements (continued)

6. Long-Term Loans (continued)

UniCredit Bank (formerly International Moscow Bank) – \$25 million (756 at the exchange rate as of December 31, 2009) credit facility. As of December 31, 2009, this credit facility was fully drawn. This credit facility carries interest at a rate of LIBOR plus 3.5% per annum.

Transcontinental Mobile Investment Ltd. – \$2 million (61 at the exchange rate as of December 31, 2009) credit facility. As of December 31, 2009, this credit facility was fully drawn. This credit facility carries interest at a rate of 6% per annum.

Huawei Technologies – \$8.6 million (261 at the exchange rate as of December 31, 2009), of which approximately \$7.4 million is non-interest bearing and the remaining amount carries interest rates between 5% and 8% per annum.

Covenant Requirements

The Hermes, EKN, Finnvera, Hermes II, Finnvera II, SACE, Finnvera III, China Development Bank II, China Development Bank III, JBIC, NIB and Finnvera IV Credit Facilities (*Notes 6 (3), (4), (5), (6), (7), (8) and (9) above*) place various restrictions on the Company related to incurrence of debt, negative pledges, mergers and acquisitions, and material changes in the business without prior consent from the lenders. The Credit Facilities also require the Company to meet various financial and non-financial covenants, including several restrictions related to financial condition.

Undrawn Credit Facilities

In August 2006, the Company entered into a revolving credit facility with UniCredit Bank (“UniCredit Facility”) for up to 4 billion Rubles. As of December 31, 2009, the Company has not borrowed under the UniCredit Facility. The UniCredit Facility carries a rate of interest that depends on the tenor of the loan selected on each drawdown. However, the interest rate cannot exceed 8.25%. The amounts drawn under the UniCredit Facility are to be repaid no later than two years from the date the amounts are drawn. The final maturity is August 2011.

In December 2009, the Company entered into the Credit Facility with BNP Paribas London branch, Calyon Bank Helsinki branch and Nordea Bank Finland plc guaranteed by Finnvera, Finish export credit agency, (“Finnvera V Credit Facility”) for the dollar equivalent of 105 million Euros (4,556 at the exchange rate as of December 31, 2009) at fixed interest rate of 2.91%. The loan proceeds are to be utilized to finance purchases of NSN equipment only. The Finnvera V Credit Facility is to be repaid by 10 equal semi-annual installments over the period from 2011 through 2015. As of December 31, 2009, the full amount of the Finnvera V Credit Facility was unutilized.

7. Loans from Shareholders

In September 2009, the shareholders requested the Company to make early repayment of all outstanding shareholders’ loans. Where required, the relevant consents from lenders were obtained and the shareholders’ loans were fully repaid in December 2009.

MegaFon

Notes to Consolidated Financial Statements (continued)

7. Loans from Shareholders (continued)

Telecominvest

During 2001 to 2003, the Company entered into several loan agreements with Telecominvest aggregating \$28.2 million (829 at the exchange rate as of the date of repayment at December 28, 2009). The loans carried interest at rates between 6% and 10% per annum. The original maturities of the loans were from 2004 through 2009. In November 2004, the loans were extended and amended. The loans were fully repaid in December 2009.

TeliaSonera

During 2001 to 2003, the Company entered into several loan agreements with affiliates of TeliaSonera aggregating \$45 million (1,324 at the exchange rate as of the date of repayment at December 28, 2009). The loans carried interest at rates between 0% and 10% per annum. The original maturities of the loans were from 2004 through 2009. In November 2004, the loans were extended and amended. The loans were fully repaid in December 2009.

IPOC and Amikitia Investments Limited

In 2003, the Company entered into several loan agreements with IPOC aggregating \$16 million (489 at the exchange rate as of the date of repayment at December 22, 2009). The loans carried interest at a rate of 6% per annum. The original maturity of the loans was July 2004. In November 2004, the loans were extended and amended. In December 2008, the Company received notice from IPOC that, in conjunction with its liquidation, all of its rights in respect of the loans have been assigned to Amikitia Investments Limited, an affiliate of Telecominvest. In December 2009 the rights to the loans were transferred to AF Telecom Holding Limited. The loans were fully repaid in December 2009.

CT Mobile

In 2001, Sonic Duo, a wholly-owned subsidiary of the Company, entered into three Ruble denominated interest-free loan agreements with CT Mobile aggregating 624. The loans had no stated maturity. The first two loans with an aggregate principal of 527 were callable by CT Mobile not earlier than December 31, 2008 and the third loan was callable by CT Mobile not earlier than December 31, 2030. In December 2008, Sonic Duo paid the first two loans in the amount of 527 and in February 2009, Sonic Duo paid the third loan in the amount of 97.

8. Derivative Financial Instruments

In 2009, the Company entered into a number of dual-currency deposits with various banks. The dual-currency deposits are financial instruments which combine features of a time deposit and a sold foreign currency put option. The dual-currency deposits are settled either in the original deposit currency (Euro or US Dollar) or in another pre-agreed currency (Ruble, US Dollar or Euro) depending on which currency has depreciated relative to the other currency since the date of entering into the dual-currency deposit. All dual-currency deposits bear over-the-market interest rates which include a put option premium payable upon settlement. The purpose of entering into these financial instruments is for yield enhancement on the Company's foreign currency cash investments.

MegaFon

Notes to Consolidated Financial Statements (continued)

8. Derivative Financial Instruments (continued)

As of December 31, 2009, the Company held 25 million Euros (1,084 million Rubles at the exchange rate as of December 31, 2009) and \$30 million (907 million Rubles at the exchange rate as of December 31, 2009) of deposits which are classified as cash and cash equivalents in the consolidated balance sheets.

The respective embedded derivative financial instrument, which is the put option, is bifurcated and measured at fair value using the Black-Scholes model (Level 2). For accounting purposes, the Company reports all gains and losses from the change in fair value of these derivative financial instruments directly in the consolidated statements of operations.

In the third quarter of 2006 and the second quarter of 2007, the Company entered into several long-term fixed-to-fixed rate cross-currency swaps. These derivative financial instruments are used to limit exposure to changes in foreign currency exchange rates on certain long-term debt denominated in foreign currencies.

The swaps effectively converted, using the then-effective foreign currency exchange rates, some of the Company's outstanding fixed-to-fixed rate long-term US dollar and Euro denominated loans (specifically the EKN, Finnvera, Finnvera II and Finnvera III Credit Facilities) into synthetically equivalent Ruble long-term loans with fixed rates ranging from 3.95% to 6.65%. The carrying amount of such long-term loans was 7,006 as of December 31, 2008 and 3,501 as of December 31, 2009. For accounting purposes, the Company has chosen not to designate these derivatives as hedging instruments and, therefore reports all gains and losses from the change in fair value (Level 2) of these derivative financial instruments directly in the consolidated statements of operations.

Gains/(losses) on derivatives for the years ended December 31 are as follows:

	<u>2008</u>	<u>2009</u>
Put options sold	—	655
Foreign currency swaps	2,322	(955)
Total gain/(loss) on derivatives, net	<u>2,322</u>	<u>(300)</u>

The derivatives are valued using standard valuation techniques as no quoted market prices exist for the instruments. The principal technique used to value these instruments is through comparing the foreign currency exchange rates at the time that the derivatives were acquired to the forward exchange rates quoted in the existing market which is inactive as of the valuation date. The key inputs include interest rate yield curves, foreign exchange spot and forward rates. The fair value of these derivatives includes the effects of the counterparty's non-performance risk, including credit risk.

MegaFon

Notes to Consolidated Financial Statements (continued)

8. Derivative Financial Instruments (continued)

Fair values of these derivative financial instruments in the consolidated balance sheets as of December 31 are presented below:

Derivative instruments	Balance sheet location	2008	2009
Put options sold	Other current assets	—	6
Foreign currency swaps	Other current assets	888	406
	Other non-current assets	1,342	328
Total derivatives		2,230	740

The fair value of financial instruments, including cash, cash equivalents and derivative financial instruments, which are included in current assets and liabilities, accounts receivable and accounts payable approximates the carrying value of these items due to the short-term nature of these amounts.

As of December 31, 2009, the fair value of fixed and variable rate debt approximated its carrying value. As of December 31, 2008, the fair value of fixed and variable rate long-term loans (based on future cash flows discounted at current market rates) was 35,387.

The Company, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of financial instruments. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. While management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Company manages these risks and monitors their exposure on a regular basis.

9. Long-Term Incentive Program

In April 2008, the Company's Board of Directors approved a long-term motivation and retention program. The program provides that certain key executive and senior level employees will be eligible for awards of phantom share options. The phantom share options can be awarded under the 2008 Grant and 2009 Grant. Under both grants, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the value of the Company, which in turn is calculated as six times operating income before depreciation and amortization (OIBDA) reduced by debt, net of cash and cash equivalents and short-term investments (net debt). The awarded phantom share options will vest every two years over a four-year period and are contingent upon the recipient's continuing employment with the Company and increase in the value of the Company. The in-the-money phantom share options will be settled in cash upon vesting.

MegaFon

Notes to Consolidated Financial Statements (continued)

9. Long-Term Incentive Program (continued)

The following table summarizes information as of December 31, 2009 regarding outstanding phantom share options exercisable upon maturity.

	Number of phantom share options granted	Total unrecognized compensation cost	Compensation expense, inclusive of all related taxes of the year ended December 31,	
			2008	2009
2008 Grant	4,156	656	53	719
2009 Grant	4,503	343	—	15
Total	8,659	999	53	734

10. Revenues

Revenues for the years ended December 31 are as follows:

	2008	2009
Revenues from local subscribers	146,689	150,023
Roaming charges to other wireless operators	2,120	1,811
Revenues from interconnection charges	24,383	25,732
Connection fees	248	86
Sales of handsets and accessories	1,252	2,385
Other revenues	759	1,846
Total revenues	175,451	181,883

11. Cost of Services

Cost of services for the years ended December 31 are as follows:

	2008	2009
Interconnection charges	30,625	31,314
Cost of SIM-cards	1,232	1,350
Roaming expenses	2,207	1,793
Cost of handsets and accessories sold	1,363	2,387
Other costs	—	21
Total cost of services	35,427	36,865

MegaFon

Notes to Consolidated Financial Statements (continued)

12. Sales and Marketing Expenses

Sales and marketing expenses for the years ended December 31 are as follows:

	<u>2008</u>	<u>2009</u>
Advertising	7,471	6,200
Commissions to dealers for connection of new subscribers	5,573	7,763
Commissions to dealers for distribution of prepaid cards and cash collection from subscribers	3,411	3,398
Total sales and marketing expenses	<u>16,455</u>	<u>17,361</u>

13. Operating Expenses

Operating expenses for the years ended December 31 are as follows:

	<u>2008</u>	<u>2009</u>
Salaries and social charges	11,365	13,514
Rent	7,182	8,919
Operating taxes	4,035	4,388
Network repairs and maintenance	3,784	3,502
Radio frequency fees	2,270	2,651
Bad debt expense (<i>Note 15</i>)	321	1,122
Office maintenance	1,504	1,324
Professional services	953	697
Materials and supplies	378	234
Inventory write-down (<i>Note 17</i>)	—	339
Insurance	257	152
Other expenses	3,274	2,623
Total operating expenses	<u>35,323</u>	<u>39,465</u>

Rent represents expenses related to the operating lease of premises for offices, base stations and switches.

14. Income Taxes

The following presents the significant components of the Company's provision for income taxes for the years ended December 31:

	<u>2008</u>	<u>2009</u>
Current income taxes	15,330	10,555
Deferred income tax expense	144	10
Total income taxes	<u>15,474</u>	<u>10,565</u>

MegaFon

Notes to Consolidated Financial Statements (continued)

14. Income Taxes (continued)

Income taxes represent the Company's provision for profit tax. Profit tax is calculated at 20% and 24% of taxable profit for the years ended December 31, 2009 and 2008, respectively, since, in accordance with the laws of the Russian Federation, effective January 1, 2009 the corporate income tax rate decreased by 4%.

The reconciliation between the provision for income taxes reported in the consolidated financial statements versus the provision for income taxes computed by applying the Russian enacted statutory tax rate to income before income taxes and minority interest is as follows:

	2008	2009
Income before income taxes and noncontrolling interest	59,770	55,865
Statutory income tax rate	24%	20%
Theoretical provision for income taxes	14,345	11,173
Non-deductible expenses	1,197	596
Effect of income tax preferences	—	(628)
Recognized tax benefits	—	(340)
Other differences	117	(236)
Effect of change in income tax rate	(185)	—
Provision for income taxes reported in the consolidated financial statements	15,474	10,565

The effect of income tax preferences, in the table above, represents the impact of lower income tax rates for the Company under applicable regional laws of the Russian Federation. These laws provide that income tax exemptions up to 6.5% are granted to entities which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects. These exemptions are granted on an annual basis.

As of December 31, 2009, the tax years ended December 31, 2007, 2008 and 2009 remained subject to examination by the tax authorities.

The amounts reported in the accompanying consolidated financial statements at December 31 consisted of the following:

	2008	2009
Deferred tax assets:		
Revenue recognition	367	426
Loss carry-forwards	553	135
Accrued compensation and social contributions	256	608
Other assets	415	668
Total deferred tax assets	1,591	1,837
Deferred tax liabilities:		
Intangible assets	1,599	1,453
Property, plant and equipment	436	1,074
Derivative financial instruments	446	148
Other liabilities	8	230

MegaFon

Notes to Consolidated Financial Statements (continued)

14. Income Taxes (continued)

Total deferred tax liabilities	2,489	2,905
Net deferred tax liabilities	898	1,068
Add non-current deferred tax assets	94	691
Add current deferred tax assets	1,167	772
Total long-term deferred tax liabilities	2,159	2,531

For income tax purposes of the Russian Federation and Tajikistan, certain of the Company's subsidiaries have net operating loss carry-forwards ("NOLs") incurred from 2001 through 2009, which may be carried forward ten years to offset future taxable income. The use of these NOLs is not restricted in 2009 or in future years. As of December 31, 2009, these subsidiaries had NOLs available for carry-forward aggregating approximately 608 with a related tax benefit of 135 which expires in 2014.

As of December 31, 2009 the Company analyzed its tax positions for uncertainties affecting recognition and measurement thereof. Following the analysis, the Company believes that it is more likely than not that the majority of all deductible tax positions stated in the income tax return would be sustained upon the examination by the tax authorities.

15. Valuation and Qualifying Accounts

The following summarizes the changes in the allowance for doubtful accounts for the years ended December 31:

	2008	2009
Balance at the beginning of the year	222	511
Bad debt expense	321	1,122
Accounts receivable written off	(32)	(772)
Allowance for doubtful accounts at the end of the year	511	861

16. Related Party Transactions

The Company has entered into certain transactions with its shareholders and their affiliates. The outstanding receivable and payable balances and the annual revenues and costs are as follows:

	As of December 31,	
	2008	2009
Accounts receivable, related parties		
TeliaSonera (1)	31	15
Turkcell Iletisim (4)	12	2
Azercell Telekom B.M (5)	14	5
Peterservice (7)	13	4
Other	11	9
Total accounts receivable, related parties	81	35

MegaFon

Notes to Consolidated Financial Statements (continued)

16. Related Party Transactions (continued)

	As of December 31,	
	2008	2009
Accounts payable, related parties		
TeliaSonera (1)	10	147
Telecominvest (3)	—	2
Turkcell Iletisim (4)	12	2
Peterservice (7)	323	300
Yugosetinsvyazinvest (10)	—	29
Other	20	22
	<hr/>	<hr/>
Total accounts payable, related parties	365	502
	<hr/> <hr/>	<hr/> <hr/>
	For the years ended	
	December 31,	
	2008	2009
	<hr/>	<hr/>
Revenues		
TeliaSonera (1)	151	130
Turkcell Iletisim (4)	84	45
Azercell Telekom B.M (5)	34	38
Latvijas Mobilais SIA (6)	42	20
Other	102	66
	<hr/>	<hr/>
Total revenues, related parties	413	299
	<hr/> <hr/>	<hr/> <hr/>
Cost of services		
TeliaSonera (1)	44	720
Turkcell Iletisim (4)	122	63
Other	70	80
	<hr/>	<hr/>
Total cost of services, related parties	236	863
	<hr/> <hr/>	<hr/> <hr/>
Sales, Marketing and Operating expenses		
Altimo (2)	—	17
Telecominvest (3)	125	80
Peterservice (7)	506	616
Sportivny Kanal 7TV (8)	—	116
Kelly Services (9)	26	—
Other	12	23
	<hr/>	<hr/>
Total operating expenses, related parties	669	852
	<hr/> <hr/>	<hr/> <hr/>

(1) *TeliaSonera* – settlements on roaming and interconnect services.

(2) *Altimo* – provision of legal and personnel services under the agreement with Altimo, a member of the Alfa Group, effective from April 2009.

MegaFon

Notes to Consolidated Financial Statements (continued)

16. Related Party Transactions (continued)

- (3) *Telecominvest* – provision of legal and personnel services under the agreement effective from April 2009. In 2008 and 2009 Telecominvest provided invoice delivery services to customers of the Company.
- (4) *Turkcell Iletisim* – primarily settlements on roaming services. Turkcell Iletisim is an affiliate of TeliaSonera.
- (5) *Azercell Telekom B.M* – primarily settlements on roaming services. Azercell Telekom B.M is an affiliate of TeliaSonera.
- (6) *Latvijas Mobilais SIA* – primarily settlements on roaming services. Latvijas Mobilais SIA is an affiliate of TeliaSonera.
- (7) *Peterservice* – the Company purchased billing system and related support services from Peterservice, an affiliate of Telecominvest, in the amount of 1,127 during 2008 and 1,465 during 2009.
- (8) *Sportivny Kanal 7TV* – purchases of advertising space from the Sportivny Kanal 7TV, an affiliate of Telecominvest.
- (9) *Kelly Services* – payments for outsourcing of personnel. This company was an affiliate of one of the members of the Board of Directors. In April 2008, Kelly Services ceased to be a related party to the Company.
- (10) *Yugosetinsvyazinvest* – loan and interest payable to noncontrolling shareholder of Ostelecom, a subsidiary of the Company (*Note 3*).

Bank deposits

The Company maintains bank deposit accounts with Alfa Bank, a member of the Alfa Group. The amounts on deposits as of December 31, 2009 and 2008 were 3,202 and 2,206, respectively.

17. Commitments, Contingencies and Uncertainties

Leases

The Company has various cancelable and non-cancelable operating lease agreements for land, equipment and office. Future minimum lease payments under non-cancelable operating leases with terms of one year or more, as of December 31, 2009, are as follows:

2010	115
2011	115
2012	111
2013	66
2014 and thereafter	45
Total	452

MegaFon

Notes to Consolidated Financial Statements (continued)

17. Commitments, Contingencies and Uncertainties (continued)

Russian Environment and Current Economic Situation

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 Russian government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in a decline in the gross domestic product, capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian government has introduced a range of stabilization measures aimed at providing liquidity to Russian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Company and its counterparties, which could affect the Company's financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's results and financial position in a manner not currently determinable.

Telecom licenses capital commitments

In May 2007, MegaFon was awarded a license that expires on May 21, 2017, for the provision of 3G mobile radiotelephony communications services for the entire territory of the Russian Federation. The 3G license was granted subject to certain capital and other commitments. The three major conditions are that the Company will have to build a certain number of base stations that support 3G standards, will have to start commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also will have to build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the license. As of March 9, 2010, the Company is in full compliance with these license conditions, including constructing the required number of base stations required at this time.

Taxation

Russian tax, currency and customs legislation are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Company may be challenged by the relevant regional and federal authorities. Recent events within Russia suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

MegaFon

Notes to Consolidated Financial Statements (continued)

17. Commitments, Contingencies and Uncertainties (continued)

Based on tax examinations of other telecommunications companies operating in Russia, the tax authorities are currently focusing on a number of specific areas, which include, but are not limited to revenues from interconnection charges and marketing initiatives. As a result of such examinations, the tax authorities are claiming additional taxes which are currently being disputed in the courts by these Russian telecommunications companies.

Management believes that the Company and its subsidiaries are in compliance with the tax laws affecting its operations; however, the risk remains that governmental authorities could take differing positions with regard to interpretative issues.

Litigation

The Company is not a party to any material litigation, although in the ordinary course of business, some of the Company's subsidiaries may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which they operate. In the opinion of management, the Company's and its subsidiaries liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Company.

Commitments

In August 2008, the Company entered into a two-year fixed commitment with Apple Sales International ("Apple"), an Irish affiliate of Apple Computer Inc., to purchase a total of one million unlocked iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled this requirement with respect to the fourth quarter of 2008, but due to the significantly reduced handset demand brought about by the economic crisis in Russia, the Company experienced difficulty re-selling these iPhones. As a result, the Company did not purchase the additional quarterly minimum quantities of iPhones as per the contract.

The Company has had several discussions with Apple, and believes that Apple is interested in continuing business relationship with the Company. There can be no assurance, however, that Apple will not bring a claim against the Company in respect of the contract. In light of the uncertainty as to whether a claim will be made and, if made, as to the amount which Apple may be able to claim, the Company is not able to estimate the amount of loss, if any, that the Company may sustain.

In June 2009, the Company recorded an inventory write-down to lower-of-cost-or-market value of 242 related to its iPhones stock. The write-down was recorded as operating expense in the consolidated statements of operations.

In March 2009, the Company entered into an eighteen-month distribution contract with Euroset, one of the largest Russian mobile retailers, to connect approximately 7.2 million subscribers. The total cash consideration for this deal was approximately \$146 million, of which approximately \$97 million (3,292 as of April 9, 2009, the date of the payment) has been prepaid and a promissory note has been issued for the remaining amount. Management believes that as of March 9, 2010, the Euroset is in full compliance with these contract conditions.

Notes to Consolidated Financial Statements (continued)

18. Subsequent Events

In February 2010 the Federal Anti-Monopoly Service (“FAS”) announced that it is considering launching a formal investigation into the roaming charges levied by the Company and the other two major mobile operators, MTS and Vimpelcom, under Part 1 of Article 10 of the Federal law on competition. As alleged by the mass-media, in making this announcement, the FAS asserted that the charges were “unreasonably overpriced”, on the basis that an analysis carried out by the Interstate Council for Anti-Monopoly Policy showed that the roaming charges levied by the three operators were 2 to 2.5 times higher than comparable tariffs charged by other international operators and also 3 to 6 times higher than the European Commission would permit on the territory of the European Union. The Company does not believe that it is in violation of the competition law but, if its roaming charges and practices are found to be anti-competitive, the Company could face certain fines (under Article 14.31 of the Russian Federation Administrative Code, the maximum amount of such fine is 15% of overall roaming revenues). As of March 9, 2010, the Company has not received any official documents from the FAS, and, therefore, cannot evaluate the probability of such fines.

In February 2010, the Board of Directors of the Company provided their approval for the Company to enter into a Share Purchase Agreement (“SPA”) with Synterra Cyprus Limited and Burnham Advisors Limited to acquire 100% of the ownership interest in CJSC Synterra (Synterra), an alternative telecommunications operator in Russia. While negotiations regarding the transaction are continuing, the purchase price is anticipated to be approximately \$700 million including the assumption of Synterra’s external debt. The consummation of the transaction is conditioned upon, among other things, agreeing the terms of and executing the SPA, the receipt of all necessary regulatory approvals in Russia and satisfaction of all conditions precedent which will be defined in the SPA.