

**MEGAFON**

**Consolidated Financial Statements**

*Years ended December 31, 2007 and 2006  
with Report of Independent Auditors*

# MEGAFON

## Consolidated Financial Statements

Years ended December 31, 2007 and 2006

### Contents

Report of Independent Auditors .....	1
Consolidated Financial Statements	
Consolidated Balance Sheets .....	2
Consolidated Statements of Income .....	3
Consolidated Statements of Cash Flows.....	4
Consolidated Statements of Shareholders' Equity .....	5
Notes to Consolidated Financial Statements.....	6



Ernst & Young LLC  
Sadovnicheskaya Nab., 77, bld. 1  
Moscow, 115035, Russia  
Tel: +7 (495) 705 9700  
+7 (495) 755 9700  
Fax: +7 (495) 755 9701  
[www.ey.com/russia](http://www.ey.com/russia)

ООО «Эрнст энд Янг»  
Россия, 115035, Москва  
Садовническая наб., 77, стр. 1  
Тел: +7 (495) 705 9700  
+7 (495) 755 9700  
Факс: +7 (495) 755 9701  
ОКПО: 59002827

## 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, 2007 and 2006, and the related consolidated statements of income, 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, 2007 and 2006, 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.

*Ernst & Young LLC*

April 17, 2008

# MegaFon

## Consolidated Balance Sheets

(In millions of Rubles, except share amounts)  
(Note 2)

	Note	December 31,		
		2006	2007	2007
				Convenience translation, thousands US \$
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	3	6,965	4,259	\$ 173,510
Short-term investments		569	21,710	884,455
Accounts receivable, net of allowance for doubtful accounts of 222 in 2007 and 143 in 2006	4	4,740	5,443	221,745
Accounts receivable, related parties	21	418	104	4,237
Inventories		457	468	19,066
VAT receivable		3,322	2,372	96,634
Deferred tax assets	20	739	1,111	45,262
Prepayments and other current assets	5	2,469	3,704	150,898
Total current assets		19,679	39,171	1,595,807
Property, plant and equipment, net	6	87,600	102,817	4,188,714
Intangible assets, net	7	13,740	12,745	519,225
Other non-current assets	8	1,680	1,764	71,864
Total assets		122,699	156,497	\$ 6,375,610
<b>Liabilities and shareholders' equity</b>				
Current liabilities:				
Accounts payable	9	4,553	5,436	\$ 221,460
Accounts payable and accruals to equipment suppliers		2,387	3,061	124,704
Accounts payable, related parties	21	586	519	21,144
Subscribers' prepayments		5,515	5,794	236,045
Deferred revenue, current portion		1,238	499	20,329
Accrued liabilities	10	2,663	3,790	154,403
Loans from shareholders, current portion	12	–	433	17,640
Debt, current portion	11	7,496	10,130	412,691
Other current liabilities		143	260	10,592
Total current liabilities		24,581	29,922	1,219,008
Debt, net of current portion	11	31,893	26,003	1,059,349
Loans from shareholders	12	3,241	2,877	117,208
Other non-current liabilities	14	1,945	2,632	107,226
Deferred tax liabilities	20	1,449	1,228	50,028
Total liabilities		63,109	62,662	2,552,819
Commitments and contingencies	23	–	–	–
Minority interest		55	35	1,426
Shareholders' equity:	15			
Common stock (par value of 10 Rubles, 6,200,002 shares authorized, issued and outstanding)		581	581	23,670
Reserve fund		17	17	693
Additional paid-in capital		13,875	13,875	565,261
Retained earnings		45,309	79,591	3,242,496
Accumulated other comprehensive loss	2	(247)	(264)	(10,755)
Total shareholders' equity		59,535	93,800	3,821,365
Total liabilities and shareholders' equity		122,699	156,497	\$ 6,375,610

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

# MegaFon

## Consolidated Statements of Income

(In millions of Rubles)  
(Note 2)

	Note	Years ended December 31,		
		2006	2007	2007 Convenience translation, thousands US \$
<b>Revenues (including related party amounts of 1,605 in 2007 and 1,826 in 2006)</b>	16, 21	101,115	140,393	\$ 5,719,541
Cost of services, excluding depreciation and amortization (including related party amounts of 1,435 in 2007 and 2,475 in 2006)	17, 21	17,442	26,304	1,071,612
<b>Gross margin</b>		83,673	114,089	4,647,929
Sales and marketing expenses	18	11,066	13,647	555,972
Operating expenses (including related party amounts of 680 in 2007 and 841 in 2006)	19, 21	22,507	28,854	1,175,498
Depreciation and amortization	6, 7	18,393	24,187	985,366
<b>Operating income</b>		31,707	47,401	1,931,093
Other income and expenses:				
Interest expense		2,866	2,476	100,871
Change in fair value of derivative financial instruments (C-loans)		777	–	–
Other income, net		(273)	(1,164)	(47,421)
Net foreign exchange gain	13	(2,358)	(490)	(20,003)
Total other expenses, net		1,012	822	33,447
<b>Income before income taxes and minority interest</b>		30,695	46,579	1,897,646
Provision for income taxes	20	8,684	12,633	514,662
Minority interest in earnings/(loss) of a subsidiary		22	(20)	(815)
<b>Net income</b>		21,989	33,966	\$ 1,383,799

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

# MegaFon

## Consolidated Statements of Cash Flows

(In millions of Rubles)  
(Note 2)

	Years ended December 31,		
	2006	2007	2007 Convenience translation, thousands US \$
<b>Cash flows from operating activities:</b>			
Net income	21,989	33,966	\$ 1,383,799
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	18,393	24,187	985,366
Net foreign exchange gain	(2,358)	(490)	(20,003)
Minority interest in net earnings/(loss) of a subsidiary	22	(20)	(815)
Provision for deferred income taxes	(856)	(593)	(24,158)
Change in fair value of derivative financial instruments (C-loans)	777	–	–
Amortization of deferred finance charges and other non-cash items	1,257	1,182	48,154
Decrease/(increase) in:			
Accounts receivable	(2,221)	(590)	(24,036)
Accounts receivable, related parties	(326)	122	4,970
Inventories	120	(43)	(1,752)
VAT receivable	738	951	38,743
Prepayments and other current assets	(654)	(1,172)	(47,747)
Increase/(decrease) in:			
Accounts payable	1,874	668	27,214
Accounts payable, related parties	145	172	7,007
Deferred revenue	739	(734)	(29,903)
Subscribers' prepayments	742	279	11,366
Accrued liabilities	299	1,125	45,834
Net cash provided by operating activities	40,680	59,010	2,404,039
<b>Cash flows from investing activities:</b>			
Purchases of property, plant and equipment and intangible assets	(33,203)	(35,894)	(1,462,303)
Proceeds from sale of property, plant and equipment	–	218	8,881
Increase in short-term investments	(569)	(21,172)	(862,537)
Other non-current assets	475	(47)	(1,915)
Net cash used in investing activities	(33,297)	(56,895)	(2,317,874)
<b>Cash flows from financing activities:</b>			
Proceeds from long-term debt	7,238	6,305	256,863
Repayments of long-term debt and C-loans	(15,076)	(10,812)	(440,476)
Deferred finance charges paid	(154)	(176)	(7,170)
Capital lease principal repayments	(106)	(10)	(407)
Net cash used in financing activities	(8,098)	(4,693)	(191,190)
Effect of exchange rate changes on cash and cash equivalents	(192)	(128)	(5,216)
<b>Net decrease in cash and cash equivalents</b>	(907)	(2,706)	(110,241)
Cash and cash equivalents at the beginning of the year	7,872	6,965	283,751
<b>Cash and cash equivalents at the end of the year</b>	<b>6,965</b>	<b>4,259</b>	<b>\$ 173,510</b>
<b>Supplemental cash flow information:</b>			
Cash paid during the year for income taxes	9,885	14,013	\$ 570,883
Cash paid during the year for interest, net of amounts capitalized	2,512	2,532	103,152
Non-cash financing and investing activities:			
Equipment purchased under credit (See Note 11)	954	1,835	74,757

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)

(Note 2)

	<u>Common stock</u>		Reserve fund	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Comprehensive income (loss)	Total
	Shares	Amount						
<b>Balances as of December 31, 2005</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,875</b>	<b>23,320</b>	<b>–</b>	<b>–</b>	<b>37,793</b>
<b>Comprehensive income</b>								
Net income	–	–	–	–	21,989	–	21,989	<b>21,989</b>
Foreign currency translation adjustment	–	–	–	–	–	(224)	<u>(224)</u>	<b>(224)</b>
Total comprehensive income	–	–	–	–	–	–	<u><b>21,765</b></u>	–
Effect of adoption of SFAS No.158, (net of tax effect of zero)	–	–	–	–	–	(23)		<u><b>(23)</b></u>
<b>Balances as of December 31, 2006</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,875</b>	<b>45,309</b>	<b>(247)</b>		<u><b>59,535</b></u>
<b>Comprehensive income</b>								
Net income	–	–	–	–	33,966	–	33,966	<b>33,966</b>
Pensions costs (net of tax effect of zero)	–	–	–	–	–	(17)	<u>(17)</u>	<b>(17)</b>
Total comprehensive income	–	–	–	–	–	–	<u><b>33,949</b></u>	–
Effect of adoption of FIN No.48	–	–	–	–	316	–		<u><b>316</b></u>
<b>Balances as of December 31, 2007</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,875</b>	<b>79,591</b>	<b>(264)</b>		<u><b>93,800</b></u>

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

# MegaFon

## Notes to Consolidated Financial Statements

December 31, 2007 and 2006

*(In millions of Rubles, unless otherwise indicated)*

### 1. Description of Business

Open joint stock company (or “OJSC”) MegaFon (the “Company” or “MegaFon”) is a provider of a broad range of wireless telecommunications services to businesses, other telecommunications service providers and retail subscribers.

The Company and its subsidiaries have operating licenses for all Federal Districts of the Russian Federation, covering 100% of its population. MegaFon has built and is expanding a nationwide mobile communications network that operates on the dual band GSM-900/1800 standard. The Company is also operating an IMT-2000 UMTS network in St. Petersburg.

In April 2007, the results of the tender for the 3G licenses were announced. MegaFon was one of three companies that were granted a federal license allowing them to provide 3G services in Russia. In accordance with the conditions of the license, the Company must start commercial exploitation of the 3G technology in 86 regions at various dates over the period from May 2008 through May 2010.

As at December 31, 2007, MegaFon included the following operating entities:

<b>Company</b>	<b>Ownership interest</b>	<b>Region / License area</b>	<b>Date operations started</b>
<b>MegaFon:</b> (NW GSM branch)	N/A	St. Petersburg and St. Petersburg region	December 1994
<b>Subsidiaries:</b>			
Sonic Duo	100%	Moscow and Moscow Region	November 2001
MCS Povolzhie	100%	Volzhsky Federal District	August 1999
Mobicom Center	100%	Central Federal District	December 2002
Ural GSM	100%	Urals Federal District	June 2002
Mobicom Caucasus	100%	Southern Federal District	January 2001
Mobicom Novosibirsk	100%	Siberian Federal District	December 2003
Mobicom Khabarovsk	100%	Far East Federal District	March 2004
TT-Mobile	75%	Republic of Tajikistan	October 2001

During January 2007, Volzhsky GSM and Mobicom Kirov were merged with and into MCS Povolzhie and Ural GSM, respectively.



# MegaFon

## Notes to Consolidated Financial Statements (continued)

### **2. Summary of Significant Accounting Policies**

The principal accounting policies adopted for the preparation of the accompanying consolidated financial statements are set out below.

#### **Basis of Presentation**

The statutory accounting records of the Company and its subsidiaries, except for TT-Mobile, are maintained in Rubles and are prepared in accordance with the accounting requirements provided for under Russian law and accounting practices. The accounting records of TT-Mobile are maintained in the local currency and in accordance with the accounting practices of the Republic of Tajikistan. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The accompanying financial statements differ from statutory financial statements used in Russia and the Republic of Tajikistan because 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 revenue recognition, deferred taxation, consolidation, accounting for derivatives, and valuation and depreciation of property, plant and equipment and intangible assets.

As further discussed in “Foreign Currency Translation Methodology” below, effective January 1, 2007, the Company’s reporting currency changed from the US dollar to the Ruble.

#### **Basis of Consolidation**

The Company consolidates all entities for which it has voting or effective control. All significant intra-group balances and transactions are eliminated in consolidation.

#### **Management Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The most significant estimates with regard to the accompanying consolidated financial statements relate to the useful lives of tangible and intangible assets, deferred revenue, asset retirement obligation, fair value of derivative financial instruments, income tax provision and recoverability of deferred taxes.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Foreign Currency Translation Methodology

The Company's functional currency is the Ruble as the largest portion of its revenues, capital expenditures and operating costs are denominated in Rubles. The Company changed its functional currency from the US dollar to the Ruble effective January 1, 2006.

Until December 31, 2006, the Company continued to use the US dollar as its reporting currency. Effective January 1, 2007, the Company changed its reporting currency from the US dollar to the Ruble, since this is the currency of the prime economic environment in which substantially all operations of the Company are conducted.

Prior period comparative financial statements have been recast to the Ruble using a methodology consistent with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation". All assets and liabilities were translated using the December 31, 2006 exchange rate. Shareholders' equity was translated at the applicable historical rates. Income and expenses were translated using the quarterly average exchange rates. The objective of this procedure is to present comparative financial statements as if the Company had always used the Ruble as its reporting currency.

The US dollar amounts disclosed in the accompanying consolidated financial statements are presented solely for the convenience of the reader and have been translated at the exchange rate of 24.5462 Rubles per US dollar as of December 31, 2007, the exchange rate determined by the Central Bank of the Russian Federation as of such date. This translation should not be construed as representing that the Ruble amounts actually represent or have been, or could be, converted into US dollars at that exchange rate or at any other rate of exchange.

#### Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts. Cash equivalents represent short-term cash deposits held at banks with an original maturity of three months or less. Cash equivalents are carried at cost, which approximates fair value.

#### Short-Term Investments

Short-term investments represent investments in notes receivable and time deposits, which have original maturities in excess of three months but less than twelve months. These investments are accounted for 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.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Accounts Receivable

Accounts receivable are stated net of an allowance for accounts identified as doubtful. The Company provides an allowance for doubtful accounts based on management's periodic review of accounts receivable, including an assessment of the delinquency of these account balances.

#### Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the first in – first out (“FIFO”) method. Inventories are mainly comprised of SIM-cards and prepaid phone cards.

#### Value-Added Tax

Value-added taxes (“VAT”) related to revenues are generally payable to the tax authorities on an accrual basis when invoices are issued to customers and dealers. VAT incurred for purchases may be reclaimed or offset, subject to certain restrictions, against VAT related to revenues. VAT related to purchases which are not currently reclaimable as of the balance sheet dates are recognized in the balance sheets on a gross basis as VAT receivable.

VAT receivable in turn may be recoverable from the tax authorities via an offset against future VAT payable to the tax authorities on MegaFon's revenue or via direct cash receipts from the tax authorities.

Management reviews the recoverability of the balance of VAT receivable and believes that the amounts reflected in the financial statements are fully recoverable within one year with the exception of 57 and 44 which are therefore classified as non-current assets at December 31, 2007 and December 31, 2006, respectively (see Note 8).

#### 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.

#### Intangible Assets

Intangible assets represent numbering capacity, capitalized licenses and other intangible assets.

The Company and its subsidiaries have numerous operating licenses granted by the Ministry of Telecommunications and Information of the Russian Federation. License costs represent either an allocation of the purchase price to licenses acquired in business combinations or payments made to government organizations to receive the licenses. License costs are

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Intangible Assets (continued)

capitalized and amortized on a straight-line basis over their expected useful lives of ten to twelve years from the date operations commenced in the license area. Management believes that all existing operating licenses will be renewed in the future without substantial cost. The licenses expire between 2008 and 2013.

Numbering capacity represents payments made to acquire access to telephone numbers and the use of telephone lines. Numbering capacity costs are amortized over periods up to six years using the straight-line method.

Other intangible assets are amortized on a straight-line basis over their estimated useful lives, generally from two to ten years.

All intangible assets are subject to periodic review for indications of impairment.

#### Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation. 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 so as to amortize the cost of the assets over their expected useful lives. The expected useful lives are as follows:

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

Leasehold improvements are amortized 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.

The cost of maintenance, repairs, and replacement of minor items of property, plant and equipment are expensed. Betterments of property are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are removed from the accounts. Any resulting gains or losses are included in the determination of operating results.

In 2007 and 2006, the Company revised its estimates of useful lives and residual values of certain equipment. These revisions were reflected through an additional charge to depreciation, which resulted in a decrease of net income for 2007 and 2006 by approximately 1,139 and 421, respectively. These revisions represent the outcome of a comprehensive

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Property, Plant and Equipment (continued)

management analysis of the estimated future usage, residual values and timing of disposal of these assets.

The Company accounts for asset retirement obligations in accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record 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 remaining useful life of the asset. 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 has certain legal obligations related to rented sites for base stations and masts, which fall within the scope of SFAS No. 143. These legal obligations include requirements to restore the real estate upon which the base stations and masts are located.

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 changes in accordance with the provisions of SFAS No. 143.

#### Impairment of Long-Lived Assets

The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Company compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets.

When these undiscounted cash flows are less than the carrying amounts of the assets, the Company will record impairment losses to write-down the asset to fair value, measured by the discounted estimated net future cash flows expected to be generated from the assets. During the years ended December 31, 2007 and 2006, no such impairments have occurred.

#### Subscribers' Prepayments

Amounts received from subscribers in advance of services being provided are deferred and recognized as revenues when the services are provided.

#### Interest Free Loans from Shareholders

The Company accounts for interest free loans from non-controlling shareholders in accordance with Accounting Principles Board Opinion No. 21 "Interest on Receivables and Payables". Accordingly, these loans 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 statements of shareholders' equity. The accretion of imputed interest is included as interest expense in the accompanying statements of income.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Revenue Recognition

Revenues are categorized as follows:

- Revenue from subscribers, including subscription fees, usage charges, fees for value-added services and the fees charged to subscribers for roaming outside MegaFon's network;
- Roaming fees charged to other wireless operators for guest roamers utilizing MegaFon's network;
- Revenue from interconnection charges;
- Connection fees; and
- Other: technical support, sales of handsets and accessories.

Revenues are stated net of VAT charged to customers.

#### *Subscription Fees*

The Company recognizes monthly subscription fees as revenue in the month when the service is provided.

#### *Usage Charges and Value Added Services Fees*

Usage charges consist of fees based on airtime or data services used by the subscriber. The Company recognizes revenues related to usage charges and value-added services in the period when the services are rendered.

For prepaid subscribers, the Company recognizes revenues for services provided to subscribers with negative (i.e., debit) account balances only upon subsequent collection of the cash from such subscribers.

The Company presents revenue from some value-added services (e.g., content services) on a gross basis when the Company is responsible for providing the content and on a net basis when the content service provider is responsible for providing the content.

#### *Prepaid Phone Cards*

Prepaid phone cards allow subscribers to make a predetermined monetary amount of wireless phone calls and/or take advantage of other services, such as short messages and sending or receiving of faxes. At the time that the prepaid phone card is purchased, the receipt of cash is recorded as a subscriber prepayment. Revenues are recognized in the period when services are actually rendered. Unused value relating to phone cards is recognized as revenue when the prepaid phone card expires.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Revenue Recognition (continued)

##### *Roaming Fees*

The Company charges roaming fees (generally on a per-minute basis) to other wireless operators for “guest” roamers utilizing MegaFon’s network. The Company recognizes revenues from roaming fees in the period when the services are rendered.

##### *Interconnection fees*

The Company rents telecommunication channels to the other telecommunications operators in Russia. Also, the Company charges other operators for terminating traffic on the Company’s network (see Note 17). The Company records these charges as interconnection revenue. The Company recognizes revenue from rent and for termination of traffic in the month when the services are provided.

##### *Connection Fees*

Connection fees consist of non-refundable charges received from subscribers at the time of service initiation. The Company defers revenue from initial connection fees and recognizes them as revenue over the estimated average subscriber lives. These estimated average subscriber lives differ by region and by type of tariff plans and range from six to twenty months.

##### *Other*

The Company provides technical support to the other telecommunication operators in Russia. The Company recognizes revenue from technical support in the month when the services are rendered. Also, the Company sells a relatively small quantity of handsets and accessories. The Company recognizes revenues from the sale of handsets and accessories upon the transfer of handsets and accessories to a customer.

##### *Arrangements with Multiple Deliverables*

Certain of the Company’s commercial arrangements constitute a contractual arrangement with multiple deliverables. In accordance with the Emerging Issues Task Force Consensus No. 00-21, “Revenue Arrangements with Multiple Deliverables”, the Company allocates the consideration received from a subscriber to the separate units of accounting inherent in the contract based on their relative fair values.

##### *Discounts and Commissions to Dealers*

Dealers purchase service contracts and prepaid phone cards from the Company at a discount and resell them to subscribers at prices set by the Company. Also, dealers collect payments for services from subscribers and remit them to the Company. In turn, the Company pays dealers a commission which is determined as a percentage of amounts collected. The respective discounts and commissions are recorded as a part of sales and marketing expenses.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Revenue Recognition (continued)

Also, the Company pays dealers a commission for each subscriber connected, depending on region, class or type of subscriber connected and other factors, including average revenue per subscriber for certain time periods. The Company recognizes the entire estimated commission payable when the subscriber is connected by the dealer.

#### Advertising Costs

Advertising costs are expensed as incurred (see Note 18).

#### Retirement Benefit Obligations

Both the Company and its subsidiaries are legally obliged to make defined contributions to the National Pension Fund, managed by the Russian Federation Social Security (a defined contribution plan). The Company has no legal or constructive obligation to pay future benefits under this plan. Its only obligation is to pay contributions as they fall due. The Company's contributions relating to defined contribution plans are calculated as a percentage of employees' compensation and expensed in the year to which they relate. Contributions to the National Pension Fund for the years ended December 31, 2007 and 2006 were 959 and 740, respectively.

Additionally, the Company has a noncontributory defined benefit pension plan that covers approximately half of the employees at one of its locations. The net pension benefit obligation and the related periodic net pension cost are based on, among other things, assumptions of the discount rate, estimated return on plan assets, salary increases and the mortality of participants. Before December 31, 2006, actuarial gains and losses were deferred and amortized over future periods. As of December 31, 2006 the Company adopted the provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)". SFAS No. 158 requires the Company to recognize the funded status of a defined benefit plan as an asset or liability in the statement of financial position and to recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The adoption of SFAS No. 158 at December 31, 2006 resulted in an adjustment to accumulated other comprehensive income of 23.

#### Income Taxes

Provision is made in the financial statements for taxation of profits in accordance with Russian legislation currently in force. The Company accounts for income taxes under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes". Under the liability method, deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement basis 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. The effect on deferred tax assets and liabilities of a change in the tax rates is recognized in income in the period that includes the enactment date. 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. These



# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Income Taxes (continued)

evaluations are based on the reversals of the various taxable temporary differences, tax-planning strategies and expectations of future taxable income.

As of January 1, 2007 and December 31, 2007, the Company did not have unrecognized income tax benefits which are more than inconsequential.

The Company does not provide for deferred taxes on the undistributed earnings of its subsidiaries, as such earnings are not anticipated to be distributed in a taxable manner.

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109". FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In addition, FIN No. 48 states that income taxes should not be accounted for under the provisions of SFAS No. 5, "Accounting for Contingencies".

The adoption of FIN No. 48 resulted in a cumulative effect adjustment increasing the opening balance of retained earnings as of January 1, 2007 by approximately 316. As of December 31, 2007, an asset in the amount of 497 was recorded, of which 182 and 315 are included in other current and non-current assets, respectively.

Although the Company believes it is more likely than not that all recognized income tax benefits would be sustained upon examination, the Company has recognized certain income tax benefits that have a reasonable possibility of being successfully challenged by the tax authorities (also see Note 23). If these income tax positions are successfully challenged by the tax authorities, this could result in a reduction in total unrecognized tax benefits of up to 160. However, the Company does not believe that it is reasonably possible that this will occur.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income taxes. As of December 31, 2007, the tax years ended December 31, 2005, 2006 and 2007 remained subject to examination by the tax authorities.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### 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, including Svyazbank, a related party (see Notes 3 and 21). Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within Russia. To manage the credit risk, MegaFon allocates its available cash to a limited number of Russian banks and domestic branches of international banks. Some of these Russian banks are state owned. Management periodically reviews the credit worthiness of the banks in which it deposits cash.

The Company extends credit to certain counterparties, principally international and national telecom operators, for roaming services, and to certain dealers, and establishes an allowance for doubtful accounts for specific accounts that it believes represent a potentially significant credit risk. The Company generally requires its subscribers to prepay for services, except for corporate subscribers that it deems reliable.

Starting in 2005, a significant portion of the Company's collection of cash from subscribers is handled by a single "master" dealer who, for a commission, produces and sells payment cards to sub-dealers, and collects and remits to the Company the funds received from the sub-dealers. Payments are due to the Company not later than 16 days after the payment cards are shipped to the sub-dealers. Because of the additional credit risk which this arrangement presents, management regularly monitors the status of receivables from this "master" dealer to ensure that settlements are made when they become due (see Note 4).

A significant portion of Company's sales and purchases of roaming and interconnection services is performed with related parties. Respective payables and receivables are not significant (see Note 21).

#### Comprehensive Income (Loss)

SFAS No. 130, "Reporting Comprehensive Income", requires the reporting of comprehensive income in addition to net income. Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources.

The components of accumulated other comprehensive loss, net of tax, are as follows:

	Foreign currency translation adjustment	Defined benefit pension plan	Accumulated other comprehensive loss
<b>Balance as of December 31, 2005</b>	—	—	—
Change for the period	224	23	247
<b>Balance as of December 31, 2006</b>	<b>224</b>	<b>23</b>	<b>247</b>
Change for the period	—	17	17
<b>Balance as of December 31, 2007</b>	<b>224</b>	<b>40</b>	<b>264</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### **2. Summary of Significant Accounting Policies (continued)**

#### **Derivative Instruments and Hedging Activities**

The Company follows the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Certain Hedging Activities", as amended. SFAS No. 133, as amended, requires that all derivative instruments be recorded 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, this 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 statement of income. The Company does not hold or issue derivatives for trading purposes.

#### **Comparative Information**

Certain prior year amounts and disclosures have been reclassified to conform to the 2007 presentation.

#### **New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", which clarifies the definition of fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for the year beginning January 1, 2008. The Company is currently evaluating the impact of adopting SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to SFAS No. 115". SFAS No. 159 permits companies to elect to measure many financial instruments and certain other items at fair value. SFAS No. 159 does not affect any existing accounting standards that require certain assets and liabilities to be carried at fair value. SFAS No. 159 is effective for the year beginning January 1, 2008. The Company is currently evaluating the impact of adopting SFAS No. 159 on its financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS No. 141R"), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The requirements of SFAS No. 141R will be effective for the year beginning January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 141R on its financial statements.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### New Accounting Pronouncements (continued)

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51” (“SFAS No. 160”), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. The requirements of SFAS No. 160 will be effective for the year beginning January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 160 on its financial statements.

### 3. Cash and Cash Equivalents

Cash and cash equivalents are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Bank deposits and cash on hand	2,767	2,723
Time deposits	4,198	1,536
<b>Total cash and cash equivalents</b>	<b>6,965</b>	<b>4,259</b>

Time deposits as of December 31, 2007 and 2006 have an interest yield from 2.2% to 9.5% and from 2% to 7.25%, respectively, and have original maturities of 90 days or less. These deposits can be withdrawn before their maturity dates without penalties.

As of December 31, 2007 and 2006, 678 and 535 of cash and cash equivalents were on deposit with Svyazbank, a related party (see Notes 2 and 21).

### 4. Accounts Receivable

Accounts receivable are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Subscribers	326	691
Roaming (other wireless operators)	456	449
The “master” dealer (see Note 2)	1,249	730
Other dealers	1,359	1,539
Interconnection	1,379	2,166
Other	114	90
Less allowance for doubtful accounts	(143)	(222)
<b>Total accounts receivable, net</b>	<b>4,740</b>	<b>5,443</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 5. Prepayments and Other Current Assets

Prepayments and other current assets are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Prepaid taxes	1,142	<b>1,997</b>
Advances for advertising	132	<b>129</b>
Advances for other services	620	<b>753</b>
Other current assets	575	<b>825</b>
<b>Total prepayments and other current assets</b>	<b>2,469</b>	<b>3,704</b>

Advances for other services mainly relate to interconnection, network maintenance, rent prepayments for sales offices and base station facilities, office maintenance and advances to dealers. Prepaid taxes mainly relate to prepaid income taxes, which amounted to 1,827 and 1,085 as of December 31, 2007 and 2006, respectively.

### 6. Property, Plant and Equipment

Property, plant and equipment are comprised of:

	<b>Buildings, structures and leasehold improvements</b>	<b>Telecom- munications network</b>	<b>Vehicles, computers, office and other equipment</b>	<b>Construction in-progress</b>	<b>Total</b>
<b>Cost:</b>					
At December 31, 2006	9,225	93,394	6,777	12,999	122,395
Additions	–	–	–	<b>37,296</b>	<b>37,296</b>
Transfers	<b>6,175</b>	<b>26,660</b>	<b>2,629</b>	<b>(35,464)</b>	–
Disposals	<b>(75)</b>	<b>(3,328)</b>	<b>(219)</b>	<b>(174)</b>	<b>(3,796)</b>
<b>At December 31, 2007</b>	<b>15,325</b>	<b>116,726</b>	<b>9,187</b>	<b>14,657</b>	<b>155,895</b>
<b>Accumulated depreciation:</b>					
At December 31, 2006	1,366	30,643	2,786	–	34,795
Charges	<b>1,049</b>	<b>18,208</b>	<b>2,410</b>	–	<b>21,667</b>
Disposals	<b>(28)</b>	<b>(3,202)</b>	<b>(154)</b>	–	<b>(3,384)</b>
<b>At December 31, 2007</b>	<b>2,387</b>	<b>45,649</b>	<b>5,042</b>	–	<b>53,078</b>
<b>Net book value at December 31, 2007</b>	<b>12,938</b>	<b>71,077</b>	<b>4,145</b>	<b>14,657</b>	<b>102,817</b>
<b>Net book value at December 31, 2006</b>	<b>7,859</b>	<b>62,751</b>	<b>3,991</b>	<b>12,999</b>	<b>87,600</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 6. Property, Plant and Equipment (continued)

Depreciation expense for the year ended December 31, 2006 was 15,900.

Included in construction in-progress are advances to suppliers of network equipment of 1,943 and 1,226 as of December 31, 2007 and 2006, respectively.

Software and licenses for base stations and billing systems are included in the balances of telecommunications network assets. The net book value is 4,494 and 4,437 as of December 31, 2007 and 2006, respectively.

Interest capitalized was 804 (out of the total interest expense of 3,280) and 808 (out of the total interest expense of 3,674) for the years ended December 31, 2007 and 2006, respectively.

In 2007, the Company decided to replace certain telecommunications equipment. Most of this equipment remained in use as of December 31, 2007 and is expected to be de-installed during 2008. As part of the arrangement to replace the equipment, certain of this equipment will be sold. In connection with the decision to replace the equipment, the Company re-evaluated the remaining useful lives of such equipment, resulting in the useful lives being re-set to periods ranging from 18 to 24 months as of April 1, 2007. Subsequently, in October 2007, the Company revised its estimates of the remaining useful lives of such equipment, resulting in useful lives being re-set to periods ranging from 9 to 21 months. In connection with these revisions the Company recorded additional depreciation expense of 809 for the year ended December 31, 2007. After taking into account this additional depreciation, the net book value of the assets to be sold as of December 31, 2007 was approximately 173. Equipment which will be replaced, but which was still in use as of December 31, 2007, was classified as property, plant and equipment. The acceleration of depreciation expense had the effect of decreasing net income by 615 for the year ended December 31, 2007, net of income tax.

#### *Asset Retirement Obligations*

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

	<u>2006</u>	<u>2007</u>
Asset retirement obligations at the beginning of the year	599	1,740
Liability recognized during the year	364	637
Revision in estimated cash flows	691	(335)
Accretion expense	86	214
Liability settled in the current period	—	(21)
<b>Asset retirement obligations at the end of the year</b>	<u>1,740</u>	<u>2,235</u>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 7. Intangible Assets

Intangible assets are comprised of:

	Operating licenses	Numbering capacity	Other intangible assets	Total
<b>Cost:</b>				
At December 31, 2006	18,916	2,135	3,240	24,291
Additions	4	14	1,507	1,525
Disposals	–	(11)	(176)	(187)
<b>At December 31, 2007</b>	<b>18,920</b>	<b>2,138</b>	<b>4,571</b>	<b>25,629</b>
<b>Accumulated amortization:</b>				
At December 31, 2006	7,640	1,799	1,112	10,551
Charges	1,624	233	663	2,520
Disposals	–	(11)	(176)	(187)
<b>At December 31, 2007</b>	<b>9,264</b>	<b>2,021</b>	<b>1,599</b>	<b>12,884</b>
<b>Net book value at December 31, 2007</b>	<b>9,656</b>	<b>117</b>	<b>2,972</b>	<b>12,745</b>
<b>Net book value at December 31, 2006</b>	<b>11,276</b>	<b>336</b>	<b>2,128</b>	<b>13,740</b>

Amortization expense for the year ended December 31, 2006 was 2,493.

Amortization expense for the next five years is expected to be as follows: 2008 – 2,429; 2009 – 2,128; 2010 – 1,984; 2011 – 1,811 and 2012 – 1,722.

### 8. Other Non-Current Assets

Other non-current assets are comprised of:

	December 31, 2006	December 31, 2007
VAT receivable	44	57
Deferred finance charges (see Note 11)	1,479	1,086
Other	157	621
<b>Total other non-current assets</b>	<b>1,680</b>	<b>1,764</b>

### 9. Accounts Payable

Accounts payable are comprised of:

	December 31, 2006	December 31, 2007
Roaming	369	374
Interconnection	2,052	2,130
Dealers	689	1,118
Other accounts payable	1,443	1,814
<b>Total accounts payable</b>	<b>4,553</b>	<b>5,436</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 10. Accrued Liabilities

Accrued liabilities are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Accrued taxes	1,222	<b>1,801</b>
Salary and social contributions	701	<b>1,415</b>
Accrued interest	328	<b>195</b>
Other accrued liabilities	412	<b>379</b>
<b>Total accrued liabilities</b>	<b>2,663</b>	<b>3,790</b>

### 11. Long-Term Loans

Long-term loans are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Nordea and Bayerische Hypo- und Vereinsbank AG loan (1)	817	<b>416</b>
Ruble Bonds (2)	4,500	<b>3,000</b>
Eurobonds (3)	9,874	<b>8,296</b>
Sberbank loans (4)	2,522	<b>1,508</b>
Citibank International Plc., ING BHF-Bank Aktiengesellschaft, and ING Bank N.V. loans (5)	4,144	<b>2,732</b>
Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft, Citibank N.A. London branch, and ING Bank N.V. loans (6)	11,449	<b>11,507</b>
Citibank N.A. London branch and ING Bank N.V. loan (7)	2,902	<b>6,500</b>
China Development Bank, Citibank International Plc., and Citibank N.A. London branch loan (8)	1,343	–
China Development Bank and Bayerische Landesbank (9)	–	<b>126</b>
Japan Bank for International Cooperation, Citibank N.A. Tokyo branch and Calyon Tokyo branch loan (10)	1,013	<b>1,105</b>
Nordic Investment Bank loan (11)	395	<b>368</b>
Other loans (12)	430	<b>575</b>
<b>Total long-term loans</b>	<b>39,389</b>	<b>36,133</b>
Less current portion	7,496	<b>10,130</b>
<b>Non-current portion</b>	<b>31,893</b>	<b>26,003</b>



# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 11. Long-Term Loans (continued)

Loan repayments over the four-year period beginning on January 1, 2008 are as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
<b>Total</b>	<b>10,130</b>	<b>14,336</b>	<b>4,527</b>	<b>7,140</b>	<b>36,133</b>

Lenders whose loans mature after 2011 (see Notes 11(6), (9), (10), (11)) may be entitled to require the early prepayment of the outstanding amount of these loans if the Company elects to repay certain specific loans from shareholders maturing in 2011 (see Note 12). The maturity table above assumes such prepayment of these loans.

At December 31, 2007, the Company's debt was denominated in the following currencies:

	<u>Borrowing currency</u>	<u>Millions of Rubles</u>
Rubles	4,508	4,508
US dollars (in millions)	660	16,208
Euros (in millions)	429	15,417
<b>Total long-term loans</b>		<b>36,133</b>

#### (1) Nordea and Bayerische Hypo- und Vereinsbank AG (Nordea/HVB)

In November 2004, the Company entered into a loan agreement with Nordea/HVB for approximately \$51 million (1,434 at the exchange rate as of November 30, 2004). The loan is guaranteed by EKN, a Swedish export credit agency. This loan bears interest at LIBOR plus 0.8% and is repayable over the period from 2005 to 2008. The loan also requires the Company to meet various financial and non-financial covenants. Deferred financing costs of 41 were capitalized in connection with this loan.

#### (2) Ruble Bonds

In April 2004, the Company issued 1.5 billion of Ruble bonds. The bonds were issued at face value bearing interest at an annual rate of 9.28% payable semi-annually. The Company redeemed these bonds at their maturity in April 2007.

In April 2005, the Company issued 3 billion of Ruble bonds. The bonds were issued at face value bearing interest at an annual rate of 9.25% payable semi-annually. The Company redeemed these bonds at their maturity in April 2008.

#### (3) Eurobonds

In December 2004, 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 with interest at 8% payable semi-annually. The Eurobonds mature in December 2009. 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.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 11. Long-Term Loans (continued)

In July and August 2007, the Company purchased a total \$37 million face value of its Eurobonds (950 at the exchange rates as of the transaction dates) for approximately 990. In connection with this Eurobonds repurchase, the Company recognized a loss in the amount of approximately 30 for the year ending December 31, 2007.

#### (4) Sberbank

The Company has entered into several credit line agreements with Sberbank. As of December 31, 2006, the interest on outstanding Sberbank loans ranged from 8.5% to 9%. In August 2007, the interest rate was reduced to 7.5% under all credit line agreements with Sberbank. The loans are repayable at various dates from 2006 to 2010. As of December 31, 2007, 1,608 remained undrawn under the Sberbank credit line agreements.

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

In October 2003, the Company entered into the Hermes Credit for 75.4 million Euros (2,629 at the exchange rate as of October 31, 2003) with interest at approximately 4%. This credit line can only be used for purchases of Siemens AG equipment. The loan is guaranteed by Hermes, a German export credit agency. A payment of 4.8 million Euros (167 at the exchange rate as of date of payment) was required to obtain this guarantee and has been capitalized as deferred finance charges. The Hermes Credit is repayable semi-annually from 2004 through 2011.

In May 2004, the Company entered into the EKN Credit and the Finnvera Credit for approximately \$54 million and \$135 million (1,549 and 3,913 at the exchange rate as of May 31, 2004), respectively, with interest at approximately 4%. The EKN and Finnvera credit lines can only be used for purchases of Ericsson and Nokia equipment, respectively. The loans are guaranteed by EKN, a Swedish export credit agency, and Finnvera, a Finnish export credit agency, respectively. A payment of \$14 million (406 at the exchange rate as of date of payment) was made to obtain these guarantees, which has been capitalized as deferred finance charges. These credits are repayable semi-annually from 2004 through 2009.

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

In June 2005, the Company entered into (1) the Hermes II Credit for 185 million Euros (6,387 at the exchange rate as of June 30, 2005) with interest at Euribor plus 0.35%, (2) the SACE Credit for 74.5 million Euros (2,572 at the exchange rate as of June 30, 2005) with interest at approximately 4% and (3) the Finnvera II Credit for \$321.5 million (9,217 at the exchange rate as of June 30, 2005) with interest at approximately 4%.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 11. Long-Term Loans (continued)

These loans are guaranteed by Hermes, a German export credit agency, SACE, an Italian export credit agency and Finnvera, a Finnish export credit agency, respectively. A payment of \$45.2 million (1,288 at the exchange rate as of date of payment) in the aggregate was made to obtain these guarantees, which has been capitalized as deferred finance charges.

The Hermes II, SACE and Finnvera II Credits can only be used for purchases of Siemens AG, Siemens Mobile Communications Spa and Nokia Corporation equipment, respectively. The amounts drawn under the Hermes II and the SACE Credits are repayable semi-annually from 2006 through 2015. The amounts drawn under the Finnvera II Credit are repayable semi-annually from 2005 through 2010.

- (7) Citibank N.A. London branch and ING Bank N.V. and Nokia Corporation (“Finnvera III Credit”)

In June 2006, the Company entered into the Finnvera III Credit for 218 million Euros (7,407 at the exchange rate as of June 30, 2006) with interest at approximately 4.3%. This loan is guaranteed by Finnvera, a Finnish export credit agency. A payment of 6.5 million Euros (225 at the exchange rate as of date of payment) of insurance premium was required to obtain this guarantee and is capitalized as deferred finance charges as each payment is made. The Finnvera III Credit can only be used for purchases of Nokia Corporation equipment. The amounts drawn under the Finnvera III Credit are repayable semi-annually from 2007 through 2011.

- (8) China Development Bank, Citibank International Plc. and Citibank N.A. London branch (“China Development Bank Credit”)

In December 2005, the Company entered into a credit facility agreement with China Development Bank, Citibank International Plc. and Citibank N.A. London branch (“China Development Bank Credit”) for \$51 million (1,468 at the exchange rate as of December 31, 2005) with interest at LIBOR plus 2.5%. The proceeds under the credit facility can only be used for purchases of Huawei equipment. The amounts drawn under the China Development Bank Credit were repayable semi-annually from 2007 through 2011. In December 2007, the Company early repaid the total amount outstanding under the credit facility.

- (9) China Development Bank and Bayerische Landesbank (“China Development Bank II Credit”)

In October 2007, the Company entered into a credit facility agreement with China Development Bank and Bayerische Landesbank (“China Development Bank II Credit”) for \$85 million (2,102 at the exchange rate as of October 31, 2007) with interest at LIBOR plus 1.1%. The proceeds under the credit facility can only be used for purchases of Huawei equipment. Amounts drawn under this credit facility are repayable from 2009 through 2014 in semi-annual installments.

As of December 31, 2007, the Company has an amount due to Huawei of 126. As the Company intends to repay this amount using the proceeds from the China Development Bank II Credit, the Company has classified the amount due to Huawei as long-term debt in the accompanying balance sheet as of December 31, 2007.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 11. Long-Term Loans (continued)

- (10) Japan Bank for International Cooperation, Citibank N.A. Tokyo branch and Calyon Tokyo branch

In January 2006, the Company entered into a credit facility agreement with Japan Bank for International Cooperation, Citibank N.A. Tokyo branch and Calyon Tokyo branch (“JBIC Credit”) for \$50 million (1,406 at the exchange rate as of January 31, 2006) with interest at 6.87% for Tranche A in the amount of \$30 million and LIBOR plus 0.45% for Tranche B in the amount of \$20 million. The proceeds under JBIC Credit can only be used for purchases of NEC Corporation equipment or limited local content. The amounts drawn under the JBIC Credit are repayable semi-annually from 2008 through 2012.

- (11) Nordic Investment Bank

In October 2004, the Company entered into a credit agreement with Nordic Investment Bank for \$30 million (863 at the exchange rate as of October 31, 2004). In June 2006, the Company amended this credit agreement, increasing the amount of the facility from \$30 million to \$50 million (1,354 at the exchange rate as of June 30, 2006). The amounts drawn under the Nordic Investment Bank Credit are repayable semi-annually from 2007 through 2012 and bear interest at LIBOR plus 0.85-2.20% depending on the Fitch, S&P and Moody’s international corporate ratings received by the Company.

In April 2007, the Company amended its credit agreement with Nordic Investment Bank, increasing the amount of the facility from \$50 million to \$100 million (2,569 at the exchange rate as of April 30, 2007), converting the credit facility into a revolving loan facility (“Revolving Loan Facility”), and adding other banks to the lending group.

As of December 31, 2007, \$85 million (2,086 at the exchange rate as of December 31, 2007) remained undrawn under the Nordic Investment Bank credit line agreements.

- (12) Other

The Company has entered into other credit agreements as follows – Svyazbank, a related party, for two loans under which an aggregate of 391 is outstanding, and which bear interest at 11% and 12%; Transcontinental Mobile Investment Ltd. (see Note 21), for \$2 million (63 at the exchange rate as of August 31, 2002) with interest at 6%; and Huawei Technologies for \$5.5 million (134 at the exchange rate as of December 31, 2007) without interest. These loans have varying maturities ranging from 2006 to 2012.

#### *Covenant Requirements*

The Nordea/HVB, Eurobonds, Hermes, EKN, Finnvera, Hermes II, Finnvera II, SACE, Finnvera III, China Development Bank, JBIC, and Nordic Investment Bank credit agreements (see Notes 11(1), (3), (5), (6), (7), (8), (9), (10) and (11) above) place various restrictions on the Company related to incurrence of debt, negative pledges, mergers and acquisitions, and changes in the business without prior consent from the lenders. The agreements also require the Company to meet various financial and non-financial covenants.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 11. Long-Term Loans (continued)

#### *Undrawn Credit Facilities*

In August 2006, the Company entered into a revolving credit facility with UniCredit Bank (former International Moscow Bank) for 4 billion Rubles with an interest rate which depends on the tenor of the loan selected on each drawdown. However, the interest rate cannot exceed 8.25% (“UniCredit Bank Revolving Credit”). The amounts drawn under the UniCredit Bank Revolving Credit are to be repaid no later than two years from the date the amounts are drawn. The final maturity is in August 2011. As of December 31, 2007, the UniCredit Bank Revolving Credit remains undrawn.

### 12. Loans from Shareholders

Long-term loans from shareholders are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Telecominvest (1)	955	947
TeliaSonera (2)	1,395	1,402
IPOC (3)	534	527
CT Mobile (4)	357	434
<b>Total long-term loans</b>	<b>3,241</b>	<b>3,310</b>
Less current portion	–	433
<b>Non-current portion</b>	<b>3,241</b>	<b>2,877</b>

Shareholder loan repayments over the five-year period beginning on January 1, 2008 are as follows:

<b>Year</b>	
2008	527
2009-2010	–
2011	2,876
2012	–
After 2012	97
Total repayments	3,500
Less unamortized discount	(190)
<b>Total long-term loans</b>	<b>3,310</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 12. Loans from Shareholders (continued)

In November 2004, the Company signed an amendment to existing loan agreements with Telecominvest, TeliaSonera and IPOC which capitalized (i.e., included in the underlying loans) the accrued but unpaid interest on certain loans and extended the maturity of all of these loans to the earlier of September 30, 2011 or a date ninety days after the payment in full of the Hermes, EKN and Finnvera Credits (see Note 11(5)). Also, the repayment of these shareholder loans is subordinated to the Nordea/HVB, Hermes, EKN, Finnvera, Hermes II, Finnvera II, SACE, Finnvera III, China Development Bank, JBIC, and Nordic Investment Bank credit agreements (see Notes 11(1), (5), (6), (7), (8), (9), (10), (11)) and also to the Eurobonds (see Note 11(3)).

#### (1) Telecominvest

In 2001-2003, the Company entered into several loan agreements with Telecominvest aggregating \$28.2 million (691 at the exchange rate as of December 31, 2007) and bearing interest at 6-10%. The original maturities of the loans were in 2004-2009. These loans were extended and amended in November 2004 as discussed above.

#### (2) TeliaSonera

In 2001-2003, the Company received several loans from TeliaSonera affiliated entities aggregating \$45 million (1,105 at the exchange rate as of December 31, 2007) with interest at 0-10%. The original maturities of the loans were in 2004-2009. The loans were extended and amended in November 2004 as discussed above.

#### (3) IPOC

In 2003, the Company received loans from IPOC aggregating \$16 million (394 at the exchange rate as of December 31, 2007) with interest at 6% that had an original maturity of July 2004. The loans were extended and amended in November 2004 as discussed above.

#### (4) CT Mobile

In 2001, Sonic Duo received three Ruble denominated interest-free loans from CT Mobile aggregating 624. The loans have no stated maturity. The first two loans with an aggregate principal of 527 are callable by CT Mobile not earlier than December 31, 2008 and the third loan is callable by CT Mobile not earlier than December 31, 2030.

Effective September 2004, the interest rate on these loans was changed to the 6-month LIBOR rate plus 4%. Interest accruing after September 2004 will not be capitalized but will be payable together with principal at maturity.

### 13. Derivative Financial Instruments

#### 1) C-loans

Under the C-loan agreements, each of the European Bank for Reconstruction and Development and International Finance Corporation advanced \$12 million (371 at the exchange rate as of February 28, 2002) in the aggregate to Sonic Duo. In connection with the acquisition of Sonic Duo in February 2002, the Company assumed the liability under these C-loan agreements.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 13. Derivative Financial Instruments (continued)

The C-loan agreements provided that the repayment amount of the loans would be equal in the aggregate to 3.5528% of the fair value of MegaFon at the applicable repayment date (or 1.7764% of MegaFon's fair value for each lender).

Under the agreements, the loans were to have been repaid no later than December 31, 2009. Repayment of the loans was also required upon the occurrence of certain events.

The Company accounted for the C-loans in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended. In 2002, a liability equal to the excess of the fair value of the C-loans over \$12 million (371 at the exchange rate as of February 28, 2002) was included in the purchase price allocation. Subsequent changes in the fair value of the C-loans were recorded in the consolidated statement of income. During 2006, the fair value of the C-loans increased by 185.

In July 2006, the Company fully prepaid the C-loans in the amount of \$188 million (5,052 at the exchange rate as of July 31, 2006).

#### 2) Foreign Currency Swap Agreements

During July – September 2006 and May – June 2007, the Company entered into several long-term fixed-to-fixed cross-currency swaps. These derivative financial instruments are used to limit exposure to changes in foreign currency exchange rates on certain long-term indebtedness denominated in foreign currencies.

The swaps effectively converted, using the then-effective foreign currency exchange rates, some of the Company's outstanding fixed-rate long-term US dollar and Euro denominated loans (specifically the EKN, Finnvera, Finnvera II and Finnvera III credit agreements) 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 as of December 31, 2007 was approximately \$217 million and 117 million Euro (9,512 at the exchange rate as of December 31, 2007).

For accounting purposes, the Company has chosen not to designate these swaps as hedging instruments and, therefore reports all gains and losses from the change in fair value of these derivative financial instruments directly in the consolidated statement of income as part of net foreign exchange gain.

These derivative financial instruments were recorded at fair value as of December 31, 2007 and included in other non-current assets in the amount of 191, other current liabilities in the amount of 260, and in other non-current liabilities in the amount of 176.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 14. Other Non-current Liabilities

Other non-current liabilities are comprised of:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
Asset retirement obligations (see Note 6)	1,740	<b>2,235</b>
Obligation under defined benefit pension plan	138	<b>191</b>
Other non-current liabilities	67	<b>206</b>
<b>Total other non-current liabilities</b>	<b>1,945</b>	<b>2,632</b>

### 15. Shareholders' Equity

The reserve fund, an element of Russian corporate law, represents a portion of the Company's earnings designated to create a reserve to cover future losses. The balance of the reserve fund is not available for dividends.

In accordance with Russian legislation, dividends may only be declared to the shareholders of the Company from accumulated undistributed and unreserved earnings as shown in the Company's Russian statutory financial statements. OJSC MegaFon had 29,072 of undistributed and unreserved earnings as at December 31, 2007. In addition, the Company's share in the undistributed and unreserved earnings of MegaFon's subsidiaries was 69,594 as at December 31, 2007.

### 16. Revenues

Revenues for the years ended December 31 are comprised of:

	<b>2006</b>	<b>2007</b>
Revenues from local subscribers	90,669	<b>119,331</b>
Roaming charges to other wireless operators	2,564	<b>2,342</b>
Revenues from interconnection charges	7,239	<b>17,885</b>
Connection fees	332	<b>370</b>
Other revenues	311	<b>465</b>
<b>Total revenues</b>	<b>101,115</b>	<b>140,393</b>

On March 4, 2006, amendments to the Telecommunications Law were approved which introduced the Calling Party Pays rules ("CPP Rules") which became effective as of July 1, 2006. Under the CPP Rules, all incoming calls on fixed and mobile lines in Russia became free of charge, and only the fixed-line or mobile operators originating the call may charge the subscriber for the call. To compensate for this loss of revenue from subscribers, beginning from July 1, 2006 the Company began charging other operators for terminating traffic on the Company's network, and these charges are included in revenues from interconnection charges.



# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 17. Cost of Services

Cost of services for the years ended December 31 are comprised of:

	<u>2006</u>	<u>2007</u>
Interconnection charges	14,670	23,472
Cost of SIM-cards	1,189	877
Roaming expenses	1,583	1,955
<b>Total cost of services</b>	<b><u>17,442</u></b>	<b><u>26,304</u></b>

Included in interconnection charges for 2006 and 2007, are charges from other mobile and fixed-line operators for terminating traffic which originated on the Company's network under the CPP Rules introduced beginning from July 1, 2006.

### 18. Sales and Marketing Expenses

Sales and marketing expenses for the years ended December 31 are comprised of:

	<u>2006</u>	<u>2007</u>
Advertising	4,389	5,971
Commissions to dealers for connection of new subscribers	4,453	4,946
Commissions to dealers for distribution of prepaid cards and cash collection from subscribers	2,224	2,730
<b>Total sales and marketing expenses</b>	<b><u>11,066</u></b>	<b><u>13,647</u></b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 19. Operating Expenses

Operating expenses for the years ended December 31 are comprised of:

	<b>2006</b>	<b>2007</b>
Salaries and social charges	6,745	<b>8,797</b>
Rent	3,780	<b>5,522</b>
Network repair and maintenance	2,741	<b>3,186</b>
Operating taxes	2,777	<b>3,818</b>
Materials and supplies	1,024	<b>381</b>
Office maintenance	858	<b>1,222</b>
Professional services	590	<b>766</b>
Radio frequency fees	916	<b>1,695</b>
Insurance	275	<b>291</b>
Other expenses, net	2,801	<b>3,176</b>
<b>Total operating expenses</b>	<b>22,507</b>	<b>28,854</b>

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

### 20. Income Taxes

Provision for income taxes for the years ended December 31 are comprised of:

	<b>2006</b>	<b>2007</b>
Current income taxes	9,540	<b>13,226</b>
Less deferred income tax benefit	856	<b>593</b>
<b>Total income taxes</b>	<b>8,684</b>	<b>12,633</b>

Income taxes represent the Company's provision for profit tax. Profit tax is calculated at 24% of taxable profit in 2007 and 2006, in accordance with the laws of the Russian Federation.

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 the income before income taxes and minority interest is as follows:

MegaFon

Notes to Consolidated Financial Statements (continued)

**20. Income Taxes (continued)**

	<b>2006</b>	<b>2007</b>
Provision for income taxes computed on income before income taxes and minority interest at statutory rate	7,367	11,179
Change in the fair value of C-loans (Note 13)	185	–
Non-deductible expenses	1,059	1,151
Foreign exchange gain	(56)	3
Other differences	129	300
<b>Provision for income taxes reported in the consolidated financial statements</b>	<b>8,684</b>	<b>12,633</b>

The deferred tax balances were calculated by applying the presently enacted statutory tax rate of 24% applicable to the periods in which the temporary differences between the tax basis of assets and liabilities and the amounts reported in the accompanying consolidated financial statements are expected to reverse. Deferred taxes in the accompanying consolidated financial statements as of December 31 are comprised of the following:

	<b>2006</b>	<b>2007</b>
Deferred tax assets:		
Revenue recognition	467	366
Fixed assets and other intangible assets	699	938
Loss carry-forwards	974	831
Other	558	778
<b>Total deferred tax assets</b>	<b>2,698</b>	<b>2,913</b>
Deferred tax liabilities:		
Deferred finance charges	204	95
Licenses	2,668	2,288
Other	536	647
<b>Total deferred tax liabilities</b>	<b>3,408</b>	<b>3,030</b>
Net deferred tax liabilities	710	117
Add current deferred tax assets	739	1,111
<b>Total long-term net deferred tax liabilities</b>	<b>1,449</b>	<b>1,228</b>

For Russian income tax purposes, certain subsidiaries of the Company have accumulated tax losses incurred in 2001 – 2007 which may be carried forward for ten years to use against their future income. Their use is not restricted in 2008 or in future years. As of December 31, 2007, these subsidiaries had tax losses available for carry-forward aggregating approximately 3,463 with a related tax benefit of 831 which expire as follows: 2012 – 28, 2013 – 35, 2014 – 161 and 2015 – 437, 2016 – 111 and 2017 - 59.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 20. Income Taxes (continued)

Management believes that no valuation allowance against the deferred tax asset in respect of the loss carry-forwards is required based on the Company's plans to carry out the legal merger of all of the Company's subsidiaries with the Company that would allow the Company to use the loss carry-forwards of loss-making subsidiaries against taxable profits of profit-making subsidiaries.

### 21. Related Party Transactions

The Company has entered into certain transactions with its shareholders and their affiliates. The outstanding receivable/(payable) balances and the annual revenues and expenses as of and for the years ended December 31, 2007 and 2006 are comprised of the following:

	<b>December 31, 2006</b>	<b>December 31, 2007</b>
<i>Accounts receivable, related parties</i>		
TeliaSonera (1)	19	<b>35</b>
Skylink (7)	162	–
Mezhregion Transit Telecom (8)	183	–
Other	54	<b>69</b>
<b>Total accounts receivable, related parties</b>	<b>418</b>	<b>104</b>
<i>Accounts payable, related parties</i>		
Peterservice (6)	299	<b>461</b>
Mezhregion Transit Telecom (8)	214	–
Other	73	<b>58</b>
<b>Total accounts payable, related parties</b>	<b>586</b>	<b>519</b>
	<b>2006</b>	<b>2007</b>
<i>Revenues</i>		
TeliaSonera (1)	217	<b>182</b>
Turkcell Iletisim (3)	69	<b>64</b>
Mezhregion Transit Telecom (8)	1,001	<b>706</b>
Skylink (7)	397	<b>391</b>
Other	142	<b>262</b>
<b>Total revenues, related parties</b>	<b>1,826</b>	<b>1,605</b>

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 21. Related Party Transactions (continued)

	<u>2006</u>	<u>2007</u>
<i>Cost of services</i>		
TeliaSonera (1)	56	48
Turkcell Iletisim (3)	68	87
Globus Telecom (8)	57	–
Petersburg Transit Telecom (4)	257	–
Mezhregion Transit Telecom (8)	1,846	1,000
Skylink (7)	80	83
Other	111	217
<b>Total cost of services, related parties</b>	<b><u>2,475</u></b>	<b><u>1,435</u></b>
<i>Operating expenses</i>		
Telecominvest (2)	159	129
J.P. Galmond & Co (5)	17	13
Peterservice (6)	289	222
Mezon Invest (9)	102	34
Absolut (9)	78	91
Kelly Services (10)	146	159
Other	50	32
<b>Total operating expenses, related parties</b>	<b><u>841</u></b>	<b><u>680</u></b>

- (1) *TeliaSonera* - primarily settlements on roaming services.
- (2) *Telecominvest* - payments for delivery of invoices to customers.
- (3) *Turkcell Iletisim* - primarily settlements on roaming services. Turkcell Iletisim is an affiliate of TeliaSonera.
- (4) *Petersburg Transit Telecom* - primarily fees for interconnection and rent of digital channels (included in cost of services). Petersburg Transit Telecom was a wholly-owned subsidiary of Telecominvest. In January 2007, Telecominvest sold its entire interest in Petersburg Transit Telecom to a third party.
- (5) *J. P. Galmond & Co* - payments for legal services. The legal firm is affiliated (through its principal) with Telecominvest and IPOC.
- (6) *Peterservice* - primarily installation and maintenance of information and billing systems (purchase of billing systems from Peterservice in the amount of 1,202 and 845 in 2007 and 2006, respectively). Peterservice is an affiliate of Telecominvest.
- (7) *Skylink* - settlements on roaming and telecommunications services. Skylink is an affiliate of IPOC. In August 2007, entities affiliated with IPOC sold its entire interest in Skylink to a third party.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 21. Related Party Transactions (continued)

- (8) *Globus Telecom, Mezhrefion Transit Telecom* - payments for telecommunications services. These companies are affiliates of Telecominvest and IPOC. In 2005 - 2006, their interests in *Globus Telecom* were sold to a third party. In June 2007, entities affiliated with IPOC sold its entire interest in *Mezhrefion Transit Telecom* to a third party.
- (9) *Mezon Invest* and *Absolut* - payments for rent. *Mezon Invest* and *Absolut* are affiliates of Telecominvest and IPOC. In May 2007, entities affiliated with IPOC sold its entire interest in *Mezon Invest* to a third party.
- (10) *Kelly Services* - payments for outsourcing of personnel. This company is an affiliate of one of the members of the Board of Directors.

Telecominvest and IPOC are also affiliated with the ultimate parent of one of the shareholders of Svyazbank (see Notes 2, 3 and 11), where the Company regularly maintains deposit accounts.

As described in Note 12, the Company has loans from the following shareholders: Telecominvest, TeliaSonera, IPOC and CT Mobile. The Company also has a loan from Transcontinental Mobile Investment Ltd., which was an affiliate of CT Mobile at the time that the loan was incurred, but which CT Mobile asserts was not an affiliate in 2007 and 2006.

In connection with loans from shareholders, the Company recognized interest expense of 271 and 283 during the years ended December 31, 2007 and 2006, respectively.

### 22. Guarantees

The Company issued guarantees to several banks for loans to certain employees through January 2013. As of December 31, 2007, the amount outstanding under these loans is 69. The Company would be required to perform under the applicable guarantee if any of the employees does not repay the principal, interest, or make any other payment specified in his or her loan agreement. Management believes that the fair value of these guarantees and its related potential liability are *de minimis*.

### 23. Commitments and Contingencies

#### *Operating Environment*

While there have been improvements in the Russian economy over the past few years, such as an increasing gross domestic product and a reducing rate of inflation, Russia remains in a continuing process of economic reform and development of its legal, tax and regulatory frameworks, all of which are required in order for it to develop a stable market economy.

# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 23. Commitments and Contingencies (continued)

Further growth and the positive development of the Russian economy are largely dependent on these reforms and developments being implemented and the effectiveness of economic, financial and monetary measures undertaken by the Russian government.

#### *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 the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation 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. It is not practical to determine the amount of claims that may be asserted, if any, or the likelihood of any unfavorable outcome. 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.

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

In November 2007, the Company received a final assessment from the tax inspectorate in connection with the examination of tax returns of OJSC MegaFon for 2004 through 2006. The assessment claims additional taxes amounting to 315 mainly in respect of income tax and VAT, including fines and penalties, for interconnection settlements. In November 2007, the Company paid this amount to the respective federal and local budgets. Nonetheless in January 2008, the Company appealed this decision in the Moscow Arbitration Court. In the opinion of the Company's management, it is more likely than not that the Company will sustain its position as a result of the court proceedings.

Moreover, certain of the Company's subsidiaries are currently undergoing tax audits by the tax authorities. It is possible that as a result of such audits material tax claims similar to those issued to OJSC MegaFon may arise.

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.

Notes to Consolidated Financial Statements (continued)

**23. Commitments and Contingencies (continued)**

*Litigation*

The Company is not a party to any material litigation, although some of its subsidiaries have been sued as a result of disputes arising in the ordinary course of their business and operations.

Management believes that the ultimate resolution of the matters mentioned above will not have a material effect on the Company's financial statements.

*Minimum Lease Payment under Operating Leases*

Future minimum lease payments under non-cancelable operating leases with terms of one year or more, as of December 31, 2007, are as follows: 2008 – 100, 2009 – 49, 2010 – 31, 2011 - 31, 2012 - 8.

**24. Fair Value of Financial Instruments and Risk Management**

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value:

*Cash, Cash Equivalents and Short-Term Investments*

The carrying amount approximates their fair value because of the short maturity of those items.

*Long-Term Debt*

The fair value of long-term debt is estimated based on market interest rates for the same or similar issues, or based on the current rates offered to the Company for debt of the same remaining maturities.



# MegaFon

## Notes to Consolidated Financial Statements (continued)

### 24. Fair Value of Financial Instruments and Risk Management (continued)

#### *Derivative Financial Instruments*

The fair values of the derivative financial instruments are determined using estimated discounted cash flows.

The estimated fair values of the Company's financial instruments at December 31 are as follows:

	2006		2007	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	6,965	6,965	4,259	4,259
Short-term investments	569	569	21,710	21,710
Long-term debt	42,630	42,979	39,443	39,579
Derivative financial instruments (foreign currency swaps)	99	99	245	245

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.