

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

Consolidated Financial Statements

As of December 31, 2007 and 2006
and for the Years Ended
December 31, 2007, 2006 and 2005

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries ("the Group") as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the consolidated financial statements, the Group changed the manner in which it accounts for uncertain tax positions effective January 1, 2007, in accordance with the adoption of Statement of Financial Accounting Standards Interpretation No. 48, "Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109".

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 15, 2008 expressed an unqualified opinion on the Group's internal control over financial reporting.



April 15, 2008

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2007 AND 2006

(Amounts in thousands of U.S. Dollars, except share and per share amounts)

| | December 31, | |
|--|----------------------|---------------------|
| | 2007 | 2006 |
| CURRENT ASSETS: | | |
| Cash and cash equivalents (Note 4) | \$ 634,498 | \$ 219,989 |
| Short-term investments, including related party amounts of \$15,000 and \$55,000 (Note 5) | 15,776 | 56,047 |
| Trade receivables, net (Note 6) | 386,608 | 298,479 |
| Accounts receivable, related parties (Note 15) | 25,004 | 8,434 |
| Inventory and spare parts (Note 7) | 140,932 | 196,265 |
| Prepaid expenses | 201,702 | 244,680 |
| Deferred tax assets (Note 13) | 136,466 | 141,114 |
| VAT receivable | 310,548 | 339,614 |
| Other current assets, including assets held for sale of \$35,354 and \$63,209 (Note 2) | 95,123 | 124,497 |
| Total current assets | 1,946,657 | 1,629,119 |
| PROPERTY, PLANT AND EQUIPMENT , net of accumulated depreciation of \$3,079,376 and \$1,948,368 (Note 8) | 6,607,315 | 5,297,669 |
| LICENSES , net of accumulated amortization of \$708,844 and \$747,076 (Notes 3 and 19) | 665,605 | 405,498 |
| GOODWILL (Notes 3 and 9) | 359,450 | 165,462 |
| OTHER INTANGIBLE ASSETS , net of accumulated amortization of \$949,747 and \$680,425 (Notes 3 and 9) | 1,070,413 | 835,916 |
| DEBT ISSUANCE COSTS , net of accumulated amortization of \$77,725 and \$48,733 (Note 11) | 59,279 | 70,173 |
| INVESTMENTS IN AND ADVANCES TO ASSOCIATES (Note 17) | 195,908 | 141,473 |
| OTHER INVESTMENTS | 1,355 | 3,856 |
| OTHER NON-CURRENT ASSETS , including restricted cash of \$28,618 and \$24,779 (Note 18) and assets held for sale of \$32,067 and \$nil (Note 2) | 60,685 | 24,779 |
| Total assets | \$ 10,966,667 | \$ 8,573,945 |

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

AS OF DECEMBER 31, 2007 AND 2006

(Amounts in thousands of U.S. Dollars, except share and per share amounts)

| | December 31, | |
|---|----------------------|---------------------|
| | 2007 | 2006 |
| CURRENT LIABILITIES: | | |
| Trade accounts payable | \$ 486,666 | \$ 309,712 |
| Accounts payable, related parties (Note 15) | 160,253 | 135,256 |
| Deferred connection fees, current portion (Note 10) | 32,644 | 47,528 |
| Subscriber prepayments and deposits | 470,302 | 421,539 |
| Debt, current portion (Note 11) | 309,977 | 147,260 |
| Notes payable, current portion (Note 11) | 400,000 | - |
| Capital lease obligation, current portion | 3,305 | 3,366 |
| Income tax payable | 51,958 | 29,110 |
| Accrued liabilities (Note 12) | 464,505 | 405,728 |
| Bitel liability (Note 20) | 170,000 | 170,000 |
| Other payables | 61,824 | 50,805 |
| Total current liabilities | 2,611,434 | 1,720,304 |
| LONG-TERM LIABILITIES: | | |
| Notes payable (Note 11) | 799,314 | 1,199,178 |
| Debt, net of current portion (Note 11) | 1,887,195 | 1,725,361 |
| Capital lease obligation, net of current portion | 1,876 | 3,287 |
| Deferred connection fees, net of current portion (Note 10) | 20,845 | 32,079 |
| Deferred taxes (Note 13) | 114,171 | 86,349 |
| Other long-term liabilities | 68,851 | 10,800 |
| Total long-term liabilities | 2,892,252 | 3,057,054 |
| Total liabilities | 5,503,686 | 4,777,358 |
| COMMITMENTS AND CONTINGENCIES (Note 20) | | |
| MINORITY INTEREST | 20,051 | 44,806 |
| SHAREHOLDERS' EQUITY: | | |
| Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2007 and 2006, 777,396,505 and 776,550,625 of which are in the form of ADS, respectively (Note 1)) | 50,558 | 50,558 |
| Treasury stock (32,476,837 and 15,922,128 common shares at cost as of December 31, 2007 and 2006) | (368,352) | (114,778) |
| Additional paid-in capital | 579,520 | 571,718 |
| Accumulated other comprehensive income (Note 2) | 704,189 | 89,916 |
| Retained earnings | 4,477,015 | 3,154,367 |
| Total shareholders' equity | 5,442,930 | 3,751,781 |
| Total liabilities and shareholders' equity | \$ 10,966,667 | \$ 8,573,945 |

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005 (Amounts in thousands of U.S. Dollars, except share and per share amounts)

| | Years ended December 31, | | |
|---|--------------------------|---------------------|---------------------|
| | 2007 | 2006 | 2005 |
| NET OPERATING REVENUE | | | |
| Services revenue and connection fees (including related party amounts of \$100,771, \$39,138 and \$6,611, respectively) | \$ 8,172,650 | \$ 6,287,100 | \$ 4,942,288 |
| Sales of handsets and accessories | 79,728 | 97,154 | 68,730 |
| | 8,252,378 | 6,384,254 | 5,011,018 |
| Cost of services, excluding depreciation and amortization shown separately below (including related party amounts of \$135,819, \$113,732 and \$78,253, respectively) | 1,727,365 | 1,223,715 | 732,867 |
| Cost of handsets and accessories | 158,580 | 209,260 | 254,606 |
| General and administrative expenses (including related party amounts of \$40,599, \$13,301 and \$9,486, respectively) (Note 16) | 1,243,549 | 941,047 | 758,729 |
| Provision for doubtful accounts (Note 6) | 58,924 | 84,858 | 50,407 |
| Other operating expenses (including related party amounts of \$8,349, \$4,769 and \$1,086, respectively) | 116,451 | 87,822 | 67,173 |
| Sales and marketing expenses (including related party amounts of \$193,471, \$171,792 and \$80,146, respectively) | 724,115 | 607,835 | 608,092 |
| Depreciation and amortization expenses | 1,489,548 | 1,095,981 | 907,113 |
| Net operating income | 2,733,846 | 2,133,736 | 1,632,031 |
| CURRENCY EXCHANGE AND TRANSACTION GAINS | (163,092) | (24,051) | (10,319) |
| OTHER EXPENSES/(INCOME) | | | |
| Interest income (including related party amounts of \$18,930, \$4,844 and \$5,440) | (38,100) | (13,055) | (24,828) |
| Interest expense, net of capitalized interest | 134,581 | 177,145 | 132,474 |
| Equity in net income of associates (Note 17) | (72,665) | (58,083) | (42,361) |
| Bitel investment and write off (Note 20) | - | 320,000 | - |
| Other expenses, net (including related party amounts of \$nil, \$2,460 and \$2,070) | 44,034 | 65,913 | 13,211 |
| Total other expenses, net | 67,850 | 491,920 | 78,496 |
| Income before provision for income taxes and minority interest | 2,829,088 | 1,665,867 | 1,563,854 |
| PROVISION FOR INCOME TAXES (Note 13) | 738,270 | 576,103 | 410,590 |
| MINORITY INTEREST | 19,314 | 14,026 | 26,859 |
| NET INCOME | \$ 2,071,504 | \$ 1,075,738 | \$ 1,126,405 |
| Weighted average number of common shares outstanding – basic | 1,973,354,348 | 1,987,610,121 | 1,986,819,999 |
| Weighted average number of common shares outstanding – diluted | 1,974,074,908 | 1,987,646,015 | 1,987,110,039 |
| Earnings per share, basic and diluted | \$ 1.05 | \$ 0.54 | \$ 0.57 |

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005 (Amounts in thousands of U.S. Dollars, except share amounts)

| | Common Stock | | Treasury Stock | | Accumulated Other Com- prehensive Income | Additional Paid-in Capital | Unearned Compensation | Shareholder Receivable | Retained Earnings | Total |
|--|---------------|-----------|----------------|--------------|---|----------------------------------|--------------------------|---------------------------|----------------------|--------------|
| | Shares | Amount | Shares | Amount | | | | | | |
| BALANCES, December 31, 2004 | 1,993,326,138 | \$ 50,558 | (7,202,108) | \$ (7,396) | \$ 22,444 | \$ 564,160 | \$ (1,780) | \$ (18,237) | \$ 1,913,574 | \$ 2,523,323 |
| Increases for interest | - | - | - | - | - | 643 | - | (643) | - | - |
| Payments from Sistema | - | - | - | - | - | - | - | 11,698 | - | 11,698 |
| Issuance of stock options (Note 14) | - | - | - | - | - | 907 | (907) | - | - | - |
| Stock options exercised (Note 14) | - | - | 1,801,622 | 1,862 | - | 2,394 | - | - | - | 4,256 |
| Amortization of deferred compensation | - | - | - | - | - | - | 1,477 | - | - | 1,477 |
| Dividends declared | - | - | - | - | - | - | - | - | (401,240) | (401,240) |
| Currency translation adjustment | - | - | - | - | 24,898 | - | - | - | - | 24,898 |
| Change in fair value of interest rate swaps, net of tax (Note 11) | - | - | - | - | 3,272 | - | - | - | - | 3,272 |
| Net income | - | - | - | - | - | - | - | - | 1,126,405 | 1,126,405 |
| BALANCES, December 31, 2005 | 1,993,326,138 | \$ 50,558 | (5,400,486) | \$ (5,534) | \$ 50,614 | \$ 568,104 | \$ (1,210) | \$ (7,182) | \$ 2,638,739 | \$ 3,294,089 |
| Increases for interest | - | - | - | - | - | - | - | - | - | - |
| Payments from Sistema | - | - | - | - | - | - | - | 7,182 | - | 7,182 |
| Stock options exercised (Note 14) | - | - | 639,358 | 655 | - | 3,149 | - | - | - | 3,804 |
| Accrued compensation costs | - | - | - | - | - | 1,675 | - | - | - | 1,675 |
| Effect of adoption of SFAS No. 123R (Note 2) | - | - | - | - | - | (1,210) | 1,210 | - | - | - |
| Dividends declared | - | - | - | - | - | - | - | - | (560,110) | (560,110) |
| Repurchase of common stock (Note 1) | - | - | (11,161,000) | (109,899) | - | - | - | - | - | (109,899) |
| Currency translation adjustment | - | - | - | - | 41,315 | - | - | - | - | 41,315 |
| Change in fair value of interest rate swaps, net of tax (Note 11) | - | - | - | - | (2,013) | - | - | - | - | (2,013) |
| Net income | - | - | - | - | - | - | - | - | 1,075,738 | 1,075,738 |
| BALANCES, December 31, 2006 | 1,993,326,138 | \$ 50,558 | (15,922,128) | \$ (114,778) | \$ 89,916 | \$ 571,718 | \$ - | \$ - | \$ 3,154,367 | \$ 3,751,781 |
| Effect of change in functional currency (Note 2) | - | - | - | - | 358,997 | - | - | - | - | 358,997 |
| Stock options exercised (Note 14) | - | - | 848,126 | 869 | - | 5,188 | - | - | - | 6,057 |
| Accrued compensation costs | - | - | - | - | - | 2,828 | - | - | - | 2,828 |
| Effect of FIN No. 48 implementation (Note 2) | - | - | - | - | - | - | - | - | (7,610) | (7,610) |
| Dividends declared | - | - | - | - | - | - | - | - | (741,246) | (741,246) |
| Repurchase of common stock (Note 1) | - | - | (17,402,835) | (254,443) | - | - | - | - | - | (254,443) |
| Currency translation adjustment | - | - | - | - | 256,390 | (214) | - | - | - | 256,176 |
| Change in fair value of interest rate swaps, net of tax (Note 11) | - | - | - | - | (1,114) | - | - | - | - | (1,114) |
| Net income | - | - | - | - | - | - | - | - | 2,071,504 | 2,071,504 |
| BALANCES, December 31, 2007 | 1,993,326,138 | \$ 50,558 | (32,476,837) | \$ (368,352) | \$ 704,189 | \$ 579,520 | \$ - | \$ - | \$ 4,477,015 | \$ 5,442,930 |

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005 (Amounts in thousands of U.S. Dollars)

| | Years ended December 31, | | |
|--|--------------------------|--------------------|--------------------|
| | 2007 | 2006 | 2005 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | \$ 2,071,504 | \$ 1,075,738 | \$ 1,126,405 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Minority interest | 19,314 | 14,026 | 26,859 |
| Depreciation and amortization | 1,489,548 | 1,095,981 | 907,113 |
| Debt issuance cost amortization | 22,406 | 25,041 | 14,347 |
| Amortization of deferred connection fees | (75,404) | (54,486) | (44,207) |
| Equity in net income of associates | (72,665) | (58,083) | (42,361) |
| Inventory obsolescence expense | - | - | 9,112 |
| Provision for doubtful accounts | 58,924 | 84,858 | 50,407 |
| Deferred taxes | (92,088) | (133,027) | (64,959) |
| Write off of not recoverable VAT receivable | 17,516 | - | - |
| Gain from deconsolidation of a subsidiary | (8,874) | - | - |
| Foreign currency transaction gain for non-operating activity | (163,092) | - | - |
| Bitel liability and investment write off (Note 20) | - | 320,000 | - |
| Impairment of property, plant and equipment, intangible assets and assets held for sale | 18,556 | - | - |
| Non-cash expenses associated with asset retirement obligation | 1,138 | - | - |
| Non-cash expenses associated with stock bonus and stock options | 10,426 | 1,675 | 1,477 |
| Changes in operating assets and liabilities: | | | |
| Increase in accounts receivable | (137,880) | (174,790) | (86,008) |
| Decrease/(increase) in inventory | 76,950 | (39,312) | (74,557) |
| Decrease/(increase) in prepaid expenses and other current assets | 35,132 | 21,094 | (157,400) |
| Decrease/(increase) in VAT receivable | 12,567 | 58,446 | (125,186) |
| Increase in trade accounts payable, accrued liabilities and other current liabilities | 61,278 | 138,581 | 258,394 |
| Dividends received from associate | 4,900 | 3,174 | - |
| Net cash provided by operating activities | 3,350,156 | 2,378,916 | 1,799,436 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Acquisitions of subsidiaries, net of cash acquired | (873,071) | (38,188) | (178,917) |
| Purchases of property, plant and equipment | (1,316,662) | (1,449,954) | (1,757,980) |
| Purchases of intangible assets | (222,866) | (272,014) | (423,367) |
| Proceeds from sale of property, plant and equipment and assets held for sale | 22,020 | 10,987 | 4,174 |
| Purchases of short-term investments | (221,753) | (57,147) | (37,375) |
| Proceeds from disposal of short-term investments | 267,517 | 29,159 | 82,724 |
| Purchases of other investments | 2,808 | (3,856) | (150,000) |
| Net proceeds from investments in and advances to associates | 1,965 | 20,000 | 12,798 |
| Increase in restricted cash | (3,839) | (18,549) | (6,230) |
| Net cash used in investing activities | (2,343,881) | (1,779,562) | (2,454,173) |

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED) FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005 (Amounts in thousands of U.S. Dollars)

| | Years ended December 31, | | |
|--|--------------------------|-----------------------|----------------------|
| | 2007 | 2006 | 2005 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from stock options exercise | 6,057 | 3,804 | 4,256 |
| Proceeds from issuance of notes | - | - | 398,944 |
| Repurchase of common stock | (254,443) | (109,899) | - |
| Notes and debt issuance cost | (371) | (20,686) | (59,163) |
| Capital lease obligation principal paid | (4,952) | (5,815) | (8,129) |
| Dividends paid | (756,920) | (558,848) | (407,210) |
| Proceeds from loans | 475,815 | 1,284,296 | 1,012,613 |
| Loan principal paid | (158,080) | (1,064,100) | (491,481) |
| Payments from Sistema | - | 7,182 | 11,698 |
| Net cash (used in)/provided by financing activities | <u>(692,894)</u> | <u>(464,066)</u> | <u>461,528</u> |
| Effect of exchange rate changes on cash and cash equivalents | <u>101,128</u> | <u>6,417</u> | <u>(2,657)</u> |
| NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS | 414,509 | 141,705 | (195,866) |
| CASH AND CASH EQUIVALENTS, beginning of the year | <u>219,989</u> | <u>78,284</u> | <u>274,150</u> |
| CASH AND CASH EQUIVALENTS, end of the year | <u><u>634,498</u></u> | <u><u>219,989</u></u> | <u><u>78,284</u></u> |
| SUPPLEMENTAL INFORMATION: | | | |
| Income taxes paid | \$ 838,647 | \$ 673,410 | \$ 588,105 |
| Interest paid | \$ 216,997 | \$ 201,352 | \$ 145,081 |
| Non-cash investing and financing activities: | | | |
| Additions to network equipment and software under capital lease | \$ 6,037 | \$ 7,561 | \$ 4,091 |
| Amounts owed for capital expenditures | \$ 363,004 | \$ 214,835 | \$ 69,734 |
| Payable related to business acquisition (Note 3) | \$ 14,639 | \$ - | \$ 23,618 |

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005

(Amounts in thousands of U.S. Dollars, except share and per share amounts or if otherwise stated)

1. DESCRIPTION OF BUSINESS

Business of the Group – OJSC Mobile TeleSystems and its subsidiaries (“MTS” or “the Group”) is the largest provider of mobile telecommunications services in the Russian Federation (“RF”, or “Russia”), Uzbekistan, Turkmenistan and Armenia and the second largest in Ukraine in terms of the number of subscribers and revenues.

The Open Joint-Stock Company Mobile TeleSystems (“MTS OJSC”, or “the Company”) was created on March 1, 2000, through the merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary. MTS CJSC started its operations in the Moscow license area in 1994 and began expanding into nearby regions in 1997. Since that time, MTS has continued to grow by applying for Global System for Mobile Communication (“GSM”) licenses in new regions and acquiring existing GSM license holders and operators.

The Group provides a wide range of voice and data mobile telecommunications services, including text messages (“SMS”), picture messages (“MMS”) and other data services. Services are provided to both consumers and corporate customers, through a variety of both prepaid and contract tariff arrangements. The Group’s mobile services are currently offered over a GSM network, on which a General Packet Radio Service (“GPRS”) service is also provided.

In July 2006, Ukrainian Mobile Communications (“UMC”), MTS subsidiary in Ukraine, acquired a new CDMA (Code Division Multiple Access) license, which is a 3G telecommunications standard, ratified by the International Telecommunication Union. UMC plans to start rendering services through the 3G network in 2008.

In April 2007, MTS received a federal license allowing it to provide 3G services in Russia. In accordance with the conditions set forth in the tender documentation, the winning companies are required to begin commercial exploitation of a 3G network within two years from the time they receive the license. The Company is planning to start rendering commercial services under 3G license in 2008.

In April 2007, the Communication and Information Agency of Uzbekistan allocated 2500-2700 MHz frequencies to Uzdurobita, MTS subsidiary in Uzbekistan, thus allowing the Group to provide WiMAX (Worldwide Interoperability for Microwave Access) services on the entire territory of the country. MTS plans to start providing access to the Internet using WiMAX in Tashkent by the end of 2008. Additionally, in April 2007 Uzdurobita received a 3G license valid until the end of 2016 for the entire territory of Uzbekistan. 3G network will be launched in the major cities of the country, where there is effective customer demand and a need to increase network capacity. The Group is planning to launch its 3G network in 2008 in Tashkent followed by Samarkand, Bukhara and Andijan.

In October 2007, the Public Services Regulatory Commission of the Republic of Armenia allocated 3G frequencies to CJSC K-Telecom (“K-Telecom”), MTS subsidiary thus allowing the Group to provide 3G services in Armenia. The allocation is valid for ten years. K-Telecom is licensed to offer 3G (UMTS) services by virtue of its general telecommunication license.

The Group is organized by geography of its operations. MTS principal mobile operations are located in Russia, Ukraine and other CIS countries. In 2006, the Group established a new Business unit “MTS Russia”, that is responsible for the operational management of all Russian macro-regions; Business unit “MTS Ukraine”; and Business unit “Foreign subsidiaries” that includes Uzdurobita in Uzbekistan, Barash Communications Technologies, Inc. (“BCTI”) in Turkmenistan, K-Telecom in Armenia and MTS Belarus, an equity accounted affiliate of MTS, in Belarus.

MTS completed its initial public offering in 2000 and listed its shares of common stock, represented by American Depositary Shares, or ADSs, on the New York Stock Exchange under the symbol “MBT.”

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005

(Amounts in thousands of U.S. Dollars, except share and per share amounts or if otherwise stated)

Ownership – As of December 31, 2007 and 2006, MTS shareholders of record and their respective percentage direct interests in outstanding shares were as follows:

| | December 31, | |
|---|---------------|---------------|
| | 2007 | 2006 |
| Joint-Stock Financial Corporation “Sistema” (“Sistema”) | 32.4% | 32.2% |
| Sistema Holding Limited (“Sistema Holding”) | 9.9% | 9.8% |
| Invest-Svyaz, Closed Joint-Stock Company (“Invest-Svyaz”) | 8.2% | 8.1% |
| VAST, Limited Liability Company (“VAST”) | 3.1% | 3.0% |
| ADS Holders | 39.6% | 39.3% |
| Free float, GDR Holders and others | 6.8% | 7.6% |
| | <u>100.0%</u> | <u>100.0%</u> |

MTS share capital comprises 1,960,849,301 and 1,977,404,010 of outstanding common shares, net of treasury shares, as of December 31, 2007 and 2006, 777,396,505 and 776,550,625 of which are in forms of ADS, respectively. MTS wholly-owned subsidiary, Mobile TeleSystems LLC, owned 3,913,003 and 4,761,129 shares as of December 31, 2007 and 2006, respectively, in connection with the Group’s management stock option plans. During the years ended December 31, 2007 and 2006 MTS repurchased 17,402,835 and 11,161,000 of its own common shares, respectively, that represent 3,480,567 and 2,232,200 ADSs for \$254.4 million and \$110.0 million, respectively. As a result, the total shares in treasury stock of the Group comprised 32,476,837 and 15,922,128 as of December 31, 2007 and 2006, respectively.

Sistema owned 100% of Sistema Holding, Invest-Svyaz, and VAST, which collectively resulted in Sistema’s effective ownership in MTS of 53.6% and 53.1% (or 1,050,165,886 of common shares) as of December 31, 2007 and 2006, respectively.

Each ADS initially represented 20 shares of common stock of the Company. Effective January 2005, the ratio was changed from 1 ADS per 20 ordinary shares to 1 ADS per 5 ordinary shares. The Company initially issued a total of 17,262,204 ADS, representing 345,244,080 common shares. Subsequently, due to the change in ratio of ADS per ordinary shares, trading of shares on the open market and the repurchase of 5,712,767 ADS by MTS during 2007 and 2006 the number of ADS changed to 155,479,301 and 155,310,125 (representing underlying ownership of 777,396,505 and 776,550,625 shares) as of December 31, 2007 and 2006, respectively.

Since 2003, common shares of MTS OJSC have been traded on the Moscow Interbank Currency Exchange (“MICEX”).

In 2007, the Board of Directors approved a dividend policy, whereby the Group will aim to make dividend payments to shareholders in the amount of at least 50% of annual net income under U.S. GAAP. The dividend could vary depending on a number of factors, including the outlook for earnings growth, capital expenditure requirements, cash flow operations, potential acquisition opportunities, as well as Group’s debt position.

Annual dividend payments, if any, must be recommended by the Board of Directors and approved by the shareholders.

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain deductions. The net income of MTS OJSC for the years ended December 31, 2007, 2006 and 2005 that is distributable under Russian legislation totalled 37,696 million rubles (\$1,473.8 million, unaudited), 32,094 million rubles (\$1,181.0 million) and 12,544 million rubles (\$444.4 million), respectively.

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The following table summarizes the Group's declared cash dividends for the years ended December 31, 2007, 2006 and 2005:

| | December 31, | | |
|---|--------------|------------|------------|
| | 2007 | 2006 | 2005 |
| Dividends declared (including dividends on treasury shares of \$5,967, \$1,519 and \$1,360, respectively) | \$ 747,213 | \$ 561,629 | \$ 402,600 |
| Dividends, U.S. Dollars per ADS | 1.9 | 1.4 | 1.01 |
| Dividends, U.S. Dollars per share | 0.375 | 0.282 | 0.202 |

As of December 31, 2007 and 2006, dividends payable were \$0.8 million and \$1.3 million, respectively.

Starting from July, 2005 until December 31, 2007, the Company completed the merger of nineteen of its subsidiaries in Russia into MTS OJSC. These subsidiaries were Telecom XXI, Kuban-GSM, Udmurtia Digital Network-900 ("UDN-900"), Dontelecom, MTS-Barnaul, MTS-Nizhniy Novgorod ("MTS-NN"), Telecom-900, Amur Cellular Communication ("ACC"), Gorizont-RT, TAIF Telcom, MTS-RTK, Sibchallenge, Tomsk Cellular Communications ("TSS"), BM Telecom, Far East Cellular Systems-900 ("FECS-900"), Siberia Cellular Systems-900 ("SCS-900"), Uraltel, ReCom and Telesot Alania.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

Accounting principles – MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation, in Ukrainian hryvnias for UMC, Uzbek som for Uzdurobita, U.S. Dollars for BCTI, Turkmenian manat for the branch of BCTI in Turkmenistan and Armenian drams for K-Telecom based on respective local accounting and tax legislations. The accompanying consolidated financial statements have been prepared in order to present MTS financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and are expressed in terms of U.S. Dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities' books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, acquisition accounting and depreciation and valuation of property, plant and equipment, intangible assets and investments.

Basis of consolidation – Wholly-owned and majority-owned subsidiaries where the Group has operating and financial control are consolidated. Those ventures where the Group exercises significant influence, but does not have operating and financial control are accounted for using the equity method. All intercompany accounts and transactions are eliminated upon consolidation. Investments in which the Group does not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method and included in other investments in the consolidated balance sheets. The Group's share in the net income of unconsolidated associates is included in other income in the accompanying consolidated statements of operations and disclosed in Note 17. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

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As of December 31, 2007 and 2006, the Company had investments in the following significant legal entities:

| | Accounting Method | December 31, | |
|---------------------------------|-----------------------|--------------|--------|
| | | 2007 | 2006 |
| <i>Russia</i> | | | |
| Primtelefon | Consolidated | 100.0% | 100.0% |
| Volgograd Mobile | Consolidated | 100.0% | 100.0% |
| Astrakhan Mobile | Consolidated | 100.0% | 100.0% |
| MTS-Capital | Consolidated | 100.0% | 100.0% |
| Mar Mobile GSM | Consolidated | 100.0% | 100.0% |
| Novitel | Consolidated | 100.0% | 100.0% |
| MTS-Kostroma | Consolidated | 100.0% | 100.0% |
| Sibintertelecom | Consolidated | 100.0% | 100.0% |
| MSS | Consolidated | 91.0% | 91.0% |
| Sweet-Com | Consolidated | 74.9% | 74.9% |
| Dagtelecom | Consolidated | 74.9% | 74.9% |
| Bashcell | Consolidated | 100.0% | - |
| ReCom ⁽¹⁾ | Merged / Consolidated | - | 100.0% |
| Telesot Alania ⁽¹⁾ | Merged / Consolidated | - | 100.0% |
| TS-Retail | Equity/Consolidated | 25.0% | 100% |
| Coral/Sistema Strategic Fund | Equity | 35.0% | - |
| <i>Ukraine</i> | | | |
| UMC | Consolidated | 100.0% | 100.0% |
| <i>Other countries</i> | | | |
| MTS Finance ⁽²⁾ | Consolidated | 100.0% | 100.0% |
| Uzdunrobita | Consolidated | 100.0% | 74.0% |
| BCTI | Consolidated | 100.0% | 100.0% |
| MTS Bermuda Ltd. ⁽³⁾ | Consolidated | 100.0% | 100.0% |
| K-Telekom | Consolidated | 80.0% | - |
| MTS Belarus | Equity | 49.0% | 49.0% |

⁽¹⁾ Represents wholly-owned entities merged with MTS OJSC on April 1, 2007.

⁽²⁾ Represents beneficial ownership.

⁽³⁾ A wholly-owned subsidiary in Bermuda established to repurchase the Group's ADSs (Note 1).

Translation methodology – Until January 1, 2007, the functional currency for the majority of the Group's subsidiaries, excluding UMC, Kuban-GSM and BCTI where the functional currency was the local country currency, was the United States dollar ("U.S. Dollar") as the majority of revenue, cost, property and equipment purchased, debt and trade liabilities were either priced, incurred, payable or otherwise measured in U.S. Dollars.

In April 2007, an amendment to the Russian Federal law on protection of consumer's rights was enforced prohibiting companies to set up prices in currencies other than Russian rubles. Following the expected changes in regulatory environment and due to growth in share of expenditures denominated or fixed in Russian rubles, the Group's subsidiaries in the Russian Federation began pricing its services and invoicing customers in Russian rubles from January 1, 2007. As a result of these changes, the Company reevaluated the functional currency criteria under SFAS No. 52, "Foreign Currency Translation" ("SFAS No. 52"), and determined that, starting January 1, 2007, the functional currency of the Company's subsidiaries domiciled in Russia was the Russian ruble. Pursuant to SFAS No. 52 provisions, the change was adopted prospectively beginning January 1, 2007, and no retroactive restatement of previously issued financial statements was made.

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Non-monetary assets and liabilities acquired prior to when Russian economy ceased to be highly inflationary on January 1, 2003, were translated from U.S. Dollars to Russian rubles by using exchange rate at that date in accordance with EITF 92-4, "Accounting for a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary". The resulting balance became historical Russian ruble cost basis. For non-monetary assets and liabilities acquired subsequently January 1, 2003, the historical Russian ruble amounts were retained.

The impact of the change in functional currency on the financial statements was an increase in the opening translated carrying values of the following non-monetary assets and liabilities and the related deferred taxes as of January 1, 2007:

| | January 1, 2007 |
|------------------------------------|----------------------------|
| Property, plant and equipment, net | 329,475 |
| Intangible assets, net | 66,235 |
| Goodwill | 9,961 |
| Other non-current assets | 6,501 |
| Net deferred tax liability | (57,798) |
| Other, net | 4,623 |
| Total increase | <u>358,997</u> |

This increase has been reflected in shareholders equity as a part of other comprehensive income as of January 1, 2007.

MTS Belarus, the Group's equity investee, changed its functional currency from U.S. Dollar to Belarusian ruble prospectively from January 1, 2007. The impact of this change on MTS Belarus statement of financial position was not material to the consolidated financial statements.

As of December 31, 2007, the functional currencies of the Group entities were the following:

- For Russian entities – Russian ruble;
- For UMC – Ukrainian hryvnia;
- For Turkmen branch of BCTI – Turkmenian manat;
- For Uzdurobita – U.S. Dollar;
- For K-Telecom – Armenian dram;
- For MTS-Belarus – Belarusian ruble; and
- For other entities – U.S. Dollar.

Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan, Turkmenistan, Armenia and Belarus maintain their records and prepare their financial statements in the local currency, either Russian ruble, Ukrainian hryvnia, Uzbek som, Turkmenian manat, Armenian dram or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

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The Group has retained the U.S. Dollar as its reporting currency. Remeasurement of financial statements into functional currencies where applicable and translation of financial statements into U.S. Dollars has been performed in accordance with the provisions of SFAS No. 52:

- For entities whose records are not maintained in their functional currencies, monetary assets and liabilities have been remeasured at the period end exchange rates. Non-monetary assets and liabilities have been remeasured at historical rates. Revenues, expenses and cash flows have been remeasured at average rates. Remeasurement differences resulting from the use of these rates have been accounted for as currency exchange and transaction gains and losses in the accompanying consolidated statements of operations.
- For Russian entities, UMC, K-Telecom, and for the Turkmen branch of BCTI where the functional currency is other than the reporting currency, the Russian ruble, Ukrainian hryvnia, Armenian dram and Turkmenian manat, respectively, all year-end balance sheet items have been translated into U.S. Dollars at the period-end exchange rate. Revenues and expenses have been translated at period average exchange rate. Translation differences resulting from the use of these rates are reported as a component of other comprehensive income.

Management estimates – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates include the allowance for doubtful accounts, allowance for inventory obsolescence, business combinations, FIN No. 48 estimates, the recoverability of intangible assets and other long-lived assets, certain accrued liabilities and valuation of financial instruments.

Cash and cash equivalents – Cash represents cash on hand and in MTS bank accounts and short-term investments, including term deposits, having original maturities of less than three months.

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

Allowance for doubtful accounts – MTS provides an allowance for doubtful accounts based on management's periodic review for recoverability of accounts receivable from customers and other receivables.

Prepaid expenses – Prepaid expenses are primarily comprised of advance payments made to vendors for inventory and services.

Inventory – Inventory mainly consists of handsets and accessories held for sale, spare parts, to be used for equipment maintenance within the next twelve months, advertising materials, and other inventory items. Inventory is stated at the lower of cost or market value. Inventory cost is determined using the weighted average cost ("WAC") method.

Handsets and accessories held for sale are expensed when sold. The Group periodically assesses its inventories for obsolete and slow-moving stock.

Value-added tax ("VAT") – Value-added tax related to sales is payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed from the state, subject to certain restrictions, against VAT related to sales.

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Assets held for sale – In 2006, the Group management decided to discontinue use of certain telecommunication equipment (“Lucent equipment”) in MTS Russia in accordance with the Group’s network development strategy. The Group accounts for Lucent equipment in accordance with the provisions of SFAS No. 144 “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”) and reports Lucent equipment at the lower of its carrying amount or fair value less costs to sell. The equipment had a fair value less costs to sell of approximately \$67.4 million and \$63.2 million as of December 31, 2007 and 2006, respectively.

The Group has initially negotiated with a third party to sell this equipment during the year ended December 31, 2007. However, due to a wide range of geographical areas the equipment is located and its diversity, the Group reconsidered the time needed to sell the equipment in 2007 and, as a result, the original plan of sale was extended for another two years. Accordingly, part of Lucent equipment in the amount of \$35.4 million, which is expected to be sold during 2008, was classified as other current assets in the accompanying consolidated balance sheet as of December 31, 2007. The remaining portion of equipment in the amount of \$32.0 million, which is expected to be sold during 2009, was recorded in other non-current assets in the Group’s consolidated balance sheet as of December 31, 2007.

Due to the fact that initial plan of sale was reconsidered, the fair value of Lucent equipment as of December 31, 2007, was determined using the discounted cash flows based on updated expected timing of sale. As a result, an impairment loss on Lucent equipment in the amount of \$6.8 million was recorded as other operating expenses in the Group’s consolidated statement of operations for the year ended December 31, 2007. This loss is entirely attributable to “Russia” operating reportable segment.

Property, plant and equipment – Property, plant and equipment, including improvements that extend useful lives, are stated at cost. Property, plant and equipment with a useful life of more than one year is capitalized at historical cost and depreciated on a straight-line basis over its expected useful life as follows:

| | |
|------------------------------------|--|
| Network and base station equipment | 5-12 years |
| Leasehold improvements | shorter of 8-10 years or lease term |
| Office equipment and computers | 5 years |
| Buildings | 50 years |
| Vehicles | 4 years |

Construction in progress and equipment held for installation is not depreciated until the constructed or installed asset is ready for its intended use. Maintenance and repair costs are expensed as incurred, while upgrades and improvements are capitalized. Interest expense incurred during the construction phase of MTS network under development is capitalized as part of property, plant and equipment until the relevant projects are completed and placed into service.

Asset retirement obligations – In accordance with SFAS No. 143, “Accounting for Asset Retirement Obligations” and FASB Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143” (“FIN No. 47”), the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal or constructive obligation in connection with the retirement of tangible long-lived assets. The adoption of FIN No. 47 did not have material impact on the Group’s financial position or results of operations. The Group’s obligations under SFAS No. 143 relate primarily to the cost of removing its equipment from sites. As of December 31, 2005, the estimated asset retirement obligations were not significant to the Group’s consolidated financial position and results of operations.

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As of December 31, 2007 and 2006, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

| | | |
|--|----|---------------|
| Balance as of December 31, 2006 | \$ | 10,821 |
| Liabilities incurred in the current period | | 3,115 |
| Accretion expense | | 1,138 |
| Revisions in estimated cash flows | | 44,453 |
| | | <hr/> |
| Balance as of December 31, 2007 | \$ | <u>59,527</u> |

The Group recorded the present value of assets retirement obligations as other long-term liabilities in the consolidated balance sheets as of December 31, 2007 and 2006. Revisions in estimated cash flows are attributable to the increase in dismantlement works cost in dollar terms and change in the inflation rate forecast used for the calculation.

License costs – License costs are capitalized as a result of (a) the purchase price allocated to licenses acquired in business combinations and (b) licenses purchased directly from government organizations, which require license payments.

The current operating licenses of the Group do not provide for automatic renewal upon expiration. As the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized during the initial license period without consideration of possible future renewals, subject to periodic review for impairment, on a straight-line basis over three to fifteen years starting from the date such license becomes commercially operational.

Other intangible assets and goodwill – Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base, rights to use radio frequencies and rights to use premises. A part of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity with a finite contractual life is being amortized over the contract period which varies from five to ten years and the rights to use premises are being amortized over five to fifteen years. Amortization of numbering capacity costs starts immediately upon the purchase of numbering capacity. Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142").

Software and other intangible assets are amortized over one to fifteen years. Customer bases are amortized over their respective estimated average subscriber life, being from 20 to 60 months. Rights to use radio frequencies are amortized over the period of their contractual life, being from two to fifteen years. All finite-life intangible assets are amortized using the straight-line method.

Goodwill represents an excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition. Goodwill is reviewed for impairment at least annually or whenever it is determined that one or more impairment indicators exist. The Group determines whether impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If an impairment of goodwill has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

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Leasing arrangements – The Group accounts for leases based on the requirements of SFAS No. 13, “Accounting for Leases.” Entities of the Group lease operating facilities, which include switches, base stations and other cellular network equipment. The Group also leases premises and other sites to install base stations equipment and towers. Rentals payable under operating leases are charged to the income statement on a straight line basis over the term of the relevant lease. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

Investments impairment – Management periodically assesses the recoverability of the carrying values of investments and, if necessary, records impairment losses to write the investments down to fair value. For the years ended December 31, 2007 and 2005, no impairment of investments occurred. In 2006, the Group’s investment in Bitel LLC (“Bitel”) in the amount of \$150 million was written down to \$nil (Note 20).

Impairment of long-lived assets – MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares 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, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. Impairment of property, plant and equipment and intangible assets for the year ended December 31, 2007 amounted to \$10.0 million. No impairment loss occurred during the years ended December 31, 2006 and 2005.

Subscriber prepayments – MTS requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of services provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

Treasury stock – Shares of common stock repurchased by the Group are recorded at cost as treasury stock and reduce the shareholders’ equity in the Group’s consolidated financial statements.

Revenue recognition – The Group records its revenues net of VAT. Revenues are recognized only when all of the following conditions have been met: (i) there is pervasive evidence of an arrangement; (ii) delivery of services and goods has occurred; (iii) the fees are fixed and determinable; and (iv) collectibility of the fees is reasonably assured.

MTS categorizes its revenue sources in the statements of operations as follows:

- Service revenue and connection fees: (a) usage charges; (b) subscription fees; (c) value added service fees; (d) fees for connecting users of other operators’ fixed line and wireless networks to MTS network (“interconnect fees”); (e) roaming fees charged to other operators for guest roamers utilizing MTS network; (f) connection fees; and
- Sales of handsets and accessories.

Usage charges – Usage charges consist of fees determined based on airtime used by a subscriber, the destination of the call and the service utilized, and access charges. MTS recognizes revenues related to usage charges and access charges in the period when services are rendered.

Subscription fees – MTS recognizes revenues related to the monthly network subscription fees in the month when the service is provided to the subscriber.

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Value added service fees – Value added service fees are determined based on the usage of airtime or the volume of data transmitted for value added services, such as short message services (“SMS”), including content services via SMS, internet usage and data services. The Group evaluates the criteria outlined in Emerging Issues Task Force (“EITF”) Issue No. 99-19 “Reporting Revenue Gross as a Principal Versus Net as an Agent” in determining whether it is appropriate to record the gross amount of services provided and related costs or the net amount earned as commissions. Revenue is recorded gross when MTS is primarily obligated in a transaction, has latitude in establishing prices and selecting suppliers of services, or has several but not all of these indicators.

Roaming fees – MTS charges roaming per-minute fees to other wireless operators for non-MTS subscribers utilizing MTS network. MTS recognizes such revenues when the services are provided.

Interconnect fees – Effective July 1, 2006, an amendment to the RF Federal Law on Communications implemented the “calling party pays”, or CPP, principle prohibiting mobile operators from charging their subscribers for incoming calls. Previously, MTS charged subscribers in Russia for incoming calls. Under the new system, MTS charges the telecommunication operators of the calling party for incoming calls, and, in its turn, MTS pays other operators for the outgoing calls of its subscribers.

MTS recognizes interconnect fees for incoming calls to customers from fixed line or wireless networks owed by other operators in the month when services to the customer are actually provided.

Connection fees – MTS defers the initial connection fees on its prepaid and postpaid tariff plans from the moment of initial signing of the contract with subscribers and activation of value added services over the estimated average subscriber life. Based on management analysis of the subscriber base in the regions where the Group operates the average expected subscriber life ranged from 12 to 60 months in 2005 and 2006, and from 14 to 60 months in 2007.

Sales of handsets and accessories – MTS sells wireless handsets and accessories to customers who are entering into contracts for service and also as separate distinct transactions. The Group recognizes revenues from the sale of wireless handsets and accessories when the products are delivered to and accepted by the customer, as it is considered to be a separate earnings process from the sale of wireless services in accordance with EITF Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables”. The costs of wireless handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when the associated revenue is recognized.

Customer incentives – Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives, representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the fair value of the free product or service is classified as an expense. In particular, MTS sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of handsets and accessories when the sale is recorded.

Prepaid phone cards – MTS sells prepaid phone cards to subscribers, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and value-added services. The Group recognizes revenue from the services in the month when the services were actually rendered. Revenue from the sale of prepaid cards is deferred until the service is rendered to the customer uses the airtime or the card expires.

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Cost of services – Expenses incurred by MTS in connection with the provision of wireless communication services mainly relate to interconnect and line rental costs, roaming expenses and costs of handsets and accessories sold.

Calls made by MTS subscribers from areas outside of the territories covered by the Group's licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with the subscriber, being a primary obligor in providing the services, bearing the credit risk and having latitude in establishing roaming prices. MTS charges its subscribers for roaming fees paid to other networks based on the Group's existing tariffs and records such roaming fees as service revenues at the time the services are performed.

Taxation – Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and for the loss or tax credit carry-forwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely than not that these assets will not be realized.

Accounting for uncertainty in income tax – On January 1, 2007, the Group adopted the provisions of FASB Interpretation No. 48 (“FIN No. 48”), “Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109”. FIN No. 48 creates a single model to address uncertainty in tax position and clarifies the accounting for income taxes recognized by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statement. FIN No. 48 also provides guidance on recognition, measurement, classification, interest and penalties, disclosure and transition. The Group recognizes interests and penalties related to uncertain tax positions in income tax expense. The adoption of FIN No. 48 resulted in reduction on Group's accumulated income and additional accrual for unrecognized tax benefit, potential penalties and interest in the total amount of \$0.6 million, \$5.7 million and \$1.3 million, respectively, which were recorded as an adjustment to retained earnings as of January 1, 2007 (see also Note 13).

Sales and marketing expenses – Sales and marketing expenses consist primarily of dealers' commissions and advertising costs. Dealers' commissions are linked to revenues received during the six-month period from the date a new subscriber is activated by a dealer. MTS expenses these costs as incurred. Advertising costs for the years ended December 31, 2007, 2006 and 2005, were \$374,885, \$321,451 and \$248,610, respectively.

Borrowing costs – Borrowing costs include interest incurred on existing indebtedness and debt issuance costs. Interest costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized interest costs for the years ended December 31, 2007, 2006 and 2005 were \$88,810, \$70,274 and \$54,229, respectively. Debt issuance costs are capitalized and amortized over the term of the respective borrowings using the effective interest method. Interest expenses net of amounts capitalized and amortization of debt issuance costs, for the years ended December 31, 2007, 2006 and 2005, were \$129,880, \$138,977 and \$110,422, respectively.

Government Pension Fund – The Group contributes to the local state pension and social funds, on behalf of all its employees.

In Russia all social contributions are represented by a unified social tax (“UST”) calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee. The UST is allocated to three social funds, including the pension fund, where the rate of contributions varies from 20% to 2%, depending on the annual gross salary of employee. These contributions are expensed as incurred. The amount of UST paid by the Group in Russia amounted to \$42.8 million, \$35.8 million and \$35.3 million in 2007, 2006 and 2005, respectively.

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In Ukraine, Uzbekistan, Turkmenistan and Armenia the subsidiaries of the Group are required to contribute a specified percentage of each employee payroll up to a fixed limit to the local pension fund, unemployment and social security funds. Payments to the pension fund in the Ukraine amounted to \$11.7 million, \$9.1 million and \$6.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. Amounts contributed to the pension funds in Uzbekistan, Turkmenistan and Armenia were not significant.

The Group does not participate in any pension funds other than described above.

Earnings per share – Basic earnings per shares (“EPS”) have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilutive effect of stock options granted to employees. There are 1,397,256, 1,435,001 and 3,187,240 stock options outstanding as at December 31, 2007, 2006 and 2005, respectively.

The following is the reconciliation of the share component for basic and diluted EPS with respect to the Group’s net income:

| | December 31, | | |
|--|----------------------|----------------------|----------------------|
| | 2007 | 2006 | 2005 |
| Weighted average number of common shares outstanding, basic | 1,973,354,348 | 1,987,610,121 | 1,986,819,999 |
| Dilutive effect of stock options, as if exercised | 720,560 | 35,894 | 290,040 |
| Weighted average number of common shares and potential shares outstanding, diluted | <u>1,974,074,908</u> | <u>1,987,646,015</u> | <u>1,987,110,039</u> |

Financial instruments and hedging activities – From time to time in its acquisitions, the Group uses financial instruments, consisting of put and call options on all or part of the minority stakes of acquired companies, to defer payment of the purchase price and provide optimal acquisition structuring. These put and call options qualify as freestanding financial instruments and are accounted in accordance with the provisions of SFAS No. 150 “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity” and EITF 00-6 “Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary”.

From time to time the Group enters into variable-to-fixed interest rate swap agreements to manage its exposure to variability in expected future cash flows of its variable-rate long term debt, which is caused by interest rate fluctuations.

The Group accounts for these swaps in accordance with the provisions of SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities” and SFAS No. 149 “Amendment of Statement 133 on Derivative Instruments and Hedging Activities.” All derivatives are recorded as either assets or liabilities in the consolidated balance sheets and measured at their respective fair values.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in equity. The gain or loss relating to the ineffective portion is recognized immediately in the income statement.

The Group’s interest rate swap agreements are designated as cash flow hedges and the hedging relationship qualifies for hedge accounting. Accordingly, the effective portion of the change in the fair value of interest rate swap agreements is recorded in other comprehensive income and reclassified to interest expense in the same period that the related cash flows of the hedged transaction affect the interest expense.

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At the inception of the hedge, and on a quarterly basis, the Group performs an analysis to assess whether changes in the cash flows of its interest rate swap agreements are deemed highly effective in offsetting changes in the cash flows of the hedged debt. If at any time the correlation assessment indicates that the interest rate swap agreements are no longer effective as a hedge, the Group discontinues hedge accounting and all subsequent changes in fair value are recorded in net income.

The Group does not use financial instruments for trading purposes.

Fair value of financial instruments – The fair market value of financial instruments, consisting of cash and cash equivalents, short-term investments, derivative financial instruments, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. Based on the Luxemburg stock exchange quotes as of December 31, 2007, the \$400 million Notes due in 2008 had a fair value of 100.0% or \$400 million, the \$400 million Notes due in 2010 had a fair value of 103.8% or \$415 million and the \$400 million Notes due in 2012 had a fair value of 103.1% or \$412 million. As of December 31, 2007, the fair value of other fixed rate debt including capital lease obligations approximated its carrying value. The fair value of variable rate debt approximates its carrying value.

Comprehensive income – Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is the reconciliation of total comprehensive income, net of tax for the years ended December 31, 2007, 2006 and 2005:

| | Year ended December 31, | | |
|--|-------------------------|---------------------|---------------------|
| | 2007 | 2006 | 2005 |
| Net income | \$ 2,071,504 | \$ 1,075,738 | \$ 1,126,405 |
| Effect of change in functional currency | 358,997 | - | - |
| Currency translation adjustment | 256,390 | 41,315 | 24,898 |
| Change in fair value of interest rate swaps, net of tax of \$352, \$794 and \$1,033, respectively | (1,114) | (2,013) | 3,272 |
| Total comprehensive income | <u>\$ 2,685,777</u> | <u>\$ 1,115,040</u> | <u>\$ 1,154,575</u> |

Stock-based compensation – Prior to December 31, 2005, MTS accounted for stock options issued to employees under the recognition and measurement provisions of APB Opinion No. 25 “Accounting for Stock Issued to Employees, Compensation” (“APB No.25”), as permitted by FASB Statement No. 123 “Accounting for Stock-Based Compensation” (“SFAS No.123”) and SFAS No. 148 “Accounting for Stock Based Compensation – Transition and Disclosure, an Amendment to FASB Statement No. 123”. Under the requirements of these statements, the Group elected to use the intrinsic method to measure share-based awards for the purposes of recording share-based compensation expense for awards granted to employees.

Effective from January 1, 2006, MTS adopted the provisions of FASB Statement No. 123R “Share based payments” (SFAS No. 123R), which is a revision of SFAS No. 123. Under SFAS No. 123R companies must calculate and record the cost of equity instruments, such as stock options awarded to employees for services received in income statement. The cost of the equity instruments is to be measured based on the fair value of the instruments on the day they are granted (with certain exceptions) and is recognized over the period during which the employees are required to provide services in exchange for equity instruments.

The Group adopted SFAS No. 123R using the modified-prospective-application transition method. Under this transition method, compensation cost for all share-based awards granted prior to, but not yet vested as of December 31, 2006, was determined based on the grant date fair value estimated in accordance with the original requirements of SFAS No. 123, using the same assumptions and taken into account the estimated forfeitures.

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If the Group had recognized compensation costs following the provisions of the SFAS No. 123 in the year ended December 31, 2005, net income and earning per share amounts would have been as follows:

| | <u>December 31,</u> <u>2005</u> |
|---|------------------------------------|
| Net income as reported | \$ 1,126,405 |
| Add: Stock-based compensation included in reported net income, net of related tax effects | 1,175 |
| Less: Pro forma stock-based compensation under SFAS No.123, net of related tax effects | <u>(2,891)</u> |
| Pro forma net income | <u>\$ 1,124,689</u> |
| Earnings per share – basic and diluted | |
| As reported | \$ 0.57 |
| Pro forma | \$ 0.57 |

Comparative information – Certain prior year amounts have been reclassified to conform to the current period presentation.

New and recently adopted accounting pronouncements – In September 2006, the FASB issued FASB Statement No. 157, “Fair value measurements” (“SFAS No. 157”). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements of fair value measurement. SFAS No. 157 is applicable to other accounting pronouncements that require or permit fair value measurement, and accordingly, does not require any fair value measurement. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Group adopted SFAS No. 157 as of January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Group’s financial position, results of operations and cash flows.

In February 2007, the FASB issued FASB Statement No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” – including an amendment of FASB Statement No. 115” (“SFAS No.159”), which permits an entity to measure certain financial assets and financial liabilities at fair value. SFAS No. 159 offers an irrevocable option to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded in earnings (the fair value option, or FVO). The Statement’s objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. SFAS No.159 is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007. The Group does not expect the adoption of SFAS No. 159 will have a material impact on the consolidated financial statements.

In December 2007, the FASB issued FAS No. 141R, “Business Combinations” (“SFAS No. 141R”), and FAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51” (“SFAS No. 160”). These statements substantially elevate the role played by fair value and dramatically change the way companies account for business combinations and noncontrolling interests (minority interests in current GAAP). SFAS No. 141R and SFAS No.160 will require among other changes: (a) more assets acquired and liabilities assumed to be measured at fair value as of the acquisition date; (b) liabilities related to contingent consideration to be remeasured at fair value in each subsequent reporting period; (c) an acquirer to expense acquisition-related costs; and (d) noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. Both Statements are to be applied prospectively (with one exception

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related to income taxes) for fiscal years beginning on or after December 15, 2008. However, SFAS No.160 requires entities to apply the presentation and disclosure requirements retrospectively (e.g., by reclassifying noncontrolling interests to appear in equity) to comparative financial statements, if presented. Both standards prohibit early adoption. The Group is currently evaluating the impact the adoption of SFAS No. 141R and SFAS No. 160 may have on its financial position and results of operations.

In connection with the issuance of SFAS No. 160, the SEC revised EITF Topic D-98 "Classification and Measurement of Redeemable Securities" ("Topic D-98") to include the SEC Staff's views regarding the interaction between Topic D-98 and SFAS No. 160. The revised Topic D-98 indicates that the classification, measurement, and earnings-per-share guidance required by Topic D-98 applies to noncontrolling interests (e.g., when the noncontrolling interest is redeemable at a fixed price by the holder or upon the occurrence of an event that is not solely within the control of the issuer). This includes noncontrolling interests redeemable at fair value. The revisions to Topic D-98 that are specific to accounting for noncontrolling interests should be applied no later than the effective date of SFAS No. 160. The Group is currently evaluating the impact that adoption of SFAS No. 160 and Topic D-98 will have on the accounting and disclosure of the Group's minority interest.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS No. 161"). The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Group is currently evaluating the potential impact, if any, of the adoption of SFAS No. 161 on the Group's financial position, results of operations and cash flows.

3. BUSINESSES ACQUIRED

Bashcell acquisition – In December 2007, MTS acquired 100% of Bashcell, the GSM-1800 mobile services provider in the Republic of Bashkortostan, situated in Russia's Volga region. Cash consideration paid amounted to \$6.7 million. In connection to the purchase MTS assumed debt in the amount of \$31.9 million due from Bashcell to its previous shareholder.

As of November 30, 2007, Bashcell provided services to approximately 142,000 subscribers (unaudited).

This acquisition was accounted for using the purchase method of accounting. The preliminary purchase price allocation for the acquisition was as follows:

| | | |
|-------------------------|----|--------------|
| Current assets | \$ | 4,960 |
| Non-current assets | | 28,730 |
| Customer base cost | | 8,586 |
| Goodwill | | 5,123 |
| Current liabilities | | (7,568) |
| Non-current liabilities | | (31,919) |
| Deferred taxes | | (1,220) |
| | | <hr/> |
| Purchase price | \$ | <u>6,692</u> |

Goodwill is mainly attributable to the synergy expected as a result of the acquisition and was assigned to "Russia" operating segment. The total amount of goodwill is not deductible for income tax purposes. The customer base is amortized over the estimated average subscriber's life of approximately 34 months.

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Although substantially complete, final adjustments, as applicable, to the purchase price allocation for the acquisition will be finalized in the first quarter of 2008.

K-Telecom acquisition – In September 2007, MTS acquired 80% stake in International Cell Holding Ltd, 100% indirect owner of K-Telecom CJSC, Armenia’s wireless telecommunication operator. Along with acquisition, the Group entered into a call and put option agreement for the remaining 20% stake to be exercised not earlier than July 2010 and not later than July 2012. In accordance with put and call option agreement, the exercise price shall be determined by an independent investment bank at the date the option is exercised. The option is valid until July 2012. The option was accounted for at fair value which was \$nil at December 31, 2007.

K-Telecom operates under the VivaCell brand in the GSM-900/1800 standard covering the entire territory of Armenia. As of July 1, 2007, it provided services to over 986,000 subscribers (unaudited). The license is valid until the end of 2019.

In accordance with sale and purchase agreement, MTS paid €260.0 million (\$361.2 million as of the date of acquisition) for 80% of K-Telecom and €50.0 million (\$69.0 million as of the date of acquisition) shall be paid out to the sellers in the course of three years from 2008 to 2010 provided certain agreed financial targets are met by K-Telecom. Based on K-Telecom’s financial results for the year ended December 31, 2007, €10.0 million (\$14.7 million as of December 31, 2007) out of €50.0 million (\$73.6 million as of December 31, 2007) was recognized as a liability in the accompanying consolidated balance sheet and included in the purchase price of K-Telecom. In conjunction with the acquisition, MTS extended a €140.0 million (\$194.5 million as of date of acquisition) technical loan to K-Telecom for repayment of payables for equipment and other liabilities due as of the date of acquisition to PMF Telecommunications, an entity, affiliated to the sellers. As a result, K-Telecom’s liabilities to the seller and its affiliates were settled. The loan is eliminated in consolidation and is not part of purchase price. Finders and consultants fees paid in connection with the business combination comprised \$26.7 million.

This acquisition was accounted for using the purchase method of accounting. The purchase price allocation for the acquisition was as follows:

| | | |
|-------------------------|----|----------------|
| Current assets | \$ | 31,805 |
| Non-current assets | | 198,984 |
| License costs | | 217,354 |
| Customer base cost | | 76,754 |
| Trade mark | | 2,555 |
| Goodwill | | 120,579 |
| Current liabilities | | (25,138) |
| Non-current liabilities | | (149,841) |
| Deferred taxes | | (59,722) |
| Minority interest | | (10,772) |
| | | <hr/> |
| Purchase price | \$ | <u>402,558</u> |

Recording contingent consideration once financial targets are met will result in future adjustments to the purchase price.

Goodwill is mainly attributable to the economic potential of Armenia, given the low mobile penetration level of the market. Goodwill is not deductible for income tax purposes.

The customer base is amortized over the estimated average subscriber’s life of approximately 46 months.

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Uzdunrobota acquisition – In June 2007, MTS purchased an additional 26% stake in JV Uzdunrobota (“Uzdunrobota”), mobile operator in Uzbekistan, from a private investor for \$250.0 million in cash. Previously MTS owned 74% of Uzdunrobota. As a result of this transaction, MTS ownership increased to 100%. The transaction was accounted for using the purchase method. Allocation of purchase price increased the recorded license cost by \$155.7 million, customer base cost by \$6.5 million, property plant and equipment cost by \$5.4 million. Additional \$35.0 million was recognized as goodwill. Goodwill is not deductible for income tax purposes and is mainly attributable to the economic potential of the markets where Uzdunrobota operates.

License costs are amortized over the remaining contractual terms of the licenses of approximately 9 years and the customer base is amortized over the estimated average subscriber’s life of approximately 20 months.

Dagtelecom acquisition – In July 2006, MTS acquired a 74.99% controlling stake in Dagtelecom for a cash consideration of \$14.7 million. In conjunction with this acquisition, the Group entered into a put and call option agreement to buy the remaining stake at fair market value within an exercise period commencing from September 1, 2009 and ending in July 2021, for the put option, and from 2009 to 2010 for the call option. The fair values of the option was \$nil at December 31, 2007 and 2006. Dagtelecom is a GSM-900 mobile services provider in the Republic of Dagestan, a region in the South of Russia with a population of 2.6 million. Dagtelecom’s customer base at the date of acquisition was approximately 170,000 subscribers (unaudited).

This acquisition was accounted for using the purchase method of accounting. The purchase price allocation for the acquisition was as follows:

| | | |
|-------------------------|----|---------------|
| Current assets | \$ | 605 |
| Non-current assets | | 12,747 |
| Customer base cost | | 1,785 |
| Goodwill | | 12,574 |
| Current liabilities | | (7,610) |
| Non-current liabilities | | (5,086) |
| Deferred taxes | | (392) |
| Minority interest | | 77 |
| | | <hr/> |
| Purchase price | \$ | <u>14,700</u> |

Goodwill is mainly attributable to the economic potential of the macro-region South, where Dagtelecom is located. Goodwill is not deductible for income tax purposes.

The customer base is amortized over the estimated average subscriber’s life of approximately 60 months.

ReCom acquisition – In December 2005, MTS purchased the remaining 46.1% stake in ReCom for \$110.0 million. Previously, MTS owned 53.9% of ReCom. As a result of the transaction, MTS’ ownership in the subsidiary increased to 100%. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased the recorded license costs by \$43.9 million, the customer base costs by \$15.0 million and resulted in recognition of goodwill of \$16.2 million.

Goodwill is mainly attributable to the economic potential of the market given the low regional penetration level as of the date of acquisition. Goodwill is not deductible for income tax purposes.

License costs are amortized over the remaining contractual terms of the licenses of approximately 3 to 8 years and the customer base is amortized over the estimated average subscriber’s life of approximately 60 months.

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BCTI acquisition – In June 2005, MTS entered into an agreement to acquire 100% of the outstanding stock of BCTI, which is a leading cellular operator in Turkmenistan with a customer base of approximately 59,100 subscribers (unaudited). BCTI holds a license to provide GSM-900/1800 services for the whole territory of Turkmenistan. The agreement provided for the acquisition of a 51% stake and included a forward commitment to complete the acquisition of the remaining 49% stake within eight months from the date of the original agreement subject to certain conditions.

MTS acquired the 51% stake in BCTI for a cash consideration of \$28.2 million, including a finder's fee of \$2.5 million. The Group accounted for the purchase of the remaining 49% stake in BCTI as a financing of the minority interest and, consequently, consolidated 100% of the subsidiary starting from June 30, 2005. In November 2005, MTS completed the acquisition of the remaining 49% stake in BCTI for a cash consideration of \$18.5 million.

This acquisition was accounted for using the purchase method of accounting. Total purchase price amounted to \$46.7 million. The purchase price allocation for the acquisition was as follows:

| | |
|---------------------|------------------|
| Current assets | \$ 7,808 |
| Non-current assets | 3,804 |
| License costs | 50,503 |
| Deferred taxes | (10,862) |
| Current liabilities | <u>(4,566)</u> |
| Purchase price | <u>\$ 46,687</u> |

License costs are amortized over the remaining contractual terms of the licenses of approximately 4 years. In accordance with certain provisions of the license agreement with the Government of Turkmenistan, the Group shares the net profit derived from the operations of the BCTI branch located in Turkmenistan. The amount of shared net profit is calculated based on the financial statements prepared in accordance with local generally accepted accounting principles subject to certain adjustments. The Group shared 49% of the net profit since the date of acquisition up to December 21, 2005, and 20% of the net profit commencing December 21, 2005.

Gorizont-RT acquisition – In June 2005, MTS acquired the remaining 24.0% stake in Gorizont-RT, increasing its ownership to 100%. The purchase price paid was \$13.5 million. The allocation of purchase price increased the recorded license costs by \$7.5 million. Additional \$2.7 million was recognized as goodwill. Goodwill is not deductible for income tax purposes.

Telesot Alania acquisition – In December 2005, MTS acquired the remaining 47.5% stake in Telesot Alania, increasing its ownership in the company to 100%. In accordance with the purchase agreement the purchase price amounted to \$32.6 million, from which \$9.0 million was paid in 2005, and the remaining \$23.6 million was paid during 2006.

The purchase price allocation was completed in 2006. The adjustment to the preliminary purchase price allocation made as of the date of the acquisition in 2005 resulted in a reduction of goodwill to \$24.0 million and increase of license cost to \$5.0 million.

License costs are amortized over the remaining contractual terms of the license of approximately 2 years and the customer base is amortized over the estimated average subscriber's life of approximately 60 months.

Goodwill is mainly attributable to the economic potential of the market in the macro-region "South" where the company is located. Goodwill is not deductible for income tax purposes.

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Acquisitions of various regional companies – In November 2006, MTS established a wholly-owned subsidiary TS-Retail LLC (“TS-Retail”) to further expand its retail business. On December 7, 2007, MTS stake in this company decreased from 100% to 25% following the increase of share capital by TS-Retail by \$14.0 million, that was paid by MTS and certain Sistema subsidiaries. See Note 15 for detailed description of this transaction.

In December 2005, MTS acquired an additional 74% stake in MTS-Tver for \$1.4 million. As a result of the transaction, MTS ownership in the company increased to 100%. The acquisition was accounted for using the purchase method.

In December 2005, MTS acquired the remaining 6.47% stake in Sibintertelecom, which resulted in an increase of MTS ownership in Sibintertelecom to 100%. The amount paid for the stake was \$2.8 million. The allocation of purchase price increased the recorded license costs by \$1.4 million. Additional \$0.2 million was recognized as goodwill. Goodwill is not deductible for income tax purposes.

In February 2005, MTS completed the acquisition of 74.9% stake in Sweet-Com LLC for a cash consideration of \$2.0 million. Sweet-Com LLC is the holder of 3.5 GHz radio frequency allocation for the Moscow region. The company is providing wide-band radio access services for the “last mile” based on Radio-Ethernet technology. The acquisition was accounted for using the purchase method. As the result of the purchase price allocation, license costs increased by \$2.4 million.

In February 2005, MTS acquired a 74% stake in MTS-Komi Republic, increasing its ownership to 100%. The consideration paid under the transaction amounted to \$1.2 million. The acquisition was accounted for using the purchase method.

Pro forma results of operations (unaudited) – The following unaudited pro forma financial data for the years ended December 31, 2007 and 2006, give effect to the acquisitions of K-Telekom, Bashcell and the remaining stake in Uzdurobita, as though these business combinations had been completed at the beginning of each year.

| | <u>2007</u> | <u>2006</u> |
|---------------------------------------|--------------|--------------|
| Pro forma: | | |
| Net revenues | \$ 8,375,532 | \$ 6,486,102 |
| Net operating income | 2,726,235 | 2,107,181 |
| Net income | 2,054,765 | 1,019,327 |
| Earnings per share, basic and diluted | \$ 1.04 | \$ 0.51 |

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2006, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

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4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2007 and 2006, comprised the following:

| | December 31, | |
|--------------------------------------|---------------------|-------------------|
| | 2007 | 2006 |
| Ruble current accounts | \$ 71,457 | \$ 92,626 |
| Ruble deposit accounts | 61,517 | 13,292 |
| U.S. Dollar current accounts | 15,143 | 8,445 |
| U.S. Dollar deposit accounts | 255,293 | 37,601 |
| Hryvnia current accounts | 3,550 | 14,931 |
| Hryvnia deposit accounts | 6,931 | 5,941 |
| Uzbek som current accounts | 121,719 | 1,816 |
| Uzbek som deposit accounts | 45,736 | 35,513 |
| Turkmenian manat current accounts | 22,154 | 7,441 |
| Armenian dram current accounts | 14,777 | - |
| Armenian dram deposit accounts | 8,546 | - |
| Current accounts in other currencies | <u>7,675</u> | <u>2,383</u> |
| Total cash and cash equivalents | <u>\$ 634,498</u> | <u>\$ 219,989</u> |

5. SHORT-TERM INVESTMENTS

Short-term investments, consisting of deposits denominated in U.S. Dollars, as of December 31, 2007, comprised the following:

| | Annual interest rate | Maturity Date | December 31, 2007 |
|---|---------------------------------|--------------------------|------------------------------|
| OJSC Moscow Bank of Reconstruction and Development | 6.6% | June, 2008 | \$ 15,000 |
| Other | | | <u>776</u> |
| Total short-term investments | | | <u>\$ 15,776</u> |

Short-term investments, consisting of deposits denominated in U.S. Dollars, as of December 31, 2006, comprised the following:

| | Annual interest rate | Maturity Date | December 31, 2006 |
|---|---------------------------------|--------------------------|------------------------------|
| OJSC Moscow Bank of Reconstruction and Development | 7.5% | March, 2007 | \$ 42,700 |
| OJSC Moscow Bank of Reconstruction and Development | 7.5% | February, 2007 | 12,300 |
| Other | | | <u>1,047</u> |
| Total short-term investments | | | <u>\$ 56,047</u> |

OJSC Moscow Bank of Reconstruction and Development is a related party, whose controlling shareholder is Sistema (see also Note 15).

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6. TRADE RECEIVABLES, NET

Trade receivables as of December 31, 2007 and 2006, comprised the following:

| | December 31, | |
|-----------------------------------|-------------------|-------------------|
| | 2007 | 2006 |
| Accounts receivable, subscribers | \$ 180,411 | \$ 183,038 |
| Accounts receivable, interconnect | 148,902 | 89,977 |
| Accounts receivable, roaming | 44,525 | 26,104 |
| Accounts receivable, other | 56,250 | 46,795 |
| Allowance for doubtful accounts | (43,480) | (47,435) |
| Trade receivables, net | <u>\$ 386,608</u> | <u>\$ 298,479</u> |

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

| | 2007 | 2006 | 2005 |
|---------------------------------|------------------|------------------|------------------|
| Balance, beginning of the year | \$ 47,435 | \$ 39,919 | \$ 16,659 |
| Provision for doubtful accounts | 58,924 | 84,858 | 50,407 |
| Accounts receivable written off | (62,879) | (77,342) | (27,147) |
| Balance, end of the year | <u>\$ 43,480</u> | <u>\$ 47,435</u> | <u>\$ 39,919</u> |

7. INVENTORY AND SPARE PARTS

Inventory and spare parts as of December 31, 2007 and 2006, comprised the following:

| | December 31, | |
|-----------------------------------|-------------------|-------------------|
| | 2007 | 2006 |
| Spare parts for base stations | \$ 52,069 | \$ 78,120 |
| SIM cards and prepaid phone cards | 33,315 | 34,611 |
| Handsets and accessories | 18,263 | 25,458 |
| Advertising materials | 7,802 | 9,021 |
| Other materials | 29,483 | 49,055 |
| Total inventory and spare parts | <u>\$ 140,932</u> | <u>\$ 196,265</u> |

Other materials mainly consist of stationery, fuel and auxiliary materials. Obsolescence expense for the years ended December 31, 2007, 2006 and 2005, amounted to \$nil, \$nil and \$9,112, respectively, and was included in general and administrative expenses in the accompanying consolidated statements of operations. Spare parts for base stations included in inventory are expected to be utilized within the next twelve months after the balance sheet date.

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8. PROPERTY, PLANT AND EQUIPMENT

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

| | December 31, | |
|---|---------------------|---------------------|
| | 2007 | 2006 |
| Network, base station equipment (including leased network and base station equipment of \$1,533 and \$7,676, respectively) and related leasehold improvements | \$ 6,374,063 | \$ 4,517,536 |
| Office equipment, computers and other | 641,095 | 447,640 |
| Buildings and related leasehold improvements | 352,313 | 242,175 |
| Vehicles (including leased vehicles of \$13,269 and \$7,561, respectively) | 40,973 | 31,949 |
| Property, plant and equipment, at cost | <u>7,408,444</u> | <u>5,239,300</u> |
| Accumulated depreciation (including accumulated depreciation on leased equipment of \$5,625 and \$4,321) | (3,079,376) | (1,948,368) |
| Equipment for installation | 748,447 | 582,827 |
| Construction in progress | <u>1,529,800</u> | <u>1,423,910</u> |
| Property, plant and equipment, net | <u>\$ 6,607,315</u> | <u>\$ 5,297,669</u> |

Depreciation expenses during the years ended December 31, 2007, 2006 and 2005, amounted to \$999.0 million, \$689.7 million and \$510.5 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$2.8 million, \$2.3 million and \$4.0 million, respectively.

9. OTHER INTANGIBLE ASSETS AND GOODWILL

Intangible assets at December 31, 2007 and 2006, comprised the following:

| | Useful lives | December 31, 2007 | | | December 31, 2006 | | |
|---|------------------|----------------------|--------------------------|--------------------|----------------------|--------------------------|--------------------|
| | | Gross carrying value | Accumulated amortization | Net carrying value | Gross carrying value | Accumulated amortization | Net carrying value |
| Amortized intangible assets | | | | | | | |
| Billing and telecommunication software | 13 to 180 months | \$1,280,614 | \$ (604,635) | \$ 675,979 | \$ 919,400 | \$ (383,358) | \$ 536,042 |
| Acquired customer base | 20 to 60 months | 205,510 | (105,714) | 99,796 | 114,850 | (95,751) | 19,099 |
| Rights to use radio frequencies | 2 to 15 years | 199,981 | (69,398) | 130,583 | 163,963 | (52,882) | 111,081 |
| Accounting software | 13 to 48 months | 130,968 | (48,291) | 82,677 | 125,277 | (38,595) | 86,682 |
| Numbering capacity with finite contractual life | 5 to 10 years | 102,857 | (82,701) | 20,156 | 90,138 | (64,522) | 25,616 |
| Office software | 13 to 48 months | 45,577 | (27,471) | 18,106 | 63,605 | (34,113) | 29,492 |
| Other software | 3 to 15 years | 18,593 | (11,537) | 7,056 | 18,931 | (11,204) | 7,727 |
| | | <u>1,984,100</u> | <u>(949,747)</u> | <u>1,034,353</u> | <u>1,496,164</u> | <u>(680,425)</u> | <u>815,739</u> |
| Unamortized intangible assets | | | | | | | |
| Goodwill | | 359,450 | - | 359,450 | 165,462 | - | 165,462 |
| Numbering capacity with indefinite contractual life | | 36,060 | - | 36,060 | 20,177 | - | 20,177 |
| Total other intangible assets | | <u>\$2,379,610</u> | <u>\$ (949,747)</u> | <u>\$1,429,863</u> | <u>\$1,681,803</u> | <u>\$ (680,425)</u> | <u>\$1,001,378</u> |

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As a result of the limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. The costs of acquired numbering capacity with a finite contractual life are amortized over a period of five to ten years in accordance with the terms of the contract to acquire such capacity. Numbering capacity with an indefinite contractual life is not amortized.

Amortization expense for the years ended December 31, 2007, 2006 and 2005, amounted to \$294.8 million, \$195.0 million and \$202.3 million, respectively. Based on the amortizable intangible assets existing at December 31, 2007, the estimated amortization expense is \$270.1 million for 2008, \$263.4 million for 2009, \$231.6 million for 2010, \$177.3 million for 2011, \$31.8 million for 2012 and \$60.2 million thereafter. The actual amortization expense reported in future periods could differ from these estimates as a result of new intangible asset acquisitions, changes in useful lives and other relevant factors.

The change in the net carrying amount of goodwill for 2007 and 2006 by reportable segments was as follows:

| | <u>Russia</u> | <u>Ukraine</u> | <u>Other</u> | <u>Total</u> |
|---------------------------------|-------------------|-----------------|-------------------|-------------------|
| Balance as of December 31, 2005 | \$ 100,751 | \$ 8,000 | \$ 46,470 | \$ 155,221 |
| Acquisitions (Note 3) | 10,241 | - | - | 10,241 |
| Balance as of December 31, 2006 | <u>110,992</u> | <u>8,000</u> | <u>46,470</u> | <u>165,462</u> |
| Acquisitions (Note 3) | 5,123 | - | 155,544 | 160,667 |
| Currency translation adjustment | 18,703 | - | 14,618 | 33,321 |
| Balance as of December 31, 2007 | <u>\$ 134,818</u> | <u>\$ 8,000</u> | <u>\$ 216,632</u> | <u>\$ 359,450</u> |

10. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2007 and 2006, were as follows:

| | <u>2007</u> | <u>2006</u> |
|---|------------------|------------------|
| Balance at the beginning of the year | \$ 79,607 | \$ 102,185 |
| Payments received and deferred during the year | 42,446 | 31,908 |
| Amounts amortized and recognized as revenue during the year | (75,404) | (54,486) |
| Currency translation adjustment | 6,840 | - |
| Balance at the end of the year | <u>53,489</u> | <u>79,607</u> |
| Less: current portion | <u>(32,644)</u> | <u>(47,528)</u> |
| Non-current portion | <u>\$ 20,845</u> | <u>\$ 32,079</u> |

MTS defers initial connection fees paid by subscribers for the activation of network service as well as one time activation fees received for connection to various value added services. These fees are recognized as revenue over the estimated average subscriber life (Note 2).

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11. BORROWINGS

As at December 31, 2007 and 2006, the Group's borrowings comprised the following:

| | December 31, | |
|------------------------|---------------------|---------------------|
| | 2007 | 2006 |
| Notes: | | |
| 9.75% Notes due 2008 | \$ 400,000 | \$ 400,000 |
| 8.38% Notes due 2010 | 400,000 | 400,000 |
| 8.00% Notes due 2012 | 399,314 | 399,178 |
| Less: current portion | (400,000) | - |
| Total notes, long-term | <u>\$ 799,314</u> | <u>\$ 1,199,178</u> |
| Bank loans | \$ 2,197,172 | \$ 1,872,621 |
| Less: current portion | (309,977) | (147,260) |
| Total debt, long-term | <u>\$ 1,887,195</u> | <u>\$ 1,725,361</u> |

Notes – On January 30, 2003, MTS Finance S.A. (“MTS Finance”), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued \$400.0 million 9.75% notes at par. These notes were fully and unconditionally guaranteed by MTS OJSC and matured on January 30, 2008. Proceeds received from the notes issue were \$400.0 million and related issuance costs of \$3.9 million were capitalized. MTS Finance was required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes were listed on the Luxembourg Stock Exchange. These notes were fully paid in January 2008.

On October 14, 2003, MTS Finance issued \$400.0 million notes bearing interest at 8.375% at par. The cash proceeds from the notes were \$395.4 million and related issuance costs of approximately \$4.6 million were capitalized. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

On January 27, 2005, MTS Finance issued \$400.0 million 8.0% unsecured notes at 99.736%. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 28, 2012. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 28 and July 28, commencing on July 28, 2005. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were \$398.9 million and related debt issuance costs of \$2.5 million were capitalized.

Subject to certain exceptions and qualifications, the indentures governing the notes contain covenants limiting the Group's ability to:

- Incur debt;
- Create liens;
- Lease properties sold or transferred by the Group;
- Enter into loan transactions with affiliates;
- Merge or consolidate with another person or convey its properties and assets to another person; and
- Sell or transfer any of its GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas.

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In addition, if the Group experiences certain types of mergers, consolidations or other changes in control, noteholders will have the right to require the Group to redeem the notes at 101% of their principal amount, plus accrued interest. The Group is also required to take all commercially reasonable steps necessary to maintain a rating of the notes from Moody's or Standard & Poor's. The notes also have cross default provisions with publicly traded debt issued by Sistema, the shareholder of the Group.

If the Group fails to meet these covenants, after certain notice and cure periods, the noteholders can accelerate the debt to be immediately due and payable.

Management believes that the Group is in compliance with all restrictive notes covenants provisions during the three year period ended December 31, 2007.

Bank loans – As at December 31, 2007 and 2006, the Group's loans from banking institutions were as follows:

| | <u>Maturity</u> | <u>Annual interest rate (actual rate at December 31, 2007)</u> | <u>December 31,</u> | |
|------------------------------------|-----------------|--|---------------------|---------------------|
| | | | <u>2007</u> | <u>2006</u> |
| U.S. Dollar-denominated bank loans | 2008-2014 | LIBOR+0.13%-3.10% (4.73%-7.70%) | \$ 2,143,181 | \$ 1,802,340 |
| Euro-denominated bank loans | 2008-2014 | EURIBOR +0.35%-0.65% (5.06%-5.36%) | 53,299 | 66,281 |
| Other loans | various | various | 692 | 4,000 |
| Total debt | | | <u>\$ 2,197,172</u> | <u>\$ 1,872,621</u> |

The Group's loans represent amounts borrowed under credit facility agreements existing as of December 31, 2006, including the syndicated loan facility agreement with a number of international financial institutions (The Bank of Tokyo-Mitsubishi UFJ, Ltd., Bayerische Landesbank, HSBC Bank plc, ING Bank N.V., Raiffeisen Zentralbank Oesterreich AG, Sumitomo Mitsui Banking Corporation Europe Limited). This facility allows the Group to borrow up to \$1,330.0 million which was available in two tranches of \$630.0 million and \$700.0 million. The proceeds were used by OJSC MTS for general corporate purposes, including acquisitions and refinancing of existing indebtedness. The first tranche bears interest of LIBOR+0.80% per annum and matures in 2009. The second tranche bears interest of LIBOR+1.00% per annum within the first three years and LIBOR + 1.15% per annum thereafter, matures in April 2011 and is repayable in 13 equal quarterly installments, commencing in April, 2008. An arrangement fee of 0.10% of the original facility amount and agency fee of \$0.05 million per annum should be paid in accordance with the agreement. The commitment fee is 0.40% per annum on the undrawn facility in respect of second tranche. The debt issuance costs in respect of this loan of \$13.4 million were capitalized. As of December 31, 2007, the balances outstanding under the loan totalled \$1,330.0 million.

The Group's total available credit facilities as of December 31, 2007, amounted to \$11.2 million.

The loans are subject to certain restrictive covenants, including, but not limited to, certain financial ratios, limitations on dispositions of assets and limitations on transactions with associates. Management believes that as of December 31, 2007, the Group is in compliance with all existing covenants.

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The following table presents the aggregated scheduled maturities of the notes and debt principal outstanding as of December 31, 2007:

| | <u>Notes</u> | <u>Debt</u> |
|---|---------------------|---------------------|
| Payments due in the year ended December 31, | | |
| 2008 | \$ 400,000 | \$ 309,977 |
| 2009 | - | 986,774 |
| 2010 | 400,000 | 348,540 |
| 2011 | - | 237,339 |
| 2012 | 399,314 | 129,647 |
| Thereafter | <u>-</u> | <u>184,895</u> |
| Total | <u>\$ 1,199,314</u> | <u>\$ 2,197,172</u> |

Hedges – In January 2006, the Group entered into a variable-to-fixed interest rate swap agreement with HSBC Bank plc to hedge MTS exposure to variability of future cash flows caused by the change in EURIBOR related to the borrowed loan. MTS agreed with HSBC Bank plc to pay a fixed rate of 3.29% and receive a variable interest of EURIBOR on €26.0million for the period from April 28, 2006, up to October 29, 2013. As of December 31, 2007, the Group recorded an asset of \$1.0 million in relation to the hedge contract in the accompanying consolidated balance sheet and income of \$0.8 million, net of tax of \$0.2 million, as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of this agreement.

In December 2007, the Group entered into several variable-to-fixed interest rate swap agreements with HSBC Bank plc, Rabobank, Citibank N.A. and ING Bank N.V. to hedge MTS exposure to variability of future cash flows caused by the change in LIBOR related to the borrowed loans.

MTS agreed with HSBC Bank plc to pay a fixed rate of 4.14% and receive a variable interest of LIBOR on \$96.1 million for the period from March 31, 2008, to September 30, 2014. The agreement with Rabobank was to pay a fixed rate of 4.16% and receive a variable interest of LIBOR on \$86.1 million for the period from April 09, 2008, to April 09, 2014. MTS agreed with Citibank N.A. to pay a fixed rate of 4.29% and receives a variable interest of LIBOR on \$53.5 million for the period from September 28, 2007, to September 30, 2013. Two agreements were signed with ING Bank N.V. Under the first agreement MTS pays to ING Bank N.V. a fixed rate of 4.19% and receive a variable interest of LIBOR on \$92.6 million for the period from February 29, 2008, to February 28, 2014. According to the terms of the second agreement, MTS pays to ING Bank N.V. a fixed rate of 4.41% and receives a variable interest of LIBOR on \$67.0 million for the period from July 16, 2007, to January 15, 2014.

As of December 31, 2007, the Group recorded a liability of \$1.4 million in relation to the above hedge contracts in the accompanying consolidated balance sheet and loss of \$1.1 million, net of tax of \$0.3 million, to other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements.

These instruments qualified as a cash flow hedges under the requirements of SFAS No. 133 as amended by SFAS No. 149. As of December 31, 2007, the outstanding hedges were effective. Approximately \$0.4 million is expected to be reclassified in net income during the next twelve months.

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12. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2007 and 2006, comprised the following:

| | December 31, | |
|---------------------------------------|-------------------|-------------------|
| | 2007 | 2006 |
| Accruals for services | \$ 187,062 | \$ 145,862 |
| Accrued payroll and vacation | 101,901 | 80,269 |
| Accruals for payments to social funds | 53,109 | 51,665 |
| Accruals for taxes | 60,905 | 68,098 |
| Interest payable on debt | 61,528 | 59,834 |
| Total accrued liabilities | <u>\$ 464,505</u> | <u>\$ 405,728</u> |

13. INCOME TAX

MTS provision for income taxes was as follows for the years ended December 31, 2007, 2006 and 2005:

| | December 31, | | |
|------------------------------------|-------------------|-------------------|-------------------|
| | 2007 | 2006 | 2005 |
| Current provision for income taxes | \$ 830,358 | \$ 709,130 | \$ 475,549 |
| Deferred income tax benefit | (92,088) | (133,027) | (64,959) |
| Total provision for income taxes | <u>\$ 738,270</u> | <u>\$ 576,103</u> | <u>\$ 410,590</u> |

The statutory income tax rates for 2007 in Russia and Ukraine were 24% and 25%, respectively. The statutory income tax rates for 2007 in Uzbekistan and Turkmenistan were 10% and 20%, respectively. Income tax rate in Armenia in 2007 was 20%.

The statutory income tax rate reconciled to MTS effective income tax rate is as follows for the years ended December 31, 2007, 2006 and 2005:

| | 2007 | 2006 | 2005 |
|--|--------------|--------------|--------------|
| Statutory income tax rate for year | 24.0% | 24.0% | 24.0% |
| Adjustments: | | | |
| Expenses not deductible for tax purposes | 1.0 | 2.9 | 3.0 |
| Currency exchange and transaction loss/(gain) | 0.1 | 2.8 | (0.8) |
| Effect of FIN No. 48 adoption | 0.6 | - | - |
| Bitel investment and liability write off, not deductible for tax purposes | - | 4.6 | - |
| Effect of different tax rate of foreign subsidiaries | 0.2 | 0.3 | 0.3 |
| Other | 0.2 | - | (0.2) |
| Effective income tax rate | <u>26.1%</u> | <u>34.6%</u> | <u>26.3%</u> |

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Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2007 and 2006:

| | <u>December 31,</u> | |
|---|-------------------------|-------------------------|
| | <u>2007</u> | <u>2006</u> |
| Assets/(liabilities) arising from tax effect of: | | |
| Deferred tax assets | | |
| Depreciation of property, plant and equipment | \$ 138,781 | \$ 93,865 |
| Deferred connection fees | 12,908 | 19,214 |
| Subscriber prepayments | 24,341 | 25,755 |
| Accrued expenses | 95,636 | 72,864 |
| Allowance for doubtful accounts | 1,220 | 18,837 |
| Inventory obsolescence | 5,325 | 2,246 |
| Other | 2,929 | 9,994 |
| Total deferred tax assets | <u>281,140</u> | <u>242,775</u> |
| Valuation allowance | - | (3,086) |
| Total deferred tax assets net of valuation allowance | <u>281,140</u> | <u>239,689</u> |
| Deferred tax liabilities | | |
| Licenses acquired | \$ (131,621) | \$ (83,462) |
| Depreciation of property, plant and equipment | (63,484) | (48,574) |
| Customer base | (4,113) | (4,055) |
| Other intangible assets | (18,807) | (19,479) |
| Debt issuance cost | (14,184) | (16,841) |
| Other | <u>(26,636)</u> | <u>(12,513)</u> |
| Total deferred tax liabilities | <u>(258,845)</u> | <u>(184,924)</u> |
| Net deferred tax asset | <u>22,295</u> | <u>54,765</u> |
| Net deferred tax asset, current | \$ 136,466 | \$ 141,114 |
| Net deferred tax liability, long-term | \$ (114,171) | \$ (86,349) |

The Group does not record a deferred tax liability related to the undistributed earnings of UMC, Uzdunrobta, BCTI and K-Telekom as it intends to permanently reinvest these earnings. The undistributed earnings of UMC amounted to \$1,715.1 million and \$1,373.6 million for the years ended December 31, 2007 and 2006, respectively.

As of December 31, 2007, the Group included accruals for unrecognized tax benefit totalling to approximately \$29.2 million as a component of income tax payable.

A reconciliation of the beginning and ending amount of unrecognized tax benefit is as follows:

| | |
|---|-------------------------|
| Balance at January 1, 2007 | \$ 7,610 |
| Additions based on tax position related to the current year | 20,643 |
| Additions to tax positions related to prior years | 5,933 |
| Reduction in tax positions related to prior years | (1,345) |
| Settlements with taxing authorities | <u>(3,628)</u> |
| Balance at December 31, 2007 | <u>\$ 29,213</u> |

At December 31, 2007, the Group also accrued interest and penalties related to unrecognized tax benefit of \$2.5 and \$1.9 million respectively. The Group does not expect the unrecognized tax benefit to change significantly over the next twelve months.

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14. SHARE BASED COMPENSATION

The Stock Option Plan

In 2000, MTS established a stock bonus plan and stock option plan (“the Stock Option Plan”) for selected officers, key employees and key advisors. During its initial public offering in 2000 (see Note 1) MTS allotted 9,966,631 shares of its common stock to fund the Stock Option Plan.

Since 2002, MTS has made several grants pursuant to its stock option plan to employees and directors of the Group. These options generally vest over a two year period from the date of the grant, contingent on continued employment of the grantee with the Company. The options are exercisable within two weeks after the vesting date, and, if not exercised, are forfeited. The exercise price of the options equaled average market share price during the hundred day period preceding the grant date.

A summary of the status of the Group’s Stock Option Plan is presented below:

| | <u>Number of shares</u> | <u>Weighted average exercise price (per share), U.S. Dollars</u> | <u>Weighted average grant date fair value of options (per share), U.S. Dollars</u> | <u>Aggregate intrinsic value</u> |
|----------------------------------|-----------------------------|--|--|--------------------------------------|
| Outstanding at December 31, 2004 | 3,530,970 | \$ 4.09 | \$ 1.65 | \$ 2,777 |
| Granted | 1,778,694 | 6.89 | 1.74 | 907 |
| Exercised | (1,801,622) | 2.43 | 1.02 | (924) |
| Forfeited | (320,802) | 5.25 | 2.06 | (305) |
| Outstanding at December 31, 2005 | 3,187,240 | \$ 6.47 | \$ 2.02 | \$ 2,455 |
| Granted | - | - | - | - |
| Exercised | (639,357) | 5.95 | 2.36 | (695) |
| Forfeited | (1,112,882) | 6.23 | 2.17 | (1,017) |
| Outstanding at December 31, 2006 | 1,435,001 | \$ 6.89 | \$ 1.74 | \$ 743 |
| Granted | 1,778,694 | 6.31 | 5.95 | 6,652 |
| Exercised | (848,126) | 6.89 | 1.74 | (433) |
| Forfeited | (968,313) | 6.66 | 2.65 | (1,726) |
| Outstanding at December 31, 2007 | 1,397,256 | \$ 6.31 | \$ 4.05 | \$ 5,236 |

Stock options outstanding as of December 31, 2007 will vest during the year ended December 31, 2008. None of the stock options outstanding as of December 31, 2007 were exercisable.

The fair value of options granted during the years ended December 31, 2007 and 2005, was estimated using the lattice model based on the following assumptions:

| | <u>2007</u> | <u>2005</u> |
|--|-------------|-------------|
| Risk free rate | 3.1% | 4.7% |
| Expected dividend yield | 0.3% | 3% |
| Expected volatility | 40.3% | 40.0% |
| Expected life, years | 2 | 2 |
| Fair value of options (per share), U.S. Dollar | \$5.95 | \$1.74 |

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Compensation costs under Stock Option Plan of \$2.8 million, \$1.7 million and \$1.5 million was recognized in consolidated statements of operations during the years ended December 31, 2007, 2006 and 2005, respectively.

The effect from forfeitures comprised \$0.3 million for the year ended December 31, 2005. The effect of the estimated forfeitures on Group's operations since adoption of SFAS No. 123R was \$1.7 million and \$1.0 million in 2007 and 2006, respectively.

As of December 31, 2007, there is \$3.0 million of total unrecognized compensation cost related to non-vested stock-based compensation awards under Stock Option Plan. This amount is expected to be recognized over a weighted-average period of 0.54 years.

In accordance with the Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

Phantom Stock Plan

In June 2007, MTS board of directors approved the Phantom Stock Plan to provide deferred compensation to certain key employees (the "Participants") of the Group. The plan is based on units equivalent to the Company's common shares (the "Phantom Shares"). Under the Phantom Stock Plan, the Participants are entitled to a cash payment equal to the difference between the initial grant price and the exercise price of Phantom Shares, multiplied by the number of Phantom Shares granted, upon vesting of the award. The initial grant price is determined based on average market share price during the hundred day period preceding the grant date. The exercise price of Phantom Shares is determined based on average market share price during the hundred day period preceding the vesting date. The vesting period is two years from the grant date, contingent upon the continuing employment of the Participants by the Group. Further, the award shall vest only if at the end of the vesting period the cumulative percentage of the Company's market capitalization growth since the grant date exceeds the cumulative cost of equity determined by the Board of Directors for the same period.

The Group has a maximum of 3,600,000 phantom ADSs, or 18,000,000 Phantom Shares, reserved for issuance under the Phantom Stock Plan, of which 720,000 ADSs, or 3,600,000 Phantom Shares, were granted in 2007. A summary of the status of the Group's Phantom Stock Plan is presented below:

| | <u>Number of shares</u> | <u>Weighted average exercise price (per share), U.S. Dollar</u> | <u>Weighted average fair value of options (per share), U.S. Dollar</u> | <u>Aggregate intrinsic value</u> |
|----------------------------------|-----------------------------|---|--|--------------------------------------|
| Outstanding at December 31, 2006 | - | \$ - | \$ - | \$ - |
| Granted | 3,600,000 | 11.4 | 8.8 | 32,400 |
| Exercised | | | | |
| Forfeited | <u>(183,320)</u> | <u>11.4</u> | <u>8.8</u> | <u>(1,650)</u> |
| Outstanding at December 31, 2007 | <u>3,416,680</u> | <u>\$ 11.4</u> | <u>\$ 8.8</u> | <u>\$ 30,750</u> |

All Phantom Shares outstanding as of December 31, 2007 are non-vested and will vest in 2009. None of the Phantom Shares were exercisable as of December 31, 2007.

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The fair value of the liability under the Phantom Stock Plan as of December 31, 2007, were estimated using the Monte-Carlo simulation technique based on the following assumptions:

| | <u>2007</u> |
|--|-------------|
| Risk free rate | 3.1% |
| Present value of expected dividends, U.S. Dollars | \$5.3 |
| Expected volatility | 40.3% |
| Remaining vesting period, years | 1.5 |
| Cumulative cost of equity | 21.7% |
| Fair value of phantom share award (per share), U.S. Dollar | \$8.8 |

The compensation cost under the Phantom Stock Plan recognized in consolidated statements of operations for the year ended December 31, 2007 amounted to \$7.6 million and related deferred tax benefit amounted to \$1.8 million. The respective liability of \$7.6 million was included in other long-term liabilities in the consolidated balance sheet as of December 31, 2007.

As of December 31, 2007, there was \$23.7 million of total unrecognized compensation cost related to non-vested Phantom Shares. This amount is expected to be recognized over a weighted-average period of 1.5 years. The Group is required to estimate expected forfeiture rate, as well as the probability that performance conditions that affect the vesting of Phantom Shares awards will be achieved and only recognize expense for those shares expected to vest. The Group's estimated forfeiture rate was 5.1%. The effect of forfeitures amounted to \$2.0 million for the year ended December 31, 2007.

15. RELATED PARTIES

Related parties balances as of December 31, 2007 and 2006, comprised the following:

| | <u>December 31,</u> | |
|---|---------------------|-------------------|
| | <u>2007</u> | <u>2006</u> |
| Accounts receivable: | | |
| TS-Retail | \$ 8,578 | \$ - |
| Comstar UTS for interconnect | 6,048 | - |
| Maxima for advertising | 4,305 | 152 |
| MTT for interconnect | 3,029 | 5,164 |
| MGTS for interconnect | 2,631 | - |
| Mediaplanning for advertising | - | 2,041 |
| Rosno for insurance | - | 640 |
| Other | 413 | 437 |
| Total accounts receivable, related parties | <u>\$ 25,004</u> | <u>\$ 8,434</u> |
| Accounts payable: | | |
| Sitronics for software and FORIS outstaffing services | \$ 99,816 | \$ 106,176 |
| Kvazar-Micro.ru for systems integration services | 20,230 | 8,172 |
| MTT for interconnect | 19,197 | 4,834 |
| Comstar UTS for interconnect | 6,825 | 1,598 |
| Sitronics Smart Tehnologies for SIM and prepaid phone cards | 5,754 | 6,304 |
| Mediaplanning for advertising | 2,609 | 1,244 |
| MGTS for interconnect | 1,833 | 766 |
| Maxima for advertising | 1,266 | 4,167 |
| Other | 2,723 | 1,995 |
| Total accounts payable, related parties | <u>\$ 160,253</u> | <u>\$ 135,256</u> |

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Transactions with major related parties are described below.

Moscow Bank of Reconstruction and Development (“MBRD”) – MTS maintains certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2007 and 2006, MTS cash position at MBRD amounted to \$321.7 million and \$86.5 million in current accounts, respectively. Deposit accounts at MBRD amounted to \$265.0 million as of December 31, 2007, and \$55.0 million as of December 31, 2006. The related interest accrued and collected on the deposits for the years ended December 31, 2007, 2006 and 2005, amounted to \$18.9 million, \$4.8 million and \$5.4 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

TS-Retail – As discussed in Note 3, in November 2006, MTS established a wholly-owned subsidiary, TS-Retail, with a registered capital of \$1.1 million for further expansion of Group’s retail operations. In December 2007, following the execution of a business development plan, TS-Retail carried out an increase in charter capital up to \$14.0 million which was bought out by MTS (\$2.4 million) and other subsidiaries of Sistema (\$11.6 million). As a result of the transaction, the Group’s share in TS-Retail decreased to 25%. MTS deconsolidated TS-Retail since that date and subsequently accounted for this investment under the equity method. During 2007, MTS granted a short-term loan to TS-Retail in the amount of \$8.6 million.

Comstar UTS (“Comstar”) – MTS had interconnect, line and numbering capacity rental agreements with Comstar, Telmos and MTU-Inform, subsidiaries of Sistema. During 2007 Telmos and MTU-Inform merged with Comstar. Revenue under agreements with these entities for the years ended December 31, 2007, 2006 and 2005, amounted to \$10.0 million, \$1.7 million and \$nil million, respectively. Interconnect and line rental expenses for 2007, 2006 and 2005 comprised \$34.8 million, \$25.9 million and \$25.2 million.

Maxima Advertising Agency (“Maxima”) – In 2007, 2006 and 2005, MTS had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising costs related to Maxima for the years ended December 31, 2007, 2006 and 2005, amounted to \$127.7 million, \$117.8 million and \$58.6 million, respectively.

MTT – In 2007, 2006 and 2005, MTS had interconnect and line rental agreements with MTT, a subsidiary of Sistema. Interconnect revenue for 2007, 2006 and 2005 amounted to \$62.0 million, \$29.4 million and \$5.0 million, respectively. Interconnect expenses for 2007, 2006 and 2005 amounted to \$83.1 million, \$69.3 million and \$41.1 million, respectively.

Moscow City Telephone Network (“MGTS”) – In 2007, 2006 and 2005, MTS had line rental agreements with MGTS, a subsidiary of Sistema, and rented a cable plant from MGTS for the installation of optic-fiber cable. MTS also rented buildings for administrative offices as well as premises for switchboard and base station equipment. Rental expenses for the years 2007, 2006 and 2005 amounted to \$16.3 million, \$13.1 million and \$8.3 million, respectively. Interconnect revenue for 2007, 2006 and 2005 amounted to \$25.2 million, \$7.9 million and \$0.3 million, respectively.

Mediaplanning – During 2007, 2006 and 2005, MTS entered into a number of agreements to purchase advertising services with Mediaplanning, a subsidiary of Sistema. Related advertising costs recorded for the years ended December 31, 2007, 2006 and 2005 amounted to \$48.8 million, \$45.1 million and \$21.5 million, respectively.

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Rosno OJSC (“Rosno”) – MTS arranged medical insurance for its employees and property insurance with Rosno (a subsidiary of Sistema until February, 2007). Insurance premiums paid to Rosno for the years ended December 31, 2006 and 2005, amounted to \$11.3 million and \$12.6 million, respectively. Starting from February, 2007, Rosno is no longer a related party of the Group, as Sistema sold its controlling stake in Rosno to Allianz.

Sitronics – Sitronics Telecom Solutions Czech Republic and Russia, formerly Strom Telecom and Mediatel, are subsidiaries of Sistema. During 2007, 2006 and 2005, the Group acquired from these companies telecommunications equipment, billing systems (FORIS) and related services for approximately \$67.1 million, \$231.2 million and \$179.2 million, respectively. FORIS implementation was substantially completed in 2007.

Kvazar-Micro.ru (“Kvazar”) – In 2004, MTS signed agreements for software implementation services with Kvazar, a subsidiary of Sistema. Pursuant to these agreements, Kvazar provided to MTS systems integration services in respect to implementation of Oracle E-Business Suite (“OEBS”) in 2007, 2006 and 2005 of approximately \$64.8 million, \$52.1 million and \$62.0 million, respectively. The implementation of OEBS was substantially completed at the end of 2007.

Sitronics Smart Technologies (former SmartCards) – In 2007 and 2006, MTS purchased SIM cards and prepaid phone cards from Sitronics Smart Technologies, a subsidiary of Sistema, for approximately \$19.3 million and \$37.0 million.

Sistema Telecom – In May 2006, Sistema introduced a universal brand featuring a new egg-shaped logo for each of the telecommunication companies operating within the Sistema group, including MTS. The brand is owned by Sistema Telecom, a subsidiary of Sistema. The expenses related to the use of the brand name incurred by MTS and paid for in 2007 and 2006, amounted to \$14.5 million and \$9.7 million, respectively.

City Hals – In 2007 and 2006, City Hals, a subsidiary of Sistema, provided rent, repair, maintenance and cleaning services to MTS of approximately \$6.1 million and \$5.2 million, respectively.

The Group does not have the intent and ability to offset the outstanding accounts payable and accounts receivable with related parties under the terms of existing agreements with them.

16. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the years ended December 31, 2007, 2006 and 2005, comprised the following:

| | December 31, | | |
|-------------------------------------|---------------------|-------------------|-------------------|
| | 2007 | 2006 | 2005 |
| Salaries and social contributions | \$ 562,924 | \$ 430,443 | \$ 336,203 |
| Rent | 179,436 | 123,378 | 79,869 |
| General and administrative | 145,109 | 125,934 | 100,257 |
| Repair and maintenance | 142,969 | 94,242 | 90,609 |
| Taxes other than income | 141,254 | 88,089 | 62,102 |
| Billing and data processing | 36,052 | 44,886 | 37,287 |
| Consulting expenses | 23,742 | 23,352 | 26,486 |
| Insurance | 12,063 | 10,723 | 16,804 |
| Inventory obsolescence expense | - | - | 9,112 |
| General and administrative expenses | <u>\$ 1,243,549</u> | <u>\$ 941,047</u> | <u>\$ 758,729</u> |

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17. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2007 and 2006, the Group's investments in and advances to associates comprised the following:

| | December 31, | |
|--|-------------------|-------------------|
| | 2007 | 2006 |
| MTS Belarus – equity investment | \$ 188,622 | \$ 119,802 |
| MTS Belarus – loans receivable | - | 21,341 |
| Coral/Sistema Strategic Fund – equity investment | 6,916 | - |
| Receivables from other investee companies | 370 | 330 |
| Total investments in and advances to associates | <u>\$ 195,908</u> | <u>\$ 141,473</u> |

MTS Belarus – As of December 31, 2006, the Group provided MTS Belarus with a total of \$21.3 million in loans. These loans bore interest of 3% to 11% per annum. As of December 31, 2007 these loans were fully repaid.

Coral/Sistema Strategic Fund – In August 2007, the Group purchased an equity interest in a strategic fund organized by Sistema in order to invest in various projects in the telecommunications and high-technology area. The fund is organized in the form of limited partnership. The Group has committed to invest up to \$26.3 million if called upon by the General Partner.

The equity investment in TS-Retail is recorded at \$nil as of December 31, 2007. See also Note 15.

The Group's share in net income of associates is included in other income in the accompanying consolidated statements of operations. For the years ended December 31, 2007, 2006 and 2005, this share amounted to \$72.7 million, \$58.1 million and \$42.4 million, respectively.

18. RESTRICTED CASH

Restricted cash of \$28.6 million and \$24.8 million, as of December 31, 2007 and 2006, respectively, consists of cash deposited by Uzdurobita in a special bank account, which was created to be in compliance with government regulation of local currency conversion into foreign currencies. The cash deposited will be further converted from Uzbek som into U.S. Dollars and used for settlements with suppliers of equipment and software.

19. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various operating GSM licenses by the Russian Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Russian Ministry of Information Technologies and Communications, the Group has been granted access to various telecommunication licenses through acquisitions. In foreign subsidiaries, the licenses are granted by the local Communication authorities.

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At December 31, 2007 and 2006, the recorded values of the Group's telecommunication licenses were as follows:

| | December 31, | |
|--|-------------------|-------------------|
| | 2007 | 2006 |
| Moscow license area | \$ 302,724 | \$ 233,970 |
| Armenia | 246,917 | - |
| Uzbekistan | 196,517 | 40,861 |
| Asian Russian regions | 196,119 | 179,473 |
| North – West region | 96,648 | 74,639 |
| Ukraine | 63,535 | 63,535 |
| Far East | 58,091 | 48,107 |
| European Russia Regions | 53,382 | 111,198 |
| Turkmenistan | 50,504 | 50,503 |
| Krasnodar, Adygeya and Northern Osetia | 9,985 | 149,986 |
| Tatarstan Republic | - | 104,159 |
| Other | 100,027 | 96,143 |
| Licenses, at cost | 1,374,449 | 1,152,574 |
| Accumulated amortization | (708,844) | (747,076) |
| Licenses, net | <u>\$ 665,605</u> | <u>\$ 405,498</u> |

Amortization expense for the years ended December 31, 2007, 2006 and 2005, amounted to \$195.7 million, \$211.3 million and \$194.3 million, respectively.

As of December 31, 2007, operating licenses related to Tatarstan Republic and the majority of licenses related to Krasnodar, Adygeya and Northern Osetia were fully amortized and their respective cost and accumulated amortization were written off from the consolidated balance sheet.

Based on the cost of amortizable operating licenses existing at December 31, 2007, the estimated future amortization expenses are \$148.1 million during 2008, \$86.0 million during 2009, \$78.8 million during 2010, \$55.5 million during 2011, \$42.0 million during 2012 and \$255.2 million thereafter. The actual amortization expense reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

In 2006, each of the Group's licenses, except for the licenses covering the Moscow license area and Uzbekistan, contained a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. In 2007, there were alterations in terms of licenses covering the Russian Federation. The requirements for subscriber numbers and territorial coverage targets were revoked. Instead, the targets were set for start date of service. Management believes that the Group is in compliance with all material terms of its licenses.

The Group's operating licenses do not provide for automatic renewal. However, licenses that expired during the year ended December 31, 2007, were renewed. The cost to renew the licenses was not significant. The Group has limited experience with the renewal of its existing licenses. Management believes that licenses required for the Group's operations will be renewed upon expiration.

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20. COMMITMENTS AND CONTINGENCIES

Capital commitments – As of December 31, 2007, the Group had executed purchase agreements of approximately \$252.7 million to acquire property, plant and equipment, and intangible assets.

Operating leases – The Group has entered into non-cancellable agreements to lease the space for telecommunication equipment, offices and transmission channels, which expire in various years up to 2056. Rental expenses under the operating leases of \$179.4 million, \$123.4 million and \$73.2 million for the years ended December 31, 2007, 2006 and 2005, respectively, are included in operating expenses in the accompanying consolidated statements of operations. Future minimum lease payments due under these leases at December 31, 2007 are as follows:

| | |
|--|-------------------|
| Payments due in the years ended December 31, | |
| 2008 | \$ 184,281 |
| 2009 | 32,963 |
| 2010 | 23,186 |
| 2011 | 12,759 |
| 2012 | 9,372 |
| Thereafter | <u>37,553</u> |
| Total | <u>\$ 300,114</u> |

Operating environment – The Russian and Ukrainian economies, while deemed to be of market status, continue to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls. The continued success and stability of the Russian and Ukrainian economies will be subject to their government’s continued actions with regard to supervisory, legal and economic reforms.

The Federal Law on Communications sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. In addition, the law created a universal service fund (“USF”) charge, which became effective May 3, 2005, calculated as 1.2% of revenue from services provided to customers, excluding interconnection and other operators’ traffic routing revenue. For the years ended December 31, 2007, 2006 and 2005, the Group incurred approximately \$64.8 million, \$54.2 million and \$30.3 million in USF charges, respectively, which are recorded in other operating expenses in the accompanying consolidated statements of operations.

The Group’s operations in Turkmenistan are subject to certain restrictions in accordance with the local regulatory environment including, but not limited to, the sale of hard currency on the local market and hard currency repatriation. The effect of those restrictions on the financial statements is represented by a loss from currency translation transactions in Turkmenistan of \$22.0 million and \$24.3 million recognized as other non-operating expense in the Group’s consolidated statements of operations for the year ended December 31, 2007 and 2006, respectively. The amount of loss from currency translation transactions for the year ended December 31, 2005 was insignificant.

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Taxation – Russia and Ukraine currently have a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than typically found in countries with more developed tax systems.

In September 2006, the Russian tax authorities audited MTS OJSC's compliance with tax legislation for the years ended December 31, 2003 and 2004. Based on the results of this audit, the Russian tax authorities assessed that 1,283,660 thousand rubles (approximately \$52.3 million as of December 31, 2007) of additional taxes, penalties and fines were payable by the Group. The Group has prepared and filed a petition with the Arbitration Court of Moscow to recognize the tax authorities' resolution to be partially invalid. The amount of disputed taxes and fines equals 1,220,096 thousand rubles (approximately \$49.7 million). In 2007, a final court hearing considered this matter which resulted in a judgment in favour of the Group. Tax authorities prepared an appeal with Court of Appeal; however the judgment was not changed. As of December 31, 2007, no provision in relation to the above tax audit was accrued in the Group's financial statements or paid to tax authorities.

Generally, according to Russian tax legislation tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2007, tax declarations of MTS OJSC and other subsidiaries in Russia for the preceding three fiscal years were open for further review, assuming no resolution issued based on the results of tax audit of the years ended December 31, 2005 and 2006. In January 2008, the Russian tax authorities started auditing MTS OJSC's compliance with tax legislation for the years ended December 31, 2005 and 2006. As of the date of these statements, the audit has not been finalized. Official resolution is not expected before July 2008, and it is not possible at this time to predict the outcome.

There are regulatory uncertainties in Ukraine related to the treatment for VAT purposes of contributions payable to the Ukrainian State Pension Fund ("Pension Fund") in respect of the cash paid for the consumption of telecommunication services by customers. Also it could have influence on income tax and other taxes paid by the Group.

As a result of a tax audit of the period from July 1, 2004 to April 1, 2007, additional VAT charges (including penalties) calculated on the Pension Fund contributions could be up to \$11.5 million. In 2005, UMC initiated a litigation case in respect of this issue against the tax authorities, and has received favorable rulings from the courts on three occasions (the most recent from the Highest Administrative Court of Ukraine). Management believes that VAT was not applicable to the Pension Fund contributions during the period under the tax authorities' review. Further, management believes that UMC is in line with industry practice and has already defended its position in the courts. At December 31, 2007, no VAT charges in relation to the above litigation was accrued in the Group's financial statements or paid to the tax authorities.

In 2008, tax authorities completed audit procedures in Uzdurobota, BCTI and K-Telekom for the year ended December 31, 2006. According to the local tax legislation of Uzbekistan, Turkmenistan and Armenia tax declarations remain open for further inspection for five, six and three years, respectively.

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Further, MTS purchases supplemental software from the foreign suppliers of the telecommunication equipment in the ordinary course of business. The Group's management believes that custom duties are calculated in compliance with the legislation. However there is a risk that the customs authorities may take a different view and impose additional custom duties. As of December 31, 2007 and 2006, no provision was recorded in the consolidated financial statements in respect of such additional duties.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2007 and 2006, the provision accrued amounted to \$25.4 million and \$29.8 million, respectively. However, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

Bitel – In December 2005, MTS Finance acquired a 51% stake in Tarino Limited (“Tarino”) for \$150.0 million in cash from Nomihold Securities Inc. (“Nomihold”). Tarino was at that time the indirect owner, through its wholly-owned subsidiaries, of Bitel LLC (“Bitel”), a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan.

Concurrently with the purchase of a 51% stake, the Group entered into a put and call option agreement with Nomihold to acquire the remaining 49% interest in Tarino. The call option was exercisable by the Group from November 22, 2005 to November 17, 2006, and the put option was exercisable by the seller from November 18, 2006 to December 8, 2006. The call and put option price was \$170.0 million. The put and call option was recorded at fair value, which approximated \$nil at December 31, 2005. At December 31, 2006, a liability of \$170.0 million was recorded.

After the decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. The Group could not re-gain operating control over Bitel's operations.

During 2006, the Group took steps to vindicate its ownership rights on Bitel although these efforts so far have not proven to be successful. The matter was brought to the Kyrgyz Prosecutor General for investigation. On January 15, 2007, the Prosecutor General informed the Group that it sees no grounds to become involved in the ownership dispute over Bitel and additionally stated that the Group had no basis to appeal the decision of the Kyrgyz courts in connection with ownership of Bitel.

In addition, an appeal to overturn certain adverse Kyrgyz courts rulings connected with ownership rights to Bitel was also filed with the Kyrgyz Supreme Court on December 15, 2006, but the time period in which the appeal should have been heard has expired without any action by the court.

Consequently the decision was made by the Group to write off the costs associated with the purchase of 51% stake in Bitel. As of December 31, 2006, the investment was fully impaired and the related charge of \$150.0 million was recorded in the consolidated statements of operations. Furthermore, as noted above, with the impairment of the underlying asset, a liability of \$170.0 million was recorded with an associated charge to non-operating expenses.

In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the London Court of International Arbitration in order to compel MTS Finance to purchase the remaining 49% stake in Tarino Limited for \$170.0 million. Nomihold seeks specific performance of the put option, unspecified monetary damages, interest, and costs. The matter is currently pending.

A group of individual shareholders of Sistema, the majority shareholder of MTS OJSC, has agreed to compensate MTS Finance for any potential loss up to \$170.0 million should the arbitration decision regarding exercise of the aforementioned put option prove unfavourable to MTS Finance.

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In a separate arbitration proceeding initiated against the KFG Companies (three Isle of Man companies affiliated with the Group) by Kyrgyzstan Mobitel Investment Company Limited (KMIC) under the rules of the London Court of International Arbitration, the arbitration tribunal in its award found that the KFG Companies breached a May 31, 2003 Transfer Agreement concerning the shares of Bitel. Tarino owned Bitel through KFG Companies. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited (IPOC) although IPOC subsequently assigned its interest to KMIC, and KMIC was the claimant in the arbitration. The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interests in Bitel were to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. This breach occurred prior to MTS Finance's acquisition of the KFG Companies. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. It is not possible to predict the outcome of these proceedings or the amount of damages to be paid, if any.

In addition, the KFG Companies have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel in the amount of approximately \$25.2 million plus compensatory damages, and to recover approximately \$3.7 million in losses and accrued interest. In the event that the defendants do not prevail in these lawsuits, MTS may be liable to Bitel for such claims.

The KFG Companies have also asserted counterclaims against Bitel, and claims against other defendants including Altimo and Altimo Holding, for the wrongful appropriation and control of Bitel. In November 2007 the Isle of Man court declined the jurisdiction for this claim which decision was immediately appealed by the KFG Companies. It is not possible at this time to predict the outcome or resolution of these claims.

In the ordinary course of business, MTS may be party to various legal, tax and customs proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the Group's liability, if any, in all such pending litigation, other legal proceeding or other matters will not have a material effect upon its financial condition, results of operations or liquidity of MTS.

21. SEGMENT INFORMATION

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance.

The Group has three business units: business unit "MTS Russia", which is responsible for the centralized operational management of business in all Russian macro-regions, all of which operate in the same economic environment and possess similar economic characteristics; business unit "MTS Ukraine", MTS subsidiary in Ukraine; and business unit "Foreign subsidiaries" that include Uzdunrobita in Uzbekistan, Barash Communications Technologies, Inc. in Turkmenistan, K-Telekom in Armenia and MTS Belarus, an equity accounted affiliate of MTS in Belarus. Countries of operations are managed separately due to their different economic and regulatory environment that requires separate marketing and investment strategies. The chief operating decision maker evaluates performance based on the operating income of each business unit.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005

(Amounts in thousands of U.S. Dollars, except share and per share amounts or if otherwise stated)

The Group's management has defined two operating reportable segments: Russia and Ukraine.

Intercompany eliminations presented below consist primarily of sales transactions between segments conducted under the normal course of operations.

Financial information by reportable segment is presented below:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--|---------------------|---------------------|---------------------|
| Revenue: | | | |
| Russia | \$ 6,181,023 | \$ 4,665,530 | \$ 3,700,601 |
| Ukraine | 1,608,021 | 1,490,278 | 1,201,827 |
| Other | 483,499 | 242,455 | 119,932 |
| Intercompany eliminations | <u>(20,165)</u> | <u>(14,009)</u> | <u>(11,342)</u> |
| Total revenue | <u>\$ 8,252,378</u> | <u>\$ 6,384,254</u> | <u>\$ 5,011,018</u> |
| Depreciation and amortization: | | | |
| Russia | \$ 1,076,586 | \$ 819,316 | \$ 722,977 |
| Ukraine | 324,976 | 233,744 | 153,795 |
| Other | <u>87,986</u> | <u>42,921</u> | <u>30,341</u> |
| Total depreciation and amortization | <u>\$ 1,489,548</u> | <u>\$ 1,095,981</u> | <u>\$ 907,113</u> |
| Operating income: | | | |
| Russia | \$ 2,076,083 | \$ 1,510,875 | \$ 1,153,542 |
| Ukraine | 456,777 | 530,522 | 431,292 |
| Other | <u>200,986</u> | <u>92,339</u> | <u>47,197</u> |
| Total operating income | <u>\$ 2,733,846</u> | <u>\$ 2,133,736</u> | <u>\$ 1,632,031</u> |
| Total operating income | \$ 2,733,846 | \$ 2,133,736 | \$ 1,632,031 |
| Currency exchange and transaction gains | (163,092) | (24,051) | (10,319) |
| Interest income | (38,100) | (13,055) | (24,828) |
| Interest expense | 134,581 | 177,145 | 132,474 |
| Equity in net income of associates | (72,665) | (58,083) | (42,361) |
| Bitel investment and write off | - | 320,000 | - |
| Other expense, net | <u>44,034</u> | <u>65,913</u> | <u>13,211</u> |
| Income before provision for income taxes and minority interest | <u>\$ 2,829,088</u> | <u>\$ 1,665,867</u> | <u>\$ 1,563,854</u> |

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005

(Amounts in thousands of U.S. Dollars, except share and per share amounts or if otherwise stated)

| | <u>2007</u> | <u>2006</u> |
|--------------------------------------|----------------------|---------------------|
| Additions to long-lived assets: | | |
| Russia | \$ 619,298 | \$ 1,135,637 |
| Ukraine | 581,720 | 644,524 |
| Other | <u>189,294</u> | <u>69,609</u> |
| Total additions to long-lived assets | <u>\$ 1,390,312</u> | <u>\$ 1,849,770</u> |
| Long-lived assets: | | |
| Russia | \$ 5,378,043 | \$ 4,638,096 |
| Ukraine | 2,062,015 | 1,794,828 |
| Other | <u>1,262,725</u> | <u>271,621</u> |
| Total long-lived assets | <u>\$ 8,702,783</u> | <u>\$ 6,704,545</u> |
| Total assets: | | |
| Russia | \$ 7,154,657 | \$ 6,257,781 |
| Ukraine | 2,243,328 | 1,955,188 |
| Other | <u>1,568,683</u> | <u>360,976</u> |
| Total assets | <u>\$ 10,966,667</u> | <u>\$ 8,573,945</u> |

22. SUBSEQUENT EVENTS

Mobilnye Sistemy Svyazi (MSS) – In line with the Group’s strategy of consolidating ownership in its subsidiaries, MTS purchased an additional 9% stake in its Omsk subsidiary, Mobilnye Sistemy Svyazi, from a private investor for \$16.0 million in cash. As a result of this transaction, MTS’ ownership in the subsidiary increases to 100%.

Redemption of \$400 million Eurobond – The Group redeemed its \$400.0 million Eurobond which matured on January 30, 2008. The coupon payments for the entire period, including the last coupon, which took place simultaneously with the retirement of Eurobond, amounted to \$195.0 million. The Eurobond was issued in January 2003 in the amount of \$400.0 million with a semi-annual coupon rate of 9.75%.