OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

Consolidated Financial Statements

As of December 31, 2008 and 2007 and for the Years Ended December 31, 2008, 2007 and 2006

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

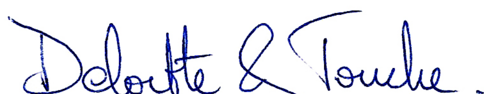
To the Shareholders of OJSC Mobile TeleSystems:

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, 2008 and 2007, 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, 2008. 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, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

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, 2008, 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 March 6, 2009 expressed an unqualified opinion on the Group's internal control over financial reporting.



Moscow, Russia
March 6, 2009

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2008 AND 2007
(Amounts in thousands of U.S. Dollars, except share and per share amounts)

	December 31, 2008	December 31, 2007
CURRENT ASSETS:		
Cash and cash equivalents (Note 4)	$ 1,058,802	$ 634,498
Short-term investments, including related party amounts of $45,000 and $15,000 (Note 5)	45,718	15,776
Trade receivables, net (Note 6)	320,559	386,608
Accounts receivable, related parties (Note 15)	49,684	25,004
Inventory and spare parts (Note 7)	110,490	140,932
Prepaid expenses, including related party amounts of $12,561 and $nil	311,821	201,702
Deferred tax assets (Note 13)	192,847	136,466
VAT receivable	102,648	310,548
Other current assets, including assets held for sale of $46,426 and $35,354 (Note 2)	176,165	95,123
Total current assets	2,368,734	1,946,657
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of $3,409,495 and $3,079,376, including advances given to related parties of $20,808 and $2,925 (Note 8)	5,900,129	6,607,315
LICENSES, net of accumulated amortization of $284,984 and $708,844 (Notes 3 and 20)	482,734	665,605
GOODWILL (Notes 3 and 9)	377,982	359,450
OTHER INTANGIBLE ASSETS, net of accumulated amortization of $ 871,897 and $949,747 (Notes 3 and 9)	909,397	1,070,413
DEBT ISSUANCE COSTS, net of accumulated amortization of $83,360 and $77,725	37,259	59,279
INVESTMENTS IN AND ADVANCES TO ASSOCIATES (Note 17)	247,358	195,908
OTHER INVESTMENTS, including related party amounts of $16,558 and $nil (Note 18)	39,076	1,355
OTHER NON-CURRENT ASSETS, including restricted cash of $23,572 and $28,618 (Note 19), assets held for sale of $nil and $32,067 (Note 2), and deferred tax assets of $62,093 and $nil (Note 13)	85,665	60,685
Total assets	$ 10,448,334	$ 10,966,667

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, 2008 AND 2007
(Amounts in thousands of U.S. Dollars, except share and per share amounts)

	December 31, 2008	December 31, 2007
CURRENT LIABILITIES:		
Trade accounts payable	$ 789,336	$ 486,666
Accounts payable, related parties (Note 15)	186,878	160,253
Deferred connection fees, current portion (Note 10)	23,795	32,644
Subscriber prepayments and deposits	395,364	470,302
Debt, current portion (Note 11)	1,181,039	309,977
Notes payable, current portion (Note 11)	-	400,000
Capital lease obligation, current portion	2,690	3,305
Income tax payable	12,784	51,958
Accrued liabilities (Note 12)	476,264	464,505
Bitel liability (Note 21)	170,000	170,000
Other payables	68,991	61,824
Total current liabilities	3,307,141	2,611,434
LONG-TERM LIABILITIES:		
Notes payable, net of current portion (Note 11)	1,578,540	799,314
Debt, net of current portion (Note 11)	1,309,956	1,887,195
Capital lease obligation, net of current portion	3,009	1,876
Deferred connection fees, net of current portion (Note 10)	16,449	20,845
Deferred taxes (Note 13)	69,473	114,171
Other long-term liabilities	85,371	68,851
Total long-term liabilities	3,062,798	2,892,252
Total liabilities	6,369,939	5,503,686
COMMITMENTS AND CONTINGENCIES (Note 21)		
MINORITY INTEREST	23,499	20,051
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, 2008 and 2007, 777,396,505 of which are in the form of ADS as of December 31, 2008 and 2007) (Note 1)	50,558	50,558
Treasury stock (108,273,338 and 32,476,837 common shares at cost as of December 31, 2008 and 2007)	(1,426,753)	(368,352)
Additional paid-in capital	590,759	579,520
Accumulated other comprehensive (loss)/income	(346,178)	704,189
Retained earnings	5,186,510	4,477,015
Total shareholders' equity	4,054,896	5,442,930
Total liabilities and shareholders' equity	$ 10,448,334	$ 10,966,667

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, 2008, 2007 AND 2006
(Amounts in thousands of U.S. Dollars, except share and per share amounts)

	Years ended December 31,		
	2008	**2007**	**2006**
NET OPERATING REVENUE			
Services revenue and connection fees (including related party amounts of $149,784, $100,771 and $39,138, respectively)	$ 10,176,255	$ 8,172,650	$ 6,287,100
Sales of handsets and accessories	69,038	79,728	97,154
	10,245,293	**8,252,378**	**6,384,254**
Cost of services, excluding depreciation and amortization shown separately below (including related party amounts of $229,426, $135,819 and $113,732, respectively)	2,247,948	1,727,365	1,223,715
Cost of handsets and accessories	169,615	158,580	209,260
General and administrative expenses (including related party amounts of $45,396, $40,599 and $13,301, respectively) (Note 16)	1,492,156	1,243,549	941,047
Provision for doubtful accounts	147,435	58,924	84,858
Other operating expenses (including related party amounts of $12,008, $8,349 and $4,769, respectively)	165,302	116,451	87,822
Sales and marketing expenses (including related party amounts of $238,856, $193,471 and $171,792, respectively)	882,508	724,115	607,835
Depreciation and amortization expenses	1,936,837	1,489,548	1,095,981
Net operating income	**3,203,492**	**2,733,846**	**2,133,736**
CURRENCY EXCHANGE AND TRANSACTION LOSS/(GAIN)	563,292	(163,092)	(24,051)
OTHER EXPENSES/(INCOME)			
Interest income (including related party amounts of $21,138, $18,930 and $4,844)	(33,166)	(38,100)	(13,055)
Interest expense, net of capitalized interest	153,341	134,581	177,145
Equity in net income of associates (Note 17)	(75,976)	(72,665)	(58,083)
Write-off of investment in Bitel (Note 21)	-	-	320,000
Other expenses, net (including related party amounts of $nil, $nil and $2,460)	25,317	44,034	65,913
Total other expenses, net	**69,516**	**67,850**	**491,920**
Income before provision for income taxes and minority interest	**2,570,684**	**2,829,088**	**1,665,867**
PROVISION FOR INCOME TAXES (Note 13)	630,621	738,270	576,103
MINORITY INTEREST	9,644	19,314	14,026
NET INCOME	**$ 1,930,419**	**$ 2,071,504**	**$ 1,075,738**
Weighted average number of common shares outstanding – basic	1,921,934,091	1,973,354,348	1,987,610,121
Weighted average number of common shares outstanding – diluted	1,921,934,091	1,974,074,908	1,987,646,015
Earnings per share, basic and diluted	$ 1.00	$ 1.05	$ 0.54

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, 2008, 2007 AND 2006
(Amounts in thousands of U.S. Dollars, except share amounts)

	Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Unearned Compensation	Shareholder Receivable	Retained Earnings	Total
	Shares	Amount	Shares	Amount						
BALANCES, December 31, 2005	1,993,326,138	$ 50,558	(5,400,486)	$ (5,534)	$ 568,104	$ 50,614	$ (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 (Note 14)	-	-	-	-	1,675	-	-	-	-	1,675
Effect of adoption of SFAS No. 123R	-	-	-	-	(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)	$ 571,718	$ 89,916	$ -	$ -	$ 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 (Note 14)	-	-	-	-	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	-	-	-	-	(214)	256,390	-	-	-	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)	$ 579,520	$ 704,189	$ -	$ -	$ 4,477,015	$ 5,442,930
Stock options exercised (Note 14)	-	-	1,397,256	1,432	7,751	-	-	-	-	9,183
Accrued compensation costs (Note 14)	-	-	-	-	3,488	-	-	-	-	3,488
Dividends declared	-	-	-	-	-	-	-	-	(1,220,924)	(1,220,924)
Repurchase of common stock (Note 1)	-	-	(77,193,757)	(1,059,833)	-	-	-	-	-	(1,059,833)
Currency translation adjustment	-	-	-	-	-	(1,034,008)	-	-	-	(1,034,008)
Change in fair value of interest rate swaps, net of tax (Note 11)	-	-	-	-	-	(16,359)	-	-	-	(16,359)
Net income	-	-	-	-	-	-	-	-	1,930,419	1,930,419
BALANCES, December 31, 2008	1,993,326,138	$ 50,558	(108,273,338)	$ (1,426,753)	$ 590,759	$ (346,178)	$ -	$ -	$ 5,186,510	$ 4,054,896

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, 2008, 2007 AND 2006
(Amounts in thousands of U.S. Dollars)

	Years ended December 31,		
	2008	**2007**	**2006**
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 1,930,419	$ 2,071,504	$ 1,075,738
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest	9,644	19,314	14,026
Depreciation and amortization	1,936,837	1,489,548	1,095,981
Debt issuance cost amortization	21,687	22,406	25,041
Amortization of deferred connection fees	(55,705)	(75,404)	(54,486)
Equity in net income of associates	(75,976)	(72,665)	(58,083)
Inventory obsolescence expense	1,251	-	-
Provision for doubtful accounts	147,435	58,924	84,858
Deferred taxes	(209,338)	(92,088)	(133,027)
Write off of irrecoverable VAT receivable	48,374	17,516	-
Gain from deconsolidation of a subsidiary	-	(8,874)	-
Foreign currency transaction loss/(gain)	563,292	(163,092)	-
Bitel liability and investment write off (Note 21)	-	-	320,000
Impairment of property, plant and equipment, intangible assets and assets held for sale	1,333	18,556	-
Non-cash expenses associated with asset retirement obligation	6,026	1,138	-
Non-cash (gain)/expenses associated with stock bonus and stock options	(3,791)	10,426	1,675
Changes in operating assets and liabilities:			
Increase in accounts receivable	(137,417)	(137,880)	(174,790)
Decrease/(increase) in inventory	4,565	76,950	(39,312)
(Increase)/decrease in prepaid expenses and other current assets	(269,629)	35,132	21,094
Decrease in VAT receivable	130,812	12,567	58,446
Increase in trade accounts payable, accrued liabilities and other current liabilities	346,874	61,278	138,581
Dividends received from associate	26,692	4,900	3,174
Net cash provided by operating activities	4,423,385	3,350,156	2,378,916
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisitions of subsidiaries, net of cash acquired	(35,111)	(873,071)	(38,188)
Purchases of property, plant and equipment	(1,847,461)	(1,316,662)	(1,449,954)
Purchases of intangible assets	(379,829)	(222,866)	(272,014)
Proceeds from sale of property, plant and equipment and assets held for sale	29,763	22,020	10,987
Purchases of short-term investments	(119,500)	(221,753)	(57,147)
Proceeds from disposal of short-term investments	54,965	267,517	29,159
Purchases of other investments	(39,404)	2,808	(3,856)
Net (outflows)/proceeds from investments in and advances to associates	(3,654)	1,965	20,000
Decrease/(increase) in restricted cash	5,046	(3,839)	(18,549)
Net cash used in investing activities	(2,335,185)	(2,343,881)	(1,779,562)

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006
(Amounts in thousands of U.S. Dollars)

	Years ended December 31,		
	2008	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from stock options exercise	9,183	6,057	3,804
Proceeds from issuance of notes	986,004	-	-
Repurchase of common stock	(1,059,833)	(254,443)	(109,899)
Repayment of notes	(485,474)	-	-
Notes and debt issuance cost	(6,693)	(371)	(20,686)
Capital lease obligation principal paid	(5,511)	(4,952)	(5,815)
Dividends paid	(1,106,469)	(756,920)	(558,848)
Proceeds from loans	710,443	475,815	1,284,296
Loan principal paid	(415,944)	(158,080)	(1,064,100)
Payments from Sistema	-	-	7,182
Net cash used in financing activities	(1,374,294)	(692,894)	(464,066)
Effect of exchange rate changes on cash and cash equivalents	(289,602)	101,128	6,417
NET INCREASE IN CASH AND CASH EQUIVALENTS	424,304	414,509	141,705
CASH AND CASH EQUIVALENTS, beginning of the year	634,498	219,989	78,284
CASH AND CASH EQUIVALENTS, end of the year	1,058,802	634,498	219,989
SUPPLEMENTAL INFORMATION:			
Income taxes paid	$ 931,291	$ 838,647	$ 673,410
Interest paid	$ 201,052	$ 216,997	$ 201,352
Non-cash investing and financing activities:			
Additions to network equipment and software under capital lease	$ 5,673	$ 6,037	$ 7,561
Amounts owed for capital expenditures	$ 544,533	$ 363,004	$ 214,835
Payable related to business acquisition (Note 3)	$ 28,219	$ 14,639	$ -

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

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.

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, its 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 GSM ("Global System for Mobile Communication") licenses in new regions and acquiring existing GSM license holders and operators.

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."

The Group provides a wide range of voice and data mobile telecommunications 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 and 3G network, on which a GPRS ("General Packet Radio Service") service and a HSPA ("High Speed Packet Access") are 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. In 2008, MTS launched commercial CDMA services in almost all district-cities in Ukraine.

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 license, the winning companies are required to begin commercial exploitation of a 3G network within two years from the time they receive the license. In 2008, MTS launched 3G networks in a number of the largest cities of Russia. MTS also launched a number of services available only through the 3G infrastructure. Customers on the new network are now able to make video calls, access mobile TV and roaming on 3G networks. In addition, international roamers are able to access high speed and advanced services on MTS' 3G networks.

In April 2007, the Communication and Information Agency of Uzbekistan allocated 2500-2700 MHz frequencies to Uzdunrobita, MTS subsidiary in Uzbekistan, thus allowing the Group to provide WiMAX ("Worldwide Interoperability for Microwave Access") services on the entire territory of the country. Additionally, in April 2007 Uzdunrobita received a 3G license valid until the end of 2016 for the entire territory of Uzbekistan. In 2008, MTS launched a 3G network in Tashkent and plans to start rendering 3G services through in a number of other cities by the end of 2009.

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 ("Universal Mobile Telecommunications System technology") services by virtue of its general telecommunication license. MTS plans to launch 3G services in Armenia by the end of 2009.

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" which is responsible for the operational management of all Russian macro-regions, business unit "MTS Ukraine", and business unit "Foreign subsidiaries" that includes Uzdunrobita in Uzbekistan, Barash Communications Technologies, Inc. ("BCTI") in Turkmenistan, K-Telekom in Armenia and MTS Belarus, an equity accounted associate of MTS, in Belarus.

Ownership – As of December 31, 2008 and 2007, MTS shareholders of record and their respective percentage direct interests in outstanding shares were as follows:

	December 31,	
	2008	**2007**
Joint-Stock Financial Corporation "Sistema" ("Sistema")	33.7%	32.4%
Sistema Holding Limited ("Sistema Holding")	10.3%	9.9%
Invest-Svyaz, Closed Joint-Stock Company ("Invest-Svyaz")	8.5%	8.2%
VAST, Limited Liability Company ("VAST")	3.2%	3.1%
ADS Holders	41.2%	39.6%
Free float, GDR Holders and others	3.1%	6.8%
	100.0%	100.0%

MTS' share capital comprises 1,885,052,800 and 1,960,849,301 of outstanding common shares, net of treasury shares, as of December 31, 2008 and 2007, 777,396,505 of which are in the form of ADSs. MTS' wholly-owned subsidiary, Mobile TeleSystems LLC, owned 2,515,747 and 3,913,003 shares as of December 31, 2008 and 2007, respectively, in connection with the Group's management stock option plans. During the years ended December 31, 2008 and 2007, MTS repurchased 77,193,757 and 17,402,835 of its own common shares, respectively, that represent 15,438,751 and 3,480,567 ADSs, for $1,059.8 million and $254.4 million, respectively. The total shares in treasury stock of the Group comprised 108,273,338 and 32,476,837 as of December 31, 2008 and 2007, respectively.

Sistema owned 100% of Sistema Holding, Invest-Svyaz, and VAST, which collectively resulted in Sistema's effective ownership in MTS of 55.7% and 53.6% (or 1,050,165,886 of common shares) as of December 31, 2008 and 2007, 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 ADSs, representing 345,244,080 common shares. During 2008, 2007 and 2006 MTS repurchased 21,151,518 ADSs.

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 shall aim to make dividend payments to shareholders in the amount of at least 50% of annual net income under accounting principles generally accepted in the United States ("U.S. GAAP"). The dividend can vary depending on a number of factors, including the outlook for earnings growth, capital expenditure requirements, cash flow from operations, potential acquisition opportunities, as well as the 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 the 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, 2008, 2007 and 2006 that is distributable under Russian legislation totaled 40,554 million rubles ($1,631.6 million, unaudited), 37,696 million rubles ($1,473.8 million) and 32,094 million rubles ($1,181.0 million), respectively.

The following table summarizes the Group's declared cash dividends for the years ended December 31, 2008, 2007 and 2006:

	December 31,		
	2008	**2007**	**2006**
Dividends declared (including dividends on treasury shares of $36,529, $5,967 and $1,519, respectively)	$ 1,257,453	$ 747,213	$ 561,629
Dividends, U.S. Dollars per ADS	3.2	1.9	1.4
Dividends, U.S. Dollars per share	0.631	0.375	0.282

As of December 31, 2008 and 2007, dividends payable were $0.6 million and $0.8 million, respectively.

Between July 2005 and December 31, 2008, the Company completed the merger of twenty-five 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, Telesot Alania, Astrakhan Mobile, Mar Mobile GSM, Primtelefon, Volgograd Mobile, Bashcell and Mobilnye Sistemy Svyazi ("MSS").

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 Uzdunrobita, the United States dollars ("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 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, 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.

As of December 31, 2008 and 2007, the Company had investments in the following significant legal entities:

	Accounting Method	December 31, 2008	December 31, 2007
Russia			
Sibintertelecom	Consolidated	100.0%	100.0%
Novitel	Consolidated	100.0%	100.0%
MTS-Kostroma	Consolidated	100.0%	100.0%
MTS-Capital	Consolidated	100.0%	100.0%
Sweet-Com	Consolidated	74.9%	74.9%
Dagtelecom	Consolidated	74.9%	74.9%
Coral/Sistema Strategic Fund	Equity	35.0%	35.0%
TS-Retail	Equity	25.0%	25.0%
Volgograd Mobile (2)	Merged/Consolidated	-	100.0%
Primtelefon (2)	Merged/Consolidated	-	100.0%
Mar Mobile GSM (1)	Merged/Consolidated	-	100.0%
Bashcell (3)	Merged/Consolidated	-	100.0%
Astrakhan Mobile (1)	Merged/Consolidated	-	100.0%
MSS (3)	Merged/Consolidated	-	91.0%
Ukraine			
UMC	Consolidated	100.0%	100.0%
Other countries			
MTS Finance (4)	Consolidated	100.0%	100.0%
Uzdunrobita	Consolidated	100.0%	100.0%
BCTI	Consolidated	100.0%	100.0%
MTS Bermuda Ltd.(5)	Consolidated	100.0%	100.0%
K-Telekom	Consolidated	80.0%	80.0%
MTS Belarus	Equity	49.0%	49.0%

(1) Represents wholly-owned subsidiaries merged with MTS OJSC on April 30, 2008.
(2) Represents wholly-owned subsidiaries merged with MTS OJSC on July 1, 2008.
(3) Represents wholly-owned subsidiaries merged with MTS OJSC on October 1, 2008.
(4) Represents beneficial ownership.
(5) A wholly-owned subsidiary established to repurchase the Group's ADSs.

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 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 ruble. Following the expected changes in the regulatory environment and due to growth in the 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.

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	358,997

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 the U.S. Dollar to the 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, 2008, the functional currencies of the Group entities were the following:

- For entities incorporated in Russian Federation, MTS Bermuda Ltd. and MTS Finance – Russian ruble;
- For UMC – Ukrainian hryvnia;
- For Turkmen branch of BCTI – Turkmenian manat;
- For K-Telecom – Armenian dram;
- For MTS-Belarus – Belarusian ruble; and
- For Uzdunrobita and other entities – U.S. Dollar.

Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan, Turkmenistan, Armenia and Belarus maintains its records and prepares its 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.

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, MTS Bermuda Ltd., MTS Finance, UMC, K-Telecom, and for the Turkmen branch of BCTI where the functional currency is other than the reporting currency 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 average exchange rate for the period. 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, valuation of assets acquired and liabilities assumed in 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 and cash equivalents represent 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 generally 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.

Provision for doubtful accounts – MTS provides an allowance for doubtful accounts based on management's periodic review for recoverability of accounts receivable, advances given, loans and other receivables. For the years ended December 31, 2008, 2007 and 2006 the provision for doubtful advances given in the amount of $27.9 million, $3.8 million and $nil, respectively, was recorded as the provision for doubtful accounts in the accompanying consolidated statements of operations. For changes in the provision for doubtful loans and accounts receivable see Notes 5 and 6, respectively.

Prepaid expenses – Prepaid expenses primarily comprise 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 and advertising materials. Inventory is stated at the lower of cost or market value. Inventory cost is determined using the weighted average cost 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.

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 $46.4 million and $67.4 million as of December 31, 2008 and 2007, respectively.

The Group 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. The amount of Lucent equipment sold during 2008 equaled $12.8 million. The remaining part of Lucent equipment held for sale in the amount of $46.4 million is expected to be sold during 2009 and was classified as other current assets in the accompanying consolidated balance sheet as of December 31, 2008.

Due to the fact that the initial plan of sale was reconsidered, the fair value of Lucent equipment 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. No impairment loss on Lucent equipment was recorded during the year ended December 31, 2008.

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 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, 2008 and 2007, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

	2008	2007
Balance, beginning of the year	$ 59,527	$ 10,821
Liabilities incurred in the current period	3,840	3,115
Accretion expense	6,026	1,138
Revisions in estimated cash flows	3,383	44,453
Currency translation adjustment	(10,723)	-
Balance, end of the year	$ 62,053	$ 59,527

The Group recorded the present value of assets retirement obligations as other long-term liabilities in the consolidated balance sheets as of December 31, 2008 and 2007. Revisions in estimated cash flows are attributable to the increase in the expected dismantlement costs.

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 Group's operating licenses do not provide for automatic renewal. As of December 31, 2008, all licenses covering the territories of Russian Federation were renewed. The cost to renew the licenses was not significant. However, the Group has limited experience with the renewal of its existing licenses covering the territories of the Group's foreign subsidiaries. Management believes that licenses required for the Group's operations will be renewed upon expiration though there is no assurance of such renewals and the Group has limited experience in seeking renewal of its 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 the period of validity which is from three to fifteen years.

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 two to ten years. 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 twenty years. Customer bases are amortized on a straight-line basis 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.

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, other cellular network equipment, vehicles, premises and 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, 2008 and 2007, no impairment of investments occurred. In 2006, the Group's investment in Bitel LLC ("Bitel") in the amount of $150.0 million was written down to $nil (Note 21).

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 the 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 amounted to $1.3 million and $10.0 million for the years ended December 31, 2008 and 2007, respectively. No impairment loss occurred during the year ended December 31, 2006.

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 persuasive evidence of an arrangement; (ii) delivery of goods and rendering of services 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.

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 the primary obligor 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" ("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 owned 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's analysis of the subscriber base in the regions where the Group operates the average expected subscriber life ranged from 14 to 60 months in 2008 and 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 cost 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.

Roaming discounts – During the years ended December 31, 2008 and 2007 the Group entered into a bilateral roaming discount agreements with a number of wireless operators. According to the terms of the agreements MTS is obliged to provide and entitled to receive a discount that is generally dependant on the volume of inter operator roaming traffic. The Group accounts for rebates received from and granted to roaming partners in accordance with EITF Issue 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor", and EITF Issue 00-22, "Accounting for "Points" and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future", respectively. The Group uses various estimates and assumptions, based on historical data and adjusted for known changes, to determine the amount of discount to be received or granted. Such estimates are adjusted monthly to reflect newly-available information. The Group accounts for discounts received as a reduction of roaming expenses and rebates granted as reduction of roaming revenue. The Group considers terms of the various roaming discount agreements in order to determine the appropriate presentation of the amounts receivable from and payable to its roaming partners in consolidated balance sheet.

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.

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 providers 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 rendered.

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 the 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, "Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109" ("FIN No. 48"). 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, treatment of 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 additional accruals for unrecognized tax benefits, potential penalties and interest in the total amount of $0.6 million, $5.7 million and $1.3 million, respectively, which were recorded as adjustments 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, 2008, 2007 and 2006, were $430.6 million, $374.9 million and $321.5 million, 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, 2008, 2007 and 2006 were $69.1 million, $88.8 million and $70.3 million, respectively. Debt issuance costs are capitalized and amortized over the term of the respective borrowings using the effective interest method. Interest expense net of amounts capitalized and amortization of debt issuance costs, for the years ended December 31, 2008, 2007 and 2006, were $131.7 million, $129.9 million and $139.0 million, 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 $62.5 million, $42.8 million and $35.8 million in 2008, 2007 and 2006, respectively.

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 $14.4 million, $11.7 million and $9.1 million for the years ended December 31, 2008, 2007 and 2006, 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 share ("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 were 1,302,070, 1,397,256 and 1,435,001 stock options outstanding as at December 31, 2008, 2007 and 2006, respectively (see also Note 14).

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

	December 31,		
	2008	**2007**	**2006**
Weighted average number of common shares outstanding, basic	1,921,934,091	1,973,354,348	1,987,610,121
Dilutive effect of stock options, as if exercised	-	720,560	35,894
Weighted average number of common shares and potential shares outstanding, diluted	1,921,934,091	1,974, 074,908	1,987,646,015

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 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. The gain or loss relating to the ineffective portion is recognized immediately in the income statement.

At the inception of a 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 highly effective as a hedge, the Group discontinues hedge accounting and all subsequent changes in fair value are recorded in net income (Note 11).

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, 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, 2008, the $400.0 million Notes due in 2010 had a fair value of 90.5% or $362.0 million, and the $400.0 million Notes due in 2012 had a fair value of 80.0% or $320.0 million. Based on the MICEX stock exchange quotes as of December 31, 2008 the $255.0 million ruble-denominated Notes due in 2013 had a fair value of 99.3% or $253.0 million, the $255.0 million ruble-denominated Notes due in 2015 had a fair value of 99.0% or $253.0 million and the $268.5 million ruble-denominated Notes due in 2018 had a fair value of 91.2% or $245.9 million. As of December 31, 2008, 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, 2008, 2007 and 2006:

	Year ended December 31,		
	2008	**2007**	**2006**
Net income	$ 1,930,419	$ 2,071,504	$ 1,075,738
Effect of change in functional currency	-	358,997	-
Currency translation adjustment	(1,034,008)	256,390	41,315
Change in fair value of interest rate swaps, net of tax of $3,826, $352 and $794, respectively	(16,359)	(1,114)	(2,013)
Total comprehensive income	$ 880,052	$ 2,685,777	$ 1,115,040

Stock-based compensation – Effective from January 1, 2006, MTS adopted the provisions of FASB Statement No. 123R, “Share-based payment” (“SFAS No. 123R”), which is a revision of SFAS No. 123, “Accounting for stock-based compensation” (“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 the income statement. The cost of the equity instruments is to be measured based on the fair value of the instruments on the date they are granted (with certain exceptions) and 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 taking into account the estimated forfeitures.

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 does not itself require any fair value measurements. 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 or cash flows.

SFAS No. 157 also established a hierarchy that classifies the inputs used to measure fair value. This hierarchy prioritizes the use of inputs used in valuation techniques into three levels based on observable and unobservable inputs. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Group. Unobservable inputs, which require more judgment, are those inputs described above that reflect management's views on the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs.

The following fair value hierarchy table presents information regarding Group's assets and liabilities measured at fair value on a recurring basis as of December 31, 2008:

	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
Liabilities:				
Interest rate swap agreements	-	(20,892)	-	(20,892)

The fair value of the Group's interest rate swap agreements is based on observable interest rate yield curves for similar instruments (Note 11).

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). Effective January 1, 2008, the Group adopted SFAS No. 159. On adoption and as of December 31, 2008, the Group did not elect to measure any financial instruments and liabilities at fair value other than those required to be accounted for at fair value under other accounting standards. Therefore, the adoption of SFAS No. 159 did not have any impact on the Group's financial position, results of operations or cash flows.

In December 2007, the FASB issued FASB Statement No. 141R, "Business Combinations" ("SFAS No. 141R"), and FASB Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS No. 160"). These statements 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 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 expects SFAS No.141R will have an impact on its accounting for future business combinations once adopted, but the effect is dependent upon the acquisitions that are made in the future.

In connection with the issuance of SFAS No. 160, EITF Topic D-98, “Classification and Measurement of Redeemable Securities” (“Topic D-98”), was revised 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 or fair value by the holder or upon the occurrence of an event that is not solely within the control of the issuer). 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 K-Telecom.

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 does not expect significant impact of the adoption of SFAS No. 161 on its financial position, results of operations and cash flows.

In April 2008, the FASB issued FSP No. FAS 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP No. 142-3”). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. The objective of FSP No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other U.S. GAAP. FSP No. 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise, and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. The Group expects FSP No. 142-3 will have an impact on its accounting for future acquisitions of intangible assets once adopted, but the effect is dependent upon the acquisitions that are made in the future.

In November 2008, the FASB issued EITF Issue No. 08-6, “Equity Method Investment Accounting Considerations” (“EITF Issue No. 08-6”). EITF Issue No. 08-6 considers the effects of the issuances of SFAS No. 141R and SFAS No. 160 on an entity’s application of the equity method under Opinion 18, “The Equity Method of Accounting for Investments in Common Stock,” i.e. determination of the initial carrying value of an equity-method investment, impairment assessment of an underlying indefinite-lived intangible asset of an equity-method investment, accounting for issuance of shares by an equity investee, and accounting for a change in an investment from the equity method to the cost method. EITF No. 08-6 is effective for transactions occurring in fiscal years beginning on or after December 15, 2008 and interim periods within those fiscal years. Early adoption is not permitted. The Group does not expect the adoption of EITF No. 08-6 to have a significant impact on its financial position, results of operations and cash flows.

In November 2008, the FASB issued EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets" ("EITF Issue No. 08-7"). EITF Issue No. 08-7 applies to all acquired intangible assets in situations in which an entity does not intend to actively use the asset but intends to hold (lock up) the asset to prevent others from obtaining access to the asset (a defensive intangible asset), except for intangible assets that are used in research and development activities. The EITF reached a consensus that a defensive intangible asset should be accounted for as a separate unit of accounting and should be assigned a useful life that reflects the entity's consumption of the expected benefits related to the asset, noting that it would be rare for a defensive intangible asset to have an indefinite life. This EITF Issue No. 08-7 is effective for intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Group expects EITF Issue No. 08-7 will have an impact on its accounting for future acquisitions of intangible assets once adopted, but the effect is dependent upon the acquisitions that are made in the future.

3. BUSINESSES ACQUIRED

MSS acquisition – In February 2008, MTS acquired 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 increased to 100%. The transaction was accounted for using the purchase method. Preliminary allocation of the purchase price increased the recorded license cost by $8.8 million and customer base cost by $3.2 million. License costs are amortized over the remaining contractual terms of the license of approximately 3 years and the customer base is amortized on a straight-line basis over the estimated average subscriber's life of approximately 60 months.

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.

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

Current assets	$	5,645
Non-current assets		13,156
Customer base cost		2,260
Goodwill		21,077
Current liabilities		(7,737)
Non-current liabilities		(31,918)
Deferred taxes		4,209
Purchase price	$	6,692

Goodwill is mainly attributable to the synergy expected as a result of the acquisition and was assigned to the "Russia" operating segment. The amount of goodwill is not deductible for income tax purposes. The customer base is amortized on a straight-line basis over the estimated average subscriber's life of approximately 60 months.

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 fair value, as determined by an independent investment bank at the date the option is exercised subject to a cap of €200.0 million (equivalent of $281.9 million as of December 31, 2008). The option is valid until July 2012. The option was accounted for at fair value which was $nil at December 31, 2008.

K-Telecom operates under the VivaCell brand in the GSM-900/1800 standard covering the entire territory of Armenia. 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-Telekom's financial results for the year ended December 31, 2007, €10.0 million ($14.7 million as of December 31, 2007) was recognized as a liability in the accompanying consolidated balance sheet as of December 31, 2007 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) 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-Telekom's liabilities to the seller and its affiliates were settled. The loan is eliminated in consolidation and is not part of the purchase price. Finders and consultants fees paid in connection with the business combination and included in the purchase price were $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)
Purchase price	$	402,558

In accordance with the terms of the sale and purchase agreement, based on K-Telekom's financial results for the year ended December 31, 2008, €20.0 million ($28.2 million as of December 31, 2008) was accounted for as the adjustment to purchase price and recoginized as as a liability in the accompanying consolidated balance sheet as of December 31, 2008. If and when future financial targets are met, additional adjustments to the purchase price will be made.

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 on a straight-line basis over the estimated average subscriber's life of approximately 46 months.

Uzdunrobita acquisition – In June 2007, MTS purchased an additional 26% stake in Uzdunrobita, a mobile telecom operator in Uzbekistan, from a private investor for $250.0 million in cash. Previously MTS owned 74% of Uzdunrobita. As a result of this transaction, MTS' ownership increased to 100%. The transaction was accounted for using the purchase method. Allocation of the purchase price increased the recorded license cost by $155.7 million, customer base cost by $6.5 million, and property plant and equipment cost by $5.4 million. Additionally, $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 Uzdunrobita 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. Dagtelecom is a GSM-900 mobile services provider in the Republic of Dagestan, Russia. 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 value of the option was $nil at December 31, 2008 and 2007.

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
Purchase price	$	14,700

Goodwill is mainly attributable to the economic potential of the "Russia" operating segment. Goodwill is not deductible for income tax purposes.

The customer base is amortized on a straight-line basis over the estimated average subscriber's life of approximately 60 months.

In January 2009, the Group received a put notice from the holder of the minority stake in Dagtelecom and therefore subsequently acquired the remaining stake (Note 23).

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2008 and 2007 comprised the following:

	December 31, 2008	December 31, 2007
Ruble current accounts	$ 106,605	$ 71,457
Ruble deposit accounts	126,275	61,517
U.S. Dollar current accounts	95,747	15,143
U.S. Dollar deposit accounts	35	255,293
Euro current accounts	5,698	7,675
Euro deposit accounts	423,150	-
Hryvnia current accounts	1,462	3,550
Hryvnia deposit accounts	1,948	6,931
Uzbek som current accounts	229,904	121,719
Uzbek som deposit accounts	57,430	45,736
Turkmenian manat current accounts	1,496	22,154
Armenian dram current accounts	4,162	14,777
Armenian dram deposit accounts	4,890	8,546
Total cash and cash equivalents	$ 1,058,802	$ 634,498

5. SHORT-TERM INVESTMENTS

As of December 31, 2008 the Group's short-term investments comprised the following:

	Annual interest rate	Maturity Date	December 31, 2008
Deposit in OJSC Moscow Bank of Reconstruction and Development (Note 15)	10.3%	July 2009	$ 30,000
Deposit in OJSC Moscow Bank of Reconstruction and Development (Note 15)	7.5%	June 2009	15,000
Other			718
Total short-term investments			$ 45,718

Beta Link – During the year ended December 31, 2008 the Group granted a short-term loan in the amount of $28.2 million to Beta Link with a maturity date of December 2, 2009 and related interest of 9.0%. The Group had 49.0% of shares of Beta Link assigned as collateral pursuant to the loan agreement. As of December 31, 2008, the Group's management became aware of the deteriorated financial position of Beta Link. Further, in March 2009, Beta Link filed a bankruptcy petition to the Arbitration Court of Moscow. The Group's management believes that a probable risk exists that such loan may not be recovered. Accordingly, an allowance for the entire loan amount was recorded in the provision for doubtful accounts in the accompanying statement of operations for the year ended December 31, 2008.

As of December 31, 2007 short-term investments comprised the following:

	Annual interest rate	Maturity Date		December 31, 2007
OJSC Moscow Bank of Reconstruction and Development (Note 15)	6.6%	June 2008	$	15,000
Other				776
Total short-term investments			$	15,776

6. TRADE RECEIVABLES, NET

Trade receivables as of December 31, 2008 and 2007 comprised the following:

	December 31,			
		2008		2007
Accounts receivable, subscribers	$	116,622	$	180,411
Accounts receivable, interconnect		93,967		148,902
Accounts receivable, dealers		86,821		16,660
Accounts receivable, roaming		33,958		44,525
Accounts receivable, other		36,882		39,590
Allowance for doubtful accounts		(47,691)		(43,480)
Trade receivables, net	$	320,559	$	386,608

The following table summarizes the changes in the allowance for doubtful accounts receivable for the years ended December 31, 2008, 2007 and 2006:

		2008		2007		2006
Balance, beginning of the year	$	43,480	$	47,435	$	39,919
Provision for doubtful accounts receivable		90,112		55,170		84,858
Accounts receivable written off		(76,678)		(62,276)		(77,342)
Currency translation adjustment		(9,223)		3,151		-
Balance, end of the year	$	47,691	$	43,480	$	47,435

7. INVENTORY AND SPARE PARTS

Inventory and spare parts as of December 31, 2008 and 2007, comprised the following:

	December 31, 2008	December 31, 2007
Spare parts for base stations	$ 45,406	$ 52,069
SIM cards and prepaid phone cards	29,673	33,315
Handsets and accessories	24,026	18,263
Advertising materials	2,966	7,802
Other materials	8,419	29,483
Total inventory and spare parts	$ 110,490	$ 140,932

Other materials mainly consist of stationery, fuel and auxiliary materials.

Obsolescence expense for the years ended December 31, 2008, 2007 and 2006, amounted to $1.3 million, $nil and $nil, 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 twelve months following the balance sheet date.

8. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2008 and 2007, was as follows:

	December 31, 2008	December 31, 2007
Network, base station equipment (including leased network and base station equipment of $1,281 and $1,533, respectively) and related leasehold improvements	$ 6,502,590	$ 6,374,063
Office equipment, computers and other	634,850	641,095
Buildings and related leasehold improvements	354,761	352,313
Vehicles (including leased vehicles of $12,114 and $13,269, respectively)	45,553	40,973
Property, plant and equipment, at cost	7,537,754	7,408,444
Accumulated depreciation (including accumulated depreciation on leased equipment of $5,391 and $5,625)	(3,409,495)	(3,079,376)
Equipment for installation	450,605	748,447
Construction in progress	1,321,265	1,529,800
Property, plant and equipment, net	$ 5,900,129	$ 6,607,315

Depreciation expenses during the years ended December 31, 2008, 2007 and 2006, amounted to $1,372.2 million, $999.0 million and $689.7 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of $3.3 million, $2.8 million and $2.3 million, respectively.

9. OTHER INTANGIBLE ASSETS AND GOODWILL

Intangible assets as of December 31, 2008 and 2007, comprised the following:

		December 31, 2008			December 31, 2007		
	Useful lives	Gross carrying value	Accumu-lated amor-tization	Net carrying value	Gross carrying value	Accumu-lated amor-tization	Net carrying value
Amortized intangible assets							
Billing and telecommunication software	13 to 240 months	$ 1,173,304	$ (638,691)	$ 534,613	$ 1,280,614	$ (604,635)	$ 675,979
Acquired customer base	20 to 60 months	103,807	(41,932)	61,875	205,510	(105,714)	99,796
Rights to use radio frequencies	2 to 15 years	205,922	(48,622)	157,300	199,981	(69,398)	130,583
Accounting software	13 to 60 months	94,027	(41,140)	52,887	130,968	(48,291)	82,677
Numbering capacity with finite contractual life	2 to 10 years	88,517	(75,971)	12,546	102,857	(82,701)	20,156
Office software	13 to 60 months	57,833	(20,366)	37,467	45,577	(27,471)	18,106
Other	3 to 50 years	20,538	(5,175)	15,363	18,593	(11,537)	7,056
		1,743,948	(871,897)	872,051	1,984,100	(949,747)	1,034,353
Unamortized intangible assets							
Goodwill		377,982	-	377,982	359,450	-	359,450
Numbering capacity with indefinite contractual life		37,346	-	37,346	36,060	-	36,060
Total other intangible assets		$ 2,159,276	$ (871,897)	$ 1,287,379	$ 2,379,610	$ (949,747)	$ 1,429,863

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 two 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, 2008, 2007 and 2006, amounted to $415.2 million, $294.8 million and $195.0 million, respectively. Based on the amortizable intangible assets existing at December 31, 2008, the estimated amortization expense is $293.5 million for 2009, $239.0 million for 2010, $159.5 million for 2011, $92.8 million for 2012, $22.8 million for 2013 and $64.5 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 2008 and 2007 by reportable segments was as follows:

	Russia	Ukraine	Other	Total
Balance as of December 31, 2006	$ 110,992	$ 8,000	$ 46,470	$ 165,462
Acquisitions (Note 3)	5,123	-	155,544	160,667
Currency translation adjustment	18,703	-	14,618	33,321
Balance as of December 31, 2007	134,818	8,000	216,632	359,450
Acquisitions (Note 3)	16,366	-	29,222	45,588
Currency translation adjustment	(23,873)	(2,492)	(691)	(27,056)
Balance as of December 31, 2008	$ 127,311	$ 5,508	$ 245,163	$ 377,982

10. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2008 and 2007, were as follows:

	2008	2007
Balance at the beginning of the year	$ 53,489	$ 79,607
Payments received and deferred during the year	52,422	42,446
Amounts amortized and recognized as revenue during the year	(55,705)	(75,404)
Currency translation adjustment	(9,962)	6,840
Balance at the end of the year	40,244	53,489
Less: current portion	(23,795)	(32,644)
Non-current portion	$ 16,449	$ 20,845

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).

11. BORROWINGS

As of December 31, 2008 and 2007, the Group's borrowings comprised the following:

	December 31, 2008	December 31, 2007
Notes:		
9.75% Notes due 2008	$ -	$ 400,000
8.38% Notes due 2010	400,000	400,000
8.00% Notes due 2012	399,463	399,314
14.01% Notes due 2013	255,272	-
14.01% Notes due 2015	255,272	-
8.70% Notes due 2018	268,533	-
Less: current portion	-	(400,000)
Total notes, long-term	$ 1,578,540	$ 799,314
Bank loans	$ 2,490,995	$ 2,197,172
Less: current portion	(1,181,039)	(309,977)
Total bank loans, long-term	$ 1,309,956	$ 1,887,195
Capital lease	5,699	5,181
Less: current portion	(2,690)	(3,305)
Total capital lease, long-term	$ 3,009	$ 1,876

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 value. Proceeds received from the notes issue were $400.0 million and related issuance costs of $3.9 million were capitalized. These notes were fully and unconditionally guaranteed by MTS OJSC and matured on January 30, 2008. 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 redeemed in January 2008.

On October 14, 2003, MTS Finance issued $400.0 million notes bearing interest at 8.375% at par value. 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.

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.

On June 24, 2008, the Group issued 10,000,000 Russian ruble-denominated notes with an aggregate face value of 10.0 billion rubles (equivalent of $423.9 million as of the date of transaction) at par value. Related issuance costs totaled $0.6 million and were capitalized. MTS is required to make interest payments on the notes semi-annually in arrears in December and June, commencing on December 23, 2008. The notes carry a coupon of 8.7% per annum during the two years ending June 22, 2010. Sequential coupons are set by the issuer. MTS has an unconditional obligation to repurchase the notes at par value if claimed by the holders of the notes subsequent to the announcement of the sequential coupon. The notes mature on June 12, 2018 and are fully and unconditionally guaranteed by MTS-Capital LLC, a subsidiary of MTS OJSC. The notes are listed on the MICEX.

The following additional transactions in relation to these notes also took place:

- On December 16, 2008, the Group repurchased 2,377,540 notes outstanding at par value of 2.4 billion rubles (equivalent of $85.5 million as of the date of transaction), 300,000 of which were subsequently resold to a third party bank for 266.9 million rubles (equivalent of $9.3 million as of the date of transaction) on December 26, 2008.
- On December 25, 2008, the Group entered into a repurchase agreement with the Bank of Moscow. Under the terms of the agreement, the Bank of Moscow acquired 1,000,000 notes for 680.0 million rubles (equivalent of $23.7 million as of the date of transaction) subject to an obligation of the Group to repurchase, and the Bank of Moscow to resell, the notes for 679.9 million rubles (equivalent of $23.1 million as of December 31, 2008) on January 12, 2009. As of December 31, 2008, the balance outstanding under this arrangement equaled $23.1 million and was classified as debt in the accompanying balance sheet.

As of December 31, 2008 the Group recorded the notes payable balance related to this issue in the amount of $268.5 million.

On October 23 and 28, 2008 MTS OJSC issued two Russian ruble-denominated notes (Issue I and Issue II) with an aggregate face value of 10.0 billion rubles each (equivalent of $371.5 million and $365.6 million, respectively, as of the dates of the transactions) at par value. Notes in the amount of 2.5 billion rubles (equivalent of $92.8 million as of the date of transaction) from Issue I and in the amount of 2.5 billion rubles from Issue II (equivalent of $91.4 million as of the date of transaction) were purchased at initial placement by Bastion LLC, a wholly-owned subsidiary of the Group. The notes under Issue I and Issue II mature on October 17, 2013 and on October 20, 2015, respectively. The notes carry a coupon of 14.01% per annum during the eighteen month periods ending April 22 and 27, 2010 for Issue I and Issue II, respectively. Coupons for subsequent periods will be determined by MTS. The notes are both subject to a put option in 2010 after the expiration of the above mentioned 18-month periods. MTS is required to make payments on the notes semi-annually in arrears in April and October, commencing on April 23, 2009 and April 28, 2009 respectively. The notes are fully and unconditionally guaranteed by MTS-Capital LLC, a subsidiary of MTS OJSC. The notes are listed on the MICEX. Related debt issuance costs in the amount of $5.8 million were capitalized. As of December 31, 2008 the notes payable balance under Issue I and Issue II amounted to $255.3 million each.

The indenture governing the notes contains certain covenants which limit the Group's ability to delist the notes from the MICEX and delay the coupon payments.

Management believes that the Group is in compliance with all restrictive note covenants as of December 31, 2008.

As mentioned above, the ruble-denominated notes issued in 2008 are all subject to put option in 2010 and therefore can be defined as callable obligations under FASB Statement No. 78, "Classification of Obligations That Are Callable by the Creditor" ("SFAS No. 78"), as the holders have the unilateral right to demand repurchase of the notes at par value upon announcement of coupons for the coupon period starting on June 23, 2010 for the notes issued in June 2008 and on April 23 and 28, 2010 for the notes issued in October 2008. SFAS No. 78 requires callable obligations to be disclosed as maturing in the reporting period, when the demand for repurchase could be submitted disregarding the expectations of the Group about the intentions of the notes holders. The Group discloses the notes as maturing in 2010 in the aggregated maturities schedule represented below as 2010 represents the reporting period when the notes holders will first have the unilateral right to demand repurchase.

Bank loans – As of December 31, 2008 and 2007, the Group's loans from banking institutions were as follows:

	Maturity	Annual interest rate (actual rate at December 31, 2008)	December 31, 2008	December 31, 2007
U.S. Dollar-denominated bank loans	2009-2015	LIBOR+0.13%-3.10% (1.88%-4.85%)	$ 2,012,876	$ 2,143,181
Euro-denominated loan from Gazprombank	2009-2011	12.00% + 2.00% commision	423,150	-
Other Euro-denominated bank loans	2009-2014	EURIBOR+0.35%-0.65% (3.35%-3.65%)	31,762	53,299
RUR-denominated bank loans	2009	8.70%	23,142	-
Other loans	various	various	65	692
Total bank loans			$ 2,490,995	$ 2,197,172

The Group's loans include the syndicated U.S. Dollar denominated bank 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, and 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, 2008 and 2007, the balances outstanding under the facility totaled $1,168.5 million and $1,330.0 million, respectively.

In August 2008 the Group signed a loan facility agreement with Skandinaviska Enskilda Banken AB for $270.3 million. The facility is available in two parts – $255.0 million ("Equipment facility") and $15.3 million ("EKN Premium Facility"). These funds are to be used to acquire telecommunication equipment from Ericsson AB. The Equipment facility agreement is available in three tranches of $80.0 million, $80.0 million and $95.0 million. The EKN Premium Facility is available in three tranches of $4.8 million, $4.8 million and $5.7 million. The facility bears interest of LIBOR + 0.225%. As of December 31, 2008 the Group has drawn $79.5 million of the first tranche, $59.1 million of the second tranche and $20.4 million of the third tranche under the "Equipment facility". The tranches are repayable in seventeen equal semiannual installments, commencing January 15, 2009 for the first tranche, May 4, 2009 for the second tranche and February 2, 2009 for the third tranche. A management fee of $0.5 million was paid in accordance with the agreement and capitalized. The commitment fee is 0.0625%, calculated on a daily basis on such portion of the total commitments not yet disbursed.

On December 23, 2008 MTS entered into a credit facility agreement with EBRD to finance its investing activities in Russia, Uzbekistan and Turkmenistan. The facility allows borrowing of up to €225.0 million and will be available in two tranches of €115.0 million and €110.0 million bearing interest of EURIBOR + 6.1% and EURIBOR + 5.9%, respectively. The margin for the second tranche can be increased at the sole descretion of EBRD which will automatically result in an increase of margin for the first tranche as it is determined as the margin for the second tranche plus 0.2%. The availability period established for the facility is March 1, 2009 to December 31, 2009.

On December 30, 2008 the Group entered into a credit agreement with Gazprombank for a total amount €300.0 million ($423.2 million as of December 31, 2008) with an interest rate of 12.0% per annum. In addition to the interest, MTS is to pay a commission of 2% per annum on the outstanding amount of the facility on a monthly basis. Gazprombank is entitled to revise the interest rate at any time during the term of the agreement. MTS is not allowed to use the received funds for refinancing or stocks acquisitions purposes. The loan is repayable in three equal installments in December 2009, December 2010 and June 2011 respectively.

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, 2008 the Group is in compliance with all existing bank loan covenants.

As of December 31, 2008, the Group's total available credit facilities amounted to $111.3 million, which related solely to the loan facility agreement with Skandinavska Enskilda Banken AB.

The following table presents the aggregated scheduled maturities of the notes and bank loans principal outstanding as of December 31, 2008:

	Notes	Bank loans
Payments due in the year ended December 31,		
2009	$ -	$ 1,181,039
2010	1,179,077	518,637
2011	-	398,163
2012	399,463	149,421
2013	-	146,786
Thereafter	-	96,949
Total	$ 1,578,540	$ 2,490,995

Hedges – In January 2006, the Group entered into a variable-to-fixed interest rate swap agreement with HSBC Bank 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 to pay a fixed rate of 3.29% and receive a variable interest of EURIBOR on €26.0 million for the period from April 28, 2006, up to October 29, 2013.

In December 2007, the Group entered into several variable-to-fixed interest rate swap agreements with HSBC Bank, 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 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. MTS agreed with Rabobank 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 receive 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. Under 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.

In October 2008, the Group entered into two interest rate swap agreements with HSBC Bank. MTS agreed to pay a variable interest of LIBOR and receive a fixed rate of 3.67% on $88.7 million for the period from September 30, 2008 to September 30, 2014. Additionally, MTS agreed to pay a fixed rate of 3.73% and receive a variable interest of LIBOR on $81.3 million for the period from November 24, 2008 to May 27, 2014.

As of December 31, 2008, the Group recorded a liability of $20.9 million in relation to the above hedge contracts in the accompanying consolidated balance sheet and a loss of $16.7 million, net of tax of $4.2 million, to other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the changes in fair value of these agreements.

These instruments qualified as cash flow hedges under the requirements of SFAS No. 133 as amended by SFAS No. 149. As of December 31, 2008, the outstanding hedges were highly effective. Approximately $4.3 million of net loss is expected to be reclassified into net income during the next twelve months.

12. ACCRUED LIABILITIES

As of December 31, 2008 and 2007, accrued liabilities comprised the following:

	December 31, 2008	December 31, 2007
Accruals for services	$ 192,205	$ 187,062
Accrued payroll and vacation	104,448	101,901
Accruals for payments to social funds	34,211	53,109
Accruals for taxes	98,930	60,905
Interest payable on debt	46,470	61,528
Total accrued liabilities	$ 476,264	$ 464,505

13. INCOME TAX

MTS' provision for income taxes was as follows for the years ended December 31, 2008, 2007 and 2006:

	December 31, 2008	December 31, 2007	December 31, 2006
Current provision for income taxes	$ 839,959	$ 830,358	$ 709,130
Deferred income tax benefit	(209,338)	(92,088)	(133,027)
Total provision for income taxes	$ 630,621	$ 738,270	$ 576,103

The statutory income tax rates in jurisdictions in which the Group operates for 2008 were as follows: Russia – 24.0%, Ukraine – 25.0%, Uzbekistan – 3.4%, Turkmenistan – 20.0%, and Armenia – 20.0%.

In 2008, the income tax rate of 20.0% was enacted in Russia for periods starting January 1, 2009. The Group adjusted deferred tax liabilities and assets as of December 31, 2008 for the effect of this change in the income tax rate. The effect is included in the consolidated statement of operations for the year ended December 31, 2008.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the years ended December 31, 2008, 2007 and 2006:

	2008	2007	2006
Statutory income tax rate for year	24.0%	24.0%	24.0%
Adjustments:			
Expenses not deductible for tax purposes	2.0	1.0	2.9
Currency exchange and transaction loss	0.5	0.1	2.8
Income tax provision under FIN No. 48	0.3	0.6	-
Effect of change in the income tax rate in Russia	0.5	-	-
Effect of revaluation of UMC tax base	(2.0)	-	-
Effect of different tax rate of foreign subsidiaries	(1.2)	0.2	0.3
Bitel investment and liability write off, not deductible for tax purposes	-	-	4.6
Other	0.4	0.2	-
Effective income tax rate	24.5%	26.1%	34.6%

Temporary differences between the tax and accounting bases of assets and liabilities gave rise to the following deferred tax assets and liabilities as of December 31, 2008 and 2007:

	December 31, 2008	December 31, 2007
Assets/(liabilities) arising from tax effect of:		
Deferred tax assets		
Depreciation of property, plant and equipment	$ 165,417	$ 138,781
Other intangible assets	8,967	-
Deferred connection fees	8,596	12,908
Subscriber prepayments	17,057	24,341
Accrued expenses	146,928	95,636
Allowance for doubtful accounts	12,417	1,220
Inventory obsolescence	2,004	5,325
Other	6,236	2,929
Total deferred tax assets	**367,622**	**281,140**
Deferred tax liabilities		
Licenses acquired	$ (85,542)	$ (131,621)
Depreciation of property, plant and equipment	(36,853)	(63,484)
Customer base	(1,211)	(4,113)
Other intangible assets	(21,326)	(18,807)
Debt issuance cost	(7,446)	(14,184)
Other	(29,777)	(26,636)
Total deferred tax liabilities	**(182,155)**	**(258,845)**
Net deferred tax asset	**185,467**	**22,295**
Net deferred tax asset, current	$ 192,847	$ 136,466
Net deferred tax asset, non-current	$ 62,093	$ -
Net deferred tax liability, long-term	$ (69,473)	$ (114,171)

The Group does not record a deferred tax liability related to the undistributed earnings of UMC, Uzdunrobita, K-Telekom and BCTI as it intends to permanently reinvest these earnings. The undistributed earnings of UMC in accordance with local statutory accounting regulations amounted to $1,268.7 million and $1,715.1 million for the years ended December 31, 2008 and 2007, respectively (unaudited). The undistributed earnings of Uzdunrobita, K-Telecom and BCTI in accordance with local statutory accounting regulations amounted to $401.6 million, $130.4 million and $ 42.7 million, respectively (unaudited).

As of December 31, 2008 certain deferred tax assets totaling $114.8 million require filing of adjusted income tax returns for the years ended December 31, 2008, 2007 and 2006 with tax authorities to realize the tax benefits. Management intends to file the adjusted tax returns within the statutory time limitations for filing and therefore believe that these deferred tax assets are more likely than not to be realized.

As of December 31, 2008 and 2007, the Group included accruals for uncertain tax positions in the amount of $6.1 million and $29.2 million, respectively, as a component of income tax payable.

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

	2008	2007
Balance, beginning of the year	$ 29,213	$ 7,610
Additions based on tax position related to the current year	17,632	20,643
Additions based on tax positions related to prior years	-	5,933
Reduction in tax positions related to prior years	(10,204)	(1,345)
Settlements with tax authorities	(31,456)	(3,628)
Currency translation adjustment	962	-
Balance, end of the year	$ 6,147	$ 29,213

As of December 31, 2008, the Group also accrued interest and penalties related to unrecognized tax benefits of $0.6 million and $1.2 million, respectively (comparing to $2.5 million and $1.9 million as of December 31, 2007). The Group does not expect the unrecognized tax benefits to change significantly over the next twelve months.

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 and key employees. During its initial public offering in 2000 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 MTS. The options are exercisable within two weeks after the vesting date, and, if not exercised, are forfeited. The exercise price of the options equaled the average market share price during the one hundred day period preceding the grant date.

In April 2008, the Board of Directors allotted an additional 651,035 ADSs (or 3,255,175 shares) to fund a Stock Option award to MTS' chief executive officer. The award vesting period is up to two years contingent upon employment with MTS. The award will vest only if at the end of the vesting period MTS is among the top 20 mobile operators in the world and top mobile operator in Russia and CIS, in each case in terms of revenue, and cumulative percentage of MTS' market capitalization growth since the grant date exceeds the predetermined threshold of 15%.

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

	Number of shares	Weighted average exercise price (per share), U.S. Dollars	Weighted average grant date fair value of options (per share), U.S. Dollars	Aggregate intrinsic value
Outstanding at December 31, 2005	3,187,240	$ 6.47	$ 2.02	$ 2,455
Granted	-	-	-	-
Exercised	(639,357)	5.95	2.36	
Forfeited	(1,112,882)	6.23	2.17	
Outstanding at December 31, 2006	1,435,001	$ 6.89	$ 1.74	$ 743
Granted	1,778,694	6.31	5.95	
Exercised	(848,126)	6.89	1.74	
Forfeited	(968,313)	6.66	2.65	
Outstanding at December 31, 2007	1,397,256	$ 6.31	$ 4.05	$ 5,236
Granted	1,302,070	15.93	2.44	
Exercised	(1,397,256)	6.31	4.05	
Forfeited	-	-	-	
Outstanding at December 31, 2008	1,302,070	$ 15.93	$ 2.44	$ -

The total intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006 was $7.4 million, $0.4 million and $0.7 million, respectively.

Stock options outstanding as of December 31, 2008 will vest during the period ended July 1, 2010. None of the stock options outstanding as of December 31, 2008 were exercisable and therefore had a negative intrinsic value.

Compensation cost under Stock Option Plan of $3.5 million, $2.8 million and $1.7 million was recognized in consolidated statements of operations during the years ended December 31, 2008, 2007 and 2006 respectively.

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

	2007
Risk free rate	3.1%
Expected dividend yield	0.3%
Expected volatility	40.3%
Expected life, years	2
Fair value of options (per share), U.S. Dollar	$ 5.95

The fair value of options granted during the year ended December 31, 2008 was estimated using the Monte-Carlo simulation model based on the following assumptions:

		2008
Risk free rate		2.3%
Present value of expected dividends, U.S. Dollars	$	4.17
Expected volatility		40.0%
Expected life, years		2
Fair value of options (per share), U.S. Dollar	$	2.44

The Group is required to estimate expected forfeiture rate, as well as the probability that performance conditions that affect the vesting of the Stock Option awards will be achieved and only recognize expense for those awards expected to vest. The effect of the estimated forfeitures on Group's operations was $2.3 million, $1.7 million and $1.0 million in 2008, 2007 and 2006, respectively.

As of December 31, 2008, there was $1.8 million of total unrecognized compensation cost related to non-vested stock-based compensation awards under the Stock Option Plan. This amount will be recognized over the period through July 1, 2010.

The 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 during 2007-2011. The plan is based on units equivalent to MTS ADSs (the "Phantom ADSs"). Each Phantom ADS is the equivalent of five MTS common 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 price of Phantom ADSs determined based on average market share price during the one hundred day period preceding the vesting date, multiplied by the number of Phantom ADSs granted, upon vesting of the award. The average 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 MTS market capitalization growth since the grant date exceeds the cumulative cost of equity determined by the Board of Directors for the same period.

In April 2008, the Phantom Stock Plan was amended to increase the number of Phantom ADSs available under the plan from the initial 3,600,000 to 9,556,716 ADSs and to increase the number of Participants potentially eligible for the Plan to up to 420 top- and mid-level managers of the Group. Further, under the amended Plan, the Phantom ADSs granted in 2008 and thereafter will vest only if at the end of the vesting period MTS is among the top 20 mobile operators in the world and top mobile operator in Russia and CIS, in each case in terms of revenue, and the cumulative percentage of MTS' market capitalization growth since the grant date exceeds the predetermined threshold of 15%. At the end of the vesting period, participants are entitled to a cash payment equal to the difference between the initial grant price and the price of Phantom ADSs determined based on average market share price during the one hundred day period preceding the vesting date, multiplied by the number of Phantom ADSs granted and adjusted by the ratio that reflects actual market capitalization growth rate. During the year ended December 31, 2008, 6,676,716 ADSs were granted to the participants, 4,562,830 of which were granted on May 1, 2008 (Phantom Grant 2008 (I)) and 2,113,886 ADSs were granted on July 1, 2008 (Phantom Grant 2008 (II)).The award of Phantom Grant 2008 (I) and (II) will vest in 14 and 24 months, respectively, after the grant date, contingent upon the continuing employment of the Participants.

A summary of the status of the Group's Phantom Stock Plan is presented below:

	Number of ADSs	Weighted average exercise price (per ADS), U.S. Dollar	Weighted average fair value of options (per ADS), U.S. Dollar	Aggregate intrinsic value
Outstanding at December 31, 2006	-	-	-	-
Granted	720,000	56.79	44.00	
Exercised	-	-	-	
Forfeited	(36,664)	56.79	44.00	
Outstanding at December 31, 2007	683,336	$ 56.79	$ 44.0	$ 30,750
Granted	6,676,716	76.64	0.68	
Exercised	-	-	-	
Forfeited	(1,346,442)	72.02	0.88	
Outstanding at December 31, 2008	6,013,610	$ 75.41	$ 0.78	$ -

All Phantom Shares outstanding as of December 31, 2008 are non-vested and will vest in 2009 and 2010. None of the Phantom Shares were exercisable as of December 31, 2008 and therefore had a negative intrinsic value.

The fair value of the liability under the Phantom Stock Plan as of December 31, 2008, were estimated using the Monte-Carlo simulation technique based on the following assumptions:

	Phantom stock grant 2007	Phantom stock grant 2008 (I)	Phantom grant 2008 (II)
Risk free rate	0.2%	0.4%	0.4%
Present value of expected dividends, U.S. Dollars	2.7	2.7	4.1
Expected volatility	135%	90%	90%
Remaining vesting period, years	0.5	0.5	1.5
Fair value of phantom share award (per phantom share), U.S. Dollar	2.00	0.07	1.99

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:

	Phantom stock grant 2007
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
Fair value of phantom share award (per share), U.S. Dollar	$ 8.8

For the year ended December 31, 2008 a reversal of previously recorded expense in the amount of $8.9 million was recognized in the consolidated statements of operations as a result of underlying stock price decrease. Related deferred tax expense amounted to $1.8 million.

The compensation cost under the Phantom Stock Grant 2008 (I) and (II) recognized in the consolidated statement of operations for the year ended December 31, 2008 amounted to $1.3 million and the related deferred tax benefit amounted to $0.3 million.

The compensation cost under the Phantom Stock Plan recognized in consolidated statement of operations for the year ended December 31, 2007 amounted to $7.6 million and the related deferred tax benefit amounted to $1.8 million.

As of December 31, 2008, there was $3.1 million of total unrecognized compensation cost related to non-vested Phantom ADSs. This amount is expected to be recognized over a weighted-average period of 1.4 years. The Group is required to estimate expected forfeiture rate, as well as the probability that performance conditions that affect the vesting of the Phantom ADSs awards will be achieved and only recognize expense for those awards expected to vest. The Group's estimated forfeiture rate was 5.1%. The effect of forfeitures amounted to $1.5 and $2.0 million for the years ended December 31, 2008 and 2007, respectively.

15. RELATED PARTIES

Related parties balances as of December 31, 2008 and 2007 comprised the following:

	December 31, 2008	December 31, 2007
Accounts receivable:		
TS-Retail	$ 16,271	$ 8,578
Glaxen	12,215	-
MGTS for interconnect	9,438	2,631
MTT for interconnect	5,664	3,029
Comstar UTS for interconnect	3,934	6,048
Other	2,162	4,718
Total accounts receivable, related parties	$ 49,684	$ 25,004
Accounts payable:		
Sitronics	$ 74,994	$ 99,816
Kvazar-Micro.ru	68,782	20,230
Maxima for advertising	15,168	1,266
MTT for interconnect	8,252	19,197
Mediaplanning for advertising	6,118	2,609
Comstar UTS for interconnect	4,254	6,825
Sitronics Smart Technologies for SIM and prepaid phone cards	2,837	5,754
Sistema Telecom	2,697	1,728
MGTS for interconnect	1,556	1,833
Other	2,220	995
Total accounts payable, related parties	$ 186,878	$ 160,253

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, 2008 and 2007, MTS cash position at MBRD amounted to $211.5 million and $321.7 million in current accounts, respectively. Deposit accounts at MBRD amounted to $149.2 million and $265.0 million as of December 31, 2008 and 2007, respectively. Deposit accounts in MBRD included deposit accounts with original maturities in excess of three months but less than twelve months totaling $45.0 million and $15.0 million as of December 31, 2008 and 2007, respectively, which are classified as short-term investments in the accompanying consolidated balance sheets. The interest accrued on the deposits for the years ended December 31, 2008, 2007 and 2006, amounted to $21.1 million, $18.9 million and $4.8 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Moscow City Telephone Network ("MGTS") – During the years ended December 31, 2008, 2007 and 2006, MTS had interconnect and 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. Interconnect, line rental and technical premises rental expenses for the years ended December 31, 2008, 2007 and 2006 amounted to $18.3 million, $16.3 million and $13.1 million, respectively. Interconnect revenue for the years ended December 31, 2008, 2007 and 2006 amounted to $32.5 million, $25.2 million and $7.9 million, respectively.

MTT – During the years ended December 31, 2008, 2007 and 2006, MTS had interconnect and line rental agreements with MTT, a subsidiary of Sistema. Interconnect revenue for the years ended December 31, 2008, 2007 and 2006 amounted to $91.0 million, $62.0 million and $29.4 million, respectively. Interconnect expenses for the years ended December 31, 2008, 2007 and 2006 amounted to $176.3 million, $83.1 million and $69.3 million, respectively.

Comstar UTS ("Comstar") – MTS had interconnect, line and numbering capacity rental agreements with Comstar, Telmos and MTU-Inform, subsidiaries of Sistema. During the year ended December 31, 2007 Telmos and MTU-Inform merged with Comstar. Revenue under agreements with these entities for the years ended December 31, 2008, 2007 and 2006, amounted to $22.1 million, $10.0 million and $1.7 million, respectively. Interconnect and line rental expenses for the years ended December 31, 2008, 2007 and 2006 comprised $36.4 million, $34.8 million and $25.9 million.

Sitronics – Sitronics Telecom Solutions Czech Republic and Sitronics Telecom Solutions Russia, formerly Strom Telecom and Mediatel, respectively, and Intracom Telecom are subsidiaries of Sistema. During the years ended December 31, 2008, 2007 and 2006, MTS acquired from these companies telecommunications equipment, billing systems (FORIS) and related services for approximately $142.8 million, $67.1 million and $231.2 million, respectively.

Kvazar-Micro.ru ("Kvazar") – During the years ended December 31, 2008, 2007 and 2006, MTS signed agreements for supply of software, equipment and software implementation services, including integration services in respect to Oracle applications, with Kvazar, a subsidiary of Sistema. Pursuant to these agreements, Kvazar provided to MTS various software, IT equipment and related services in the years ended December 31, 2008, 2007 and 2006 of approximately $157.0 million, $120.2 million and $52.1 million, respectively. From the beginning of 2009 Kvazar has started providing its services under new brand name of Sitronics Information Technologies.

Maxima Advertising Agency ("Maxima") – During the years ended December 31, 2008, 2007 and 2006, MTS had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising costs related to Maxima for the years ended December 31, 2008, 2007 and 2006, amounted to $135.8 million, $127.7 million and $117.8 million, respectively.

Mediaplanning – During the years ended December 31, 2008, 2007 and 2006, 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, 2008, 2007 and 2006 amounted to $82.0 million, $48.8 million and $45.1 million, respectively.

Sitronics Smart Technologies (***former Smart Cards***) – During the years ended December 31, 2008, 2007 and 2006, MTS purchased SIM cards and prepaid phone cards from Sitronics Smart Technologies, a subsidiary of Sistema, for approximately $39.6 million, $19.3 million and $37.0 million, respectively.

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 the years ended December 31, 2008, 2007 and 2006, amounted to $14.7 million, $14.5 million and $9.7 million, respectively.

City Hals – During the years ended December 31, 2008, 2007 and 2006, City Hals, a subsidiary of Sistema, provided rent, repair, maintenance and cleaning services to MTS of approximately $13.8 million, $6.1 million and $5.2 million, respectively.

TS-Retail – 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, MTS' stake in this company decreased from 100% to 25% following an increase of share capital by TS-Retail by $14.0 million, which was paid by MTS and certain other subsidiaries of Sistema. MTS deconsolidated TS-Retail in December 2007 and subsequently accounted for this investment under the equity method. During the years ended December 31, 2008 and 2007, the Group granted loans in total amount of $27.4 million at 11.0%-15.0% annual interest rates maturing in 2009-2010. The loans are guaranteed by Sistema. As of December 31, 2008, the long-term portion of amount receivable under these loan agreements totaling $11.2 million was included in other investments (Note 18) in the accompanying balance sheet. Further, during the years ended December 31, 2008 and 2007, the Group entered into a number of agreements for the provision of dealer services and sale of handsets with TS-Retail. For the years ended December 31, 2008 and 2007, dealer commission to TS Retail amounted to $4.4 million and $0.1 million, respectively, sales of handsets amounted to $1.5 million and $nil, respectively. As of December 31, 2008 and 2007, advances paid and accounts receivable from TS-Retail amounted to $12.2 million and $nil, respectively.

Sistema-Hals – In October 2007, MTS entered into an agreement for the construction of an aerial system in Moscow metro with Sistema-Hals, a subsidiary of Sistema. As of December 31, 2008, the advances given to Sistema-Hals under this agreement amounted to $11.7 million. This amount was included into property, plant and equipment in the accompanying consolidated balance sheet.

Glaxen – In April 2008, MTS granted a loan to Glaxen, a minority shareholder of Dagtelecom, a subsidiary of MTS, at a 16.0% annual interest rate and having a maturity date on August 1, 2009. As of December 31, 2008 the balance receivable under the agreement amounted to $12.2 million.

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, 2008, 2007 and 2006, comprised the following:

	December 31,		
	2008	2007	2006
Salaries and social contributions	$ 700,234	$ 562,924	$ 430,443
Rent	230,345	179,436	123,378
Taxes other than income	178,265	141,254	88,089
General and administrative	153,806	145,109	125,934
Repair and maintenance	135,794	142,969	94,242
Billing and data processing	50,837	36,052	44,886
Consulting expenses	35,110	23,742	23,352
Insurance	6,514	12,063	10,723
Inventory obsolescence expense	1,251	-	-
General and administrative expenses	$ 1,492,156	$ 1,243,549	$ 941,047

17. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2008 and 2007, the Group's investments in and advances to associates comprised the following:

	December 31,	
	2008	2007
MTS Belarus – equity investment	$ 237,427	$ 188,622
MTS Belarus – loan receivable	2,050	-
Coral/Sistema Strategic Fund – equity investment	7,512	6,916
Receivables from other investee companies	369	370
Total investments in and advances to associates	$ 247,358	$ 195,908

MTS Belarus – In April 2008 the Group entered into a credit facility agreement with MTS Belarus valid till March 15, 2009. The facility allows MTS Belarus borrowing up to $33.0 million and bears an interest of 10.0%. As of December 31, 2008, the balance outstanding under the facility was $2.1 million.

Coral/Sistema Strategic Fund – In August 2007, the Group purchased an equity interest in a strategic fund organized by Sistema ("General Partner") in order to invest in various projects in the telecommunications and high-technology area. The fund is organized in the form of limited partnership. As of December 31, 2008, $9.0 million was invested in the fund. The Group has committed to invest up to $26.3 million if called upon by the General Partner.

TS-Retail – As discussed in Note 15, in December 2007 the Group invested in TS-Retail, an equity investee, $3.5 million. As of December 31, 2007 the investment was reduced to $nil.

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, 2008, 2007 and 2006, this share amounted to $76.0 million, $72.7 million and $58.1 million, respectively.

18. OTHER INVESTMENTS

As of December 31, 2008, the Group's other investments comprised of the following:

	Annual interest rate	Maturity Date	December 31, 2008	December 31, 2007
Investment in Tammaron Ltd	-	on demand	$ 21,230	-
Loan receivable from TS-Retail (Note 15)	15.0%	January 2010	11,156	-
Loan receivable from Intellect Telecom	11.0%	July 2012	5,402	-
Other			1,288	1,355
Total other investments			$ 39,076	$ 1,355

Tammaron Ltd – During the year ended December 31, 2008, the Group deposited in Tammaron Ltd, a company incorporated under the laws of the British Virgin Islands, an amount of $21.2 million for a potential business acquisition.

Intellect Telecom – During the year ended December 31, 2008, MTS granted a loan to Intellect Telecom, a subsidiary of Sistema, at an interest rate of 11.0%. The loan matures on July 1, 2012. The amount receivable under the loan agreement as of December 31, 2008 totalled $5.4 million.

19. RESTRICTED CASH

Restricted cash of $23.6 million and $28.6 million, as of December 31, 2008 and 2007, respectively, consists of cash deposited by Uzdunrobita 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 converted from Uzbek som into U.S. Dollars and used for settlements with suppliers of equipment and software.

20. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various GSM operating 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.

As of December 31, 2008 and 2007, the recorded values of the Group's telecommunication licenses were as follows:

	December 31,	
	2008	2007
Russia	$ 260,929	$ 816,976
Armenia	241,710	246,917
Uzbekistan	196,517	196,517
Ukraine	49,877	63,535
Turkmenistan	18,685	50,504
Licenses, at cost	767,718	1,374,449
Accumulated amortization	(284,984)	(708,844)
Licenses, net	$ 482,734	$ 665,605

Amortization expense for the years ended December 31, 2008, 2007 and 2006, amounted to $149.4 million, $195.7 million and $211.3 million, respectively.

As of December 31, 2008, a number of operating licenses related to Russia 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, 2008, the estimated future amortization expenses are $76.6 million during 2009, $70.8 million during 2010, $54.1 million during 2011, $38.6 million during 2012, $32.8 million during 2013 and $209.6 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.

Operating licenses contain a number of requirements and conditions specified by legislation. The requirements generally include the targets for start date of service, territorial coverage and expiration date. Management believes that the Group is in compliance with all material terms of its licenses.

Licenses that expired during the year ended December 31, 2008 and 2007 were renewed, however their carrying value in accompanying consolidated balance sheets is immaterial due to low cost of renewal. Management does not presently assume renewals in its determination of the useful lives of its licenses as the Group has limited experience with renewal of licenses.

21. COMMITMENTS AND CONTINGENCIES

Capital commitments – As of December 31, 2008, the Group had executed purchase agreements of approximately $400.7 million to acquire property, plant and equipment, and intangible assets and costs related thereto.

Agreement with Apple – In August 2008, the Group entered into an unconditional purchase agreement with Apple Sales International to buy certain quantities of iPhone handsets at list prices at the dates of respective purchases over the three year period. Pursuant to the agreement the Group shall also incur certain iPhone promotion costs. The aggregate amounts of the Group's commitments under this agreement at list prices as of December 31, 2008 are $847.9 million for the years ended December 31, 2009, 2010 and 2011. The actual amounts paid in the future in connection with these purchases may vary due to changes in prices as well as due to the requirement to maintain a certain market share for iPhones purchased by Russian mobile network operators. Total amount paid for handsets purchased under the agreement for the year ended December 31, 2008 amounted to $65.4 million.

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 2057. Rental expenses under the operating leases of $230.3 million, $179.4 million and $123.4 million for the years ended December 31, 2008, 2007 and 2006, respectively, are included in operating expenses in the accompanying consolidated statements of operations. Rental expenses under the operating leases of $134.1 million, $103.8 million and $142.5 million for the years ended December 31, 2008, 2007 and 2006, respectively, are included in cost of services in the accompanying consolidated statements of operations. Future minimum lease payments due under these leases at December 31, 2008 are as follows:

Payments due in the years ended December 31,		
2009	$	221,865
2010		48,436
2011		29,604
2012		18,865
2013		9,894
Thereafter		50,898
Total	$	379,562

Issued guarantees – During the year ended December 31, 2008, the Group issued a guarantee to a third party bank for the loan taken by TS-Retail, an equity investee, for the total amount of $5.1 million. However, the amount can vary due to any penalties or litigation costs, if occur. The guarantee expires in June 2012. The fair value of issued guarantee is recorded as a liability in the accompanying consolidated balance sheet and amounted to $0.08 million as of December 31, 2008. The Group holds no assets as collateral against this guarantee, however there is a counter-guarantee provided by Sistema which would enable the Group to recover potential loss under the guarantee. As of December 31, 2008, no event of default has occurred under the guarantee issued by the Group.

Recent volatility in global and Russian financial markets – In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As at the date these financial statements are authorized for issue as a consequence of the recent market turmoil in capital and credit markets both globally and in Russia, notwithstanding any potential economic stabilization measures that may be put into place by the Russian Government, there exists economic uncertainties surrounding the continual availability, and cost, of credit facilities, the potential for economic uncertainties to continue in the foreseeable future.

Operating environment – The Russian and Ukrainian economies, while deemed to be market economies, 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 further development 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, 2008, 2007 and 2006, the Group incurred approximately $82.9 million, $64.8 million and $54.2 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 $9.2 million, $22.0 million and $24.3 million recognized as other non-operating expense in the Group's consolidated statements of operations for the years ended December 31, 2008, 2007 and 2006, respectively.

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. 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 $43.7 million as of December 31, 2008) 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 $41.5 million as of December 31, 2008). 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. No further appeals can be prepared by tax authorities due to expiration of the period for appeals. As of December 31, 2008, no provision in relation to the above tax audit was accrued in the Group's financial statements or paid to tax authorities.

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. Based on the results of this audit, the Russian tax authorities assessed that 1,129,975 thousand rubles (approximately $38.5 million as of December 31, 2008) of additional taxes, penalties and fines were payable by the Group. As of December 31, 2008 the Group has settled the total amount payable to the Russian tax authorities. However, 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 related fines and penalties equaled to 1,026,164 thousand rubles (approximately $34.9 million as of December 31, 2008). As a result of the hearing on December 22, 2008, the Arbitration Court of Moscow ruled against the tax claims and related fines and penalties in an amount of 981,490 thousand rubles (approximately $33.4 million as of December 31, 2008).

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, 2008, tax declarations of MTS OJSC and other subsidiaries in Russia for the preceding three fiscal years were open for further review.

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 $7.5 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 previously defended its position in the courts. At December 31, 2008, 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 for Uzdunrobita, BCTI and K-Telekom for the year ended December 31, 2006. The amount of additional taxes assessed as a result of these procedures is not significant. 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.

Further, MTS purchases supplemental software from foreign suppliers of telecommunication equipment in the ordinary course of business. The Group's management believes that custom duties are calculated in compliance with the applicable legislation. However there is a risk that the customs authorities may take a different view and impose additional custom duties. As of December 31, 2008 and 2007, no provision was recorded in the consolidated financial statements in respect of such additional duties.

Pricing of revenue and expenses between each of the Group's subsidiaries and various discounts and bonuses to Group's subscribers in the course of performing its marketing activities might be a subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2008 and 2007, no provision was recorded in the consolidated financial statements in respect of such additional claims.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2008 and 2007, the provision accrued amounted to $27.6 million and $25.4 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with FIN No. 48 totalled $8.0 million and $33.7 million as of December 31, 2008 and 2007, 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 S.A. ("MTS Finance") acquired a 51.0% stake in Tarino Limited ("Tarino"), from Nomihold Securities Inc. ("Nomihold"), for $150.0 million in cash based on the belief that 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.

Following the purchase of the 51.0% stake, MTS Finance entered into a put and call option agreement with Nomihold for "Option Shares," representing the remaining 49.0% interest in Tarino shares and a proportional interest in Bitel shares. The call option was exercisable by MTS Finance from November 22, 2005 to November 17, 2006, and the put option was exercisable by Nomihold from November 18, 2006 to December 8, 2006. The call and put option price was $170.0 million.

Following a decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. As the Group did not regain operational control over Bitel's operations in 2005, it accounted for its 51.0% investment in Bitel at cost as at December 31, 2005. The Group appealed the decision of the Kyrgyz Supreme Court in 2006, but the court did not act within the time period permitted for appeal. The Group subsequently sought the review of this dispute over the ownership of Bitel by the Prosecutor General of Kyrgyzstan to determine whether further investigation could be undertaken by the Kyrgyz authorities.

In January 2007, the Prosecutor General informed the Group that there were no grounds for involvement by the Prosecutor General's office in the dispute and that no legal basis existed for the Group to appeal the decision of the Kyrgyz Supreme Court. Consequently, the Group decided to write off the costs relating to the purchase of the 51.0% stake in Bitel, which was reflected in its audited annual consolidated financial statements for the year ended December 31, 2006. Furthermore, with the impairment of the underlying asset, a liability of $170.0 million was recorded with an associated charge to non-operating expenses.

In November 2006, MTS Finance received a letter from Nomihold purporting to exercise the put option and sell the Option Shares for $170.0 million to MTS Finance. 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 Option Shares. Nomihold seeks specific performance of the put option, unspecified monetary damages, interest, and costs. The matter is currently pending. MTS Finance is vigorously contesting this action and has asked the arbitration tribunal to dismiss Nomihold's claim.

A group of individual shareholders of Sistema 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 unfavorable to MTS Finance. Notwithstanding this, in the event MTS Finance does not prevail in the arbitration, the Group could be liable to Nomihold for $170.0 million plus any additional amounts that the arbitration tribunal might award to Nomihold.

In connection with the above mentioned put option exercise and the uncertainty as to the resolution of the dispute with Nomihold, the Group recognized a liability in the amount of $170.0 million in its audited annual consolidated financial statements with a corresponding charge to other non-operating expenses as of December 31, 2006 and for the year then ended.

In addition, three Isle of Man companies affiliated with the Group (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, the Group may be liable to Bitel for such claims. The KFG Companies have also asserted counterclaims against Bitel, and claims against other defendants including Altimo LLC ("Altimo"), and Altimo Holdings & Investments Limited ("Altimo Holding"), for the wrongful appropriation and control of Bitel.
On November 30, 2007 the High Court of Justice of the Isle of Man set aside orders it had previously issued granting leave to serve the non-Manx defendants out of the jurisdiction as to the KFG Companies' counterclaims on the basis of a lack of jurisdiction. The KFG Companies appealed that ruling to the Isle of Man Staff of Government and the appeal hearing took place in July 2008. On November 28, 2008, the Staff of Government reversed the High Court and ruled that the case should proceed in the Isle of Man. The defendants have sought leave to appeal from the Judicial Committee of the Privy Council of the House of Lords of the United Kingdom. It is not possible at this time to predict the ultimate outcome or resolution of these claims.

In a separate arbitration proceeding initiated against the KFG Companies 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 transfer agreement dated May 31, 2003 (the "Transfer Agreement"), concerning the shares of Bitel. 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. At the request of the parties, the tribunal agreed to stay the damages phase of the proceedings pending the resolution of the appeals process now before the second instance court in the Isle of Man, as described above. The Group is not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

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.

22. 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 associate of MTS in Belarus. Countries of operations are managed separately due to their different economic and regulatory environments which require separate marketing and investment strategies. The chief operating decision maker evaluates performance based on the operating income of each business unit.

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 in the normal course of operations.

Financial information by reportable segment is presented below:

	2008	2007	2006
Revenue:			
Russia	$ 7,840,225	$ 6,181,023	$ 4,665,530
Ukraine	1,661,951	1,608,021	1,490,278
Other	779,520	483,499	242,455
Intercompany eliminations	(36,403)	(20,165)	(14,009)
Total revenue	$ 10,245,293	$ 8,252,378	$ 6,384,254
Depreciation and amortization:			
Russia	$ 1,312,406	$ 1,076,586	$ 819,316
Ukraine	437,988	324,976	233,744
Other	186,443	87,986	42,921
Total depreciation and amortization	$ 1,936,837	$ 1,489,548	$ 1,095,981
Operating income:			
Russia	$ 2,611,882	$ 2, 076,083	$ 1,510,875
Ukraine	321,328	456,777	530,522
Other	270,282	200,986	92,339
Total operating income	$ 3,203,492	$ 2,733,846	$ 2,133,736
Total operating income	$ 3,203,492	$ 2,733,846	$ 2,133,736
Currency exchange and transaction loss/(gain)	563,292	(163,092)	(24,051)
Interest income	(33,166)	(38,100)	(13,055)
Interest expense, net of capitalized interest	153,341	134,581	177,145
Equity in net income of associates	(75,976)	(72,665)	(58,083)
Write-off of investment in Bitel	-	-	320,000
Other expense, net	25,317	44,034	65,913
Income before provision for income taxes and minority interest	$ 2,570,684	$ 2,829,088	$ 1,665,867

	2008	2007
Additions to long-lived assets:		
Russia	$ 1,595,643	$ 619,298
Ukraine	405,127	581,720
Other	313,002	189,294
Total additions to long-lived assets	$ 2,313,772	$ 1,390,312
Long-lived assets:		
Russia	$ 4,840,847	$ 5,378,043
Ukraine	1,484,317	2,062,015
Other	1,345,077	1,262,725
Total long-lived assets	$ 7,670,241	$ 8,702,783
Total assets:		
Russia	$ 6,985,076	$ 7,154,657
Ukraine	1,669,995	2,243,328
Other	1,793,263	1,568,683
Total assets	$ 10,448,334	$ 10,966,667

23. SUBSEQUENT EVENTS

Telefon.Ru – In Febrary 2009, MTS acquired 100% of Telefon.Ru, a Russian mobile retailer. The Group paid cash consideration of $60.0 million. In accordance with sale and purchase agreement, an additional $25.0 million is payable to the sellers during the period from 12 to 18 months should Telefon.Ru satisfy certain performance criteria over this period.

Acquisition of the remaining stake in Dagtelecom - In February 2009, the Group purchased the remaining 25.01% stake in Dagtelecom and increased its ownership to 100% for cash consideration of $41.6 million as Glaxen exercised its put option. Purchase price shall be reduced by $12.2 million to offset the loan granted by MTS to Glaxen during the year ended December 31, 2008 (Note 15). In addition, following the review and assessment of the subsidiary's performance during the period of the joint shareholding of MTS and Glaxen in Dagtelecom, MTS may potentially pay an additional consideration not exceeding $10.0 million.