Taxation

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. While most of our tax declarations have been inspected without significant penalties, these inspections do not eliminate the possibility of re-inspection.

We believe that we have adequately provided for tax liabilities in our financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

We recognize deferred tax assets and liabilities for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carry forwards using enacted tax rates expected to be in effect at the time these differences are realized. We record valuation allowances for deferred tax assets when it is more likely than not that these assets will not be realized. We have recorded 100% valuation allowance against tax loss carryforwards.

Recently Adopted Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset's useful life. Changes in the liability resulting from the passage of time will be recognized as operating expense. We adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on our financial position or results of operations.

In April 2002, FASB issued SFAS No. 145, "Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 4, "Reporting Gains and Losses from Extinguishments of Debt," addressed statement of operations classification of gains and losses from extinguishment of debt. SFAS No. 64 amended SFAS No. 4 and is no longer necessary due to the rescission of SFAS No. 4. SFAS No. 145 also amended SFAS No. 13 "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Following the adoption of the requirements of SFAS No. 145 effective January 1, 2003, we reclassified a gain on the extinguishment of a credit facility with OJSC AB Inkombank of $2.8 million and the related income tax expense of $0.7 million from extraordinary gain on debt repayment to other income and income tax expense, respectively, in the consolidated statement of operations for the year ended December 31, 2001.

In June 2002, FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires the recognition of a liability when incurred for costs associated with an exit or disposal activity. The fundamental conclusion reached by the FASB in this Statement is that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. We adopted the provisions of SFAS No. 146 effective January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on our financial position or results of operations.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosures about the guarantor's obligations under certain guarantees that it has issued. We adopted the initial recognition and measurement provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") issued a final consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on when and how an arrangement involving multiple deliverables should be divided in separate units of accounting. We adopted the requirements of EITF Issue No. 00-21 prospectively for arrangements entered into after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material impact on our financial position or results of operations.

In April 2003, FASB issued SFAS No. 149, "Amendments of FASB Statements No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 clarifies under what circumstances a contract with an initial investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying and certain other existing pronouncements. We adopted the requirements of SFAS No. 149 for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on our financial position or results of operations.

In May 2003, FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain classes of freestanding financial instruments that embody obligations for the issuer, including mandatory redeemable financial instruments, obligations to repurchase the issuer's equity shares by transferring assets and certain obligations to issue a variable number of shares. We adopted the requirements of SFAS No. 150 effective July 1, 2004. The adoption of this statement did not have a material impact on our financial position or results of operations.

New Accounting Pronouncements

In December 2003, the FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at a minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

We are evaluating whether the adoption of FIN 46 will have a material impact on our financial position, cash flows and results of operations. We did not enter into any transactions under the scope of FIN 46R after February 1, 2003.

In December 2003, the Commission issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and Commission rules and regulations. We believe we are following the guidance of SAB 104.

Trend Information

Sales

In 2002, our revenues increased by 52.5% from $893.2 million to $1,361.8 million and our subscriber base increased by 150.7% from 2.7 million as of December 31, 2001 to 6.6 million as of December 31, 2002. These trends continued in 2003 with our revenues increasing 87.0% from $1,361.8 million to $2,546.2 million. Our subscriber base increased by 151.7% from 6.6 million as of December 31, 2002 to 16.7 million as of December 31, 2003.

Average monthly service revenue per subscriber in Russia fell from $36 in 2001 to $23 in 2002 due to the introduction of lower tariffs in the Moscow license area and generally lower tariffs in regions as well as penetration to mass-market. This trend continued in 2003. Average monthly service revenue per subscriber in Russia in 2003 decreased to $17. In 2002 and 2003, more than half of our subscriber growth occurred outside of the Moscow license area. However, as a result of competition and the tariff structure in the regions, our average revenue per subscriber in the Russian regions remains lower than in the Moscow license area, though costs are generally lower there as well. See "Item 3. Key Information—D. Risk Factors—Risks Relating to Our Business—Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber and increasing subscriber churn which may adversely affect our results of operations." We generally expect to see a continued decline in average monthly service revenue per subscriber due to the introduction of lower tariff plans in connection with our marketing efforts.

UMC has experienced subscriber growth from 1.0 million subscribers at December 31, 2001 to 1.7 million subscribers at December 31, 2002 and to 3.3 million subscribers at December 31, 2003. Consistent with the general trends in Russia, we expect average revenue per subscriber to decrease at UMC.

Churn

Our subscriber churn in Russia increased from 26.8% in 2001 to 33.9% in 2002. The growth of the rate continued in 2003 to 47.3%. We believe that the trend of increasing churn is due to the continued growth of competition and the growing number of mass-market subscribers in our overall subscriber mix. Mass-market subscribers generally choose to prepay their mobile phone usage by purchasing pre-paid packages and are more likely to switch providers to take advantage of low-tariff promotions. As a result, competition for these subscribers will likely lead to sustained downward pressure on tariffs. The other reasons for growth of churn ratio are the absence of timing contracts with subscribers in Russia (when some minimal period of usage is accepted by subscriber) and by absence of connection fees, which generally prevent early churn. Churn, as we use it, includes internal churn within our subscriber base, *i.e.*, our subscribers switching between different tariff plans we offer. Internal churn increased following the launch in November 2002 of the "Jeans" tariff plan. See "—Subscriber Data" above.

Off-balance Sheet Arrangements

Obligations under guarantee contracts

As of December 31, 2003 and 2002, our off-balance sheet arrangements consisted of debt guarantees issued to related parties as follows:

	Guaranteed amount outstanding at December 31,	
Related Party	**2003**	**2002**
Invest-Svyaz-Holding	$ 21.6	$ 7.0
MTS Belarus	$ 14.5	—
Total	**$ 36.1**	**$ 7.0**

We issued guarantees to various financial institutions on behalf of Invest-Svyaz-Holding, or ISH, to enable ISH to finance its operations. ISH's primary business is leasing various types of telecommunications and other assets to us. See Notes 18 and 22 to our audited consolidated financial statements. We classify these leases as capital leases in our consolidated financial statements and the present value of future lease payments is reflected as a liability in our consolidated balance sheet.

We issued financial guarantees on behalf of MTS Belarus, our equity investee to assist it with its financing needs. See Note 22 to our audited consolidated financial statements. This guarantee is not reflected in our consolidated balance sheet.

Under each of the guarantees outstanding as of December 31, 2003, we could be required to compensate financial institutions in the event of the borrower's default. We are currently not aware of any events and do not expect any event that will cause a default of the borrowers and thus require us to fulfill our obligations to make payments under these guarantees.

Obligations under derivative contracts

In connection with the acquisition of 51% of the common shares and 50% of the preferred shares of TAIF Telecom in April 2003, we entered into call and put option agreements with shareholders of TAIF Telcom to acquire the remaining 49% of the common shares and 50% of the preferred shares of TAIF Telcom. See Note 4 to our audited consolidated financial statements.

The exercise period for the call option on the common shares is 48 months from the acquisition date and for the put option on the common shares is 36 months following an 18 month period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of $49.0 million plus 8% per annum commencing from the acquisition date.

The exercise period for the call option on the preferred shares is 48 months following a 24 month period after the acquisition date and for the put option on the preferred shares is a 24 month period from the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of $10.0 million plus 8% per annum commencing from the acquisition date.

We expect to exercise our options to acquire TAIF Telcom's common and preferred shares within the time periods described above. We expect to finance this acquisition from cash flows from operations.

Tabular Disclosure of Contractual Obligations

We have various contractual obligations and commercial commitments to make future payments, including debt agreements, lease obligations and certain committed obligations. The following table summarizes our future obligations (including interest) under these contracts due by the periods indicated as of December 31, 2003:

	2004	2005-2006	2007-2008	2009-thereafter	Total
Contractual Obligations:					
Notes payable	$ 707,600	$ 145,000	$ 509,205	$ 560,341	$ 1,922,146
Bank loans	112,346	127,271	25,481	—	265,098
Capital leases	12,741	8,996	65	277	22,079
Operating leases and service agreements	14,407	7,421	3,308	12,389	37,525
Committed Investments:(1)					
Purchases of property, plant and equipment	238,963	27,103	—	—	266,066
Total	$ 1,086,057	$ 315,791	$ 538,059	$ 573,007	$ 2,512,914

(1) Non-binding purchase commitments.

In addition, as of December 31, 2003, we had guaranteed indebtedness of related parties not reflected in our financial statements under which we could be potentially liable for $36.1 million. See Note 22 to the audited consolidated financial statements.

In connection with the acquisition of TAIF Telcom in April 2003, we entered into call and put option agreements with shareholders of TAIF Telcom to acquire the remaining 49% of common shares and 50% of preferred shares of TAIF Telcom. The call and put option agreements for the common shares stipulate a minimum purchase price of $49.0 million plus 8% per annum commencing from the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of $10.0 million plus 8% per annum commencing from the acquisition date.

The terms of our current licenses provide for payments to be made to finance telecommunications infrastructure improvements, which in the aggregate could total approximately $110.2 million as of December 31, 2003, which are not reflected in our financial statements. See Note 22 to the audited consolidated financial statements.