MegaFon

Consolidated financial statements

For the year ended 31 December 2014

Contents

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Independent auditors' report

The Board of Directors and Shareholders of OJSC MegaFon

We have audited the accompanying consolidated financial statements of OJSC MegaFon and its subsidiaries, which comprise the consolidated statement of financial position as of 31 December 2014, and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC MegaFon and its subsidiaries as at 31 December 2014, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

10 March 2015

MegaFon

Consolidated statement of comprehensive income

(In millions of Rubles)

	Note	Years ended 31 December 2014	2013
Revenues			
Services		291,656	279,087
Sales of equipment and accessories		23,139	18,142
Total revenues		**314,795**	**297,229**
Operating expenses			
Cost of services		63,148	58,480
Cost of equipment and accessories		21,481	16,912
Sales and marketing expenses	27	16,456	18,687
General and administrative expenses	28	75,190	70,558
Depreciation	14	47,431	44,851
Amortisation	15	7,827	6,131
Loss on disposal of non-current assets		1,437	1,200
Total operating expenses		**232,970**	**216,819**
Operating profit		**81,825**	**80,410**
Finance costs	17	(13,792)	(12,184)
Finance income		1,155	1,888
Share of loss of associates and joint ventures	10	(516)	(202)
Other non-operating loss	29	(1,370)	(81)
(Loss)/gain on financial instruments, net	17	(50)	269
Foreign exchange loss, net	17	(16,884)	(2,914)
Profit before tax		**50,368**	**67,186**
Income tax expense	12	13,368	15,416
Profit for the year		**37,000**	**51,770**

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

Consolidated statement of comprehensive income (continued)

(In millions of Rubles, except per share amounts)

	Note	Years ended 31 December 2014	2013
Other comprehensive income/(loss)			
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax		(1,288)	(188)
Net movement on cash flow hedges, net of tax	17	297	136
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		**(991)**	**(52)**
Total comprehensive income for the year, net of tax		**36,009**	**51,718**
Profit for the year			
Attributable to equity holders of the Company		36,726	51,608
Attributable to non-controlling interest		274	162
Total comprehensive income/(loss) for the year			
Attributable to equity holders of the Company		36,055	51,600
Attributable to non-controlling interest		(46)	118
Earnings per share, Rubles			
Basic, profit for the year attributable to ordinary equity holders of the Company	13	63	91
Diluted, profit for the year attributable to ordinary equity holders of the Company	13	63	89

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

Consolidated statement of financial position

(In millions of Rubles)

	Note	As of 31 December 2014	As of 31 December 2013 Restated*
Assets			
Non-current assets			
Property and equipment	14	224,655	220,272
Intangible assets, other than goodwill	15	57,427	58,848
Goodwill	9, 15	32,292	31,899
Investments in associates and joint ventures	10	34,944	35,460
Non-current financial assets	17	2,863	425
Non-current non-financial assets	18	2,053	1,300
Deferred tax assets	12	782	3,673
Total non-current assets		**355,016**	**351,877**
Current assets			
Inventory	19	6,484	8,376
Current non-financial assets	18	5,161	5,960
Prepaid income taxes	12	3,713	2,777
Trade and other receivables	20	16,260	12,493
Other current financial assets	17	48,887	39,296
Cash and cash equivalents	21	22,223	9,939
Total current assets		**102,728**	**78,841**
Assets held for sale	22	—	1,516
Total assets		**457,744**	**432,234**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	7	157,689	138,034
Non-controlling interests		144	271
Total equity		**157,833**	**138,305**
Non-current liabilities			
Loans and borrowings	17	156,319	130,825
Other non-current financial liabilities	17	1,270	20,838
Non-current non-financial liabilities	18	1,712	1,170
Provisions	23	4,958	5,355
Deferred tax liabilities	12	19,572	17,752
Total non-current liabilities		**183,831**	**175,940**
Current liabilities			
Trade and other payables	24	36,622	35,636
Loans and borrowings	17	51,149	21,184
Other current financial liabilities	17	7,658	40,785
Current non-financial liabilities	18	20,493	19,490
Income taxes payable	12	158	894
Total current liabilities		**116,080**	**117,989**
Total equity and liabilities		**457,744**	**432,234**

**Certain amounts do not correspond to the 2013 financial statements and reflect adjustments made, refer to Notes 4 and 9.*

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

MegaFon

Consolidated statement of changes in equity

(In millions of Rubles)

		Attributable to equity holders of the Company									
		Ordinary shares		Treasury shares							
	Note	Number of shares	Amount	Number of shares	Amount	Capital surplus	Retained earnings	Other capital reserves *(Note 7)*	Total	Non-controlling interests	Total equity
As of 1 January 2013		**620,000,000**	**526**	**54,690,089**	**(39,133)**	**12,567**	**143,468**	**(73)**	**117,355**	**518**	**117,873**
Net profit		—	—	—	—	—	51,608	—	51,608	162	**51,770**
Other comprehensive loss		—	—	—	—	—	—	(8)	(8)	(44)	**(52)**
Total comprehensive income							**51,608**	**(8)**	**51,600**	**118**	**51,718**
Dividends	7	—	—	—	—	—	(36,968)	—	(36,968)	—	**(36,968)**
Share-based compensation	25	—	—	—	—	—	—	1,178	1,178	—	**1,178**
Sale of treasury shares upon exercise of stock options	25	—	—	(7,750,000)	5,545	—	(122)	(554)	4,869	—	**4,869**
Sale of interest in Synterra-Media	17	—	—	—	—	—	—	—	—	(233)	**(233)**
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(132)	**(132)**
As of 31 December 2013		**620,000,000**	**526**	**46,940,089**	**(33,588)**	**12,567**	**157,986**	**543**	**138,034**	**271**	**138,305**
Net profit		—	—	—	—	—	36,726	—	36,726	274	**37,000**
Other comprehensive loss		—	—	—	—	—	—	(671)	(671)	(320)	**(991)**
Total comprehensive income							**36,726**	**(671)**	**36,055**	**(46)**	**36,009**
Dividends	7	—	—	—	—	—	(38,428)	—	(38,428)	**—**	**(38,428)**
Share-based compensation	25	—	—	—	—	—	—	689	689	—	**689**
Settlement of convertible debt	10	—	—	(22,641,056)	16,201	—	5,138	—	21,339	—	**21,339**
Contribution of non-controlling interest		—	—	—	—	—	—	—	—	51	**51**
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(132)	**(132)**
As of 31 December 2014		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**161,422**	**561**	**157,689**	**144**	**157,833**

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

MegaFon

Consolidated statement of cash flows

(In millions of Rubles)

	Note	Years ended 31 December 2014	2013
Operating activities			
Profit before tax		50,368	67,186
Non-cash adjustment to reconcile profit before tax to net cash flows:			
Depreciation	14	47,431	44,851
Amortisation	15	7,827	6,131
Loss on disposal of non-current assets		1,437	1,200
Loss/(gain) on financial instruments, net	17	50	(269)
Net foreign exchange loss		16,884	2,914
Share of loss of associates and joint ventures	10	516	202
Change in impairment allowance for receivables and other non-financial assets	28	1,398	2,037
Finance costs		13,792	12,184
Finance income		(1,155)	(1,888)
Equity-settled share-based compensation	25	689	1,178
Other non-operating loss		1,370	81
Working capital adjustments:			
(Increase)/decrease in inventory		1,900	(3,050)
(Increase)/decrease in trade and other receivables		(6,048)	1,154
(Increase)/decrease in current non-financial assets		(416)	2,078
Increase/(decrease) in trade and other payables		(3,684)	3,947
Decrease in current non-financial liabilities		(236)	(851)
Change in VAT, net		2,122	(3,103)
Income tax received		427	2,393
Income tax paid		(10,052)	(16,344)
Interest received		1,183	1,687
Interest paid, net of interest capitalised	17	(11,190)	(9,025)
Net cash flows from operating activities		**114,613**	**114,693**
Investing activities			
Purchase of property, equipment and intangible assets		(58,146)	(43,022)
Proceeds from sale of property and equipment		751	2,514
Acquisition of subsidiaries, net of cash acquired	9	(189)	(15,219)
Payment of deferred and contingent consideration	17	(36,330)	(5,878)
Net change in short-term demand deposits	17	165	(14,148)
Proceeds from sale of Synterra-Media, net of cash	17	—	76
Net cash flows used in investing activities		**(93,749)**	**(75,677)**
Financing activities			
Proceeds from borrowings, net of fees paid	17	48,522	32,200
Repayment of borrowings	17	(23,178)	(31,193)
Dividends paid to equity holders of the Company	7	(38,428)	(36,968)
Dividends paid to non-controlling interests		(132)	(132)
Payment of liability for marketing related licences	15	(184)	(539)
Proceeds from exercise of stock options	25	—	4,869
IPO transaction fees paid		—	(212)
Other		51	403
Net cash flows used in financing activities		**(13,349)**	**(31,572)**
Net increase in cash and cash equivalents		7,515	7,444
Net foreign exchange difference		4,769	108
Cash and cash equivalents at beginning of year		9,939	2,387
Cash and cash equivalents at end of year		**22,223**	**9,939**

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

1. General

Open Joint Stock Company MegaFon (“MegaFon”, the “Company” and, together with its consolidated subsidiaries, the “Group”) is a company incorporated under the laws of the Russian Federation (“Russia”) and registered in the Unified State Register of Legal Entities under number 1027809169585. Its registered office is at 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation.

MegaFon is a leading integrated telecommunications operator in Russia and provides a broad range of voice, data and other telecommunication services to retail customers, businesses, government clients and other telecommunication services providers.

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates on the dual band GSM 900/1800 standard. In May 2007 the Group was awarded a licence that expires in May 2017 for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. In July 2012 the Group was awarded a licence which expires in July 2022 for the provision of fourth-generation (“4G”) technology services under the Long Term Evolution (“LTE”) standard throughout the entire territory of Russia. As of 31 December 2014, the Group is providing and expanding 3G services in almost all of the regions in which it operates throughout Russia and, following its acquisition of LLC Scartel (“Scartel”) in October 2013 *(Note 9)*, provides 4G services in 72 regions of Russia. The Group also holds licences for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the entire territory of Russia. The Group has its own land-line and leased satellite transmission network capacities.

In November 2012 MegaFon completed an initial public offering (“IPO”) and listed its ordinary shares on the Moscow Exchange and its ordinary shares represented by Global Depositary Receipts, or GDRs, on the London Stock Exchange, in each case under the symbol ‘‘MFON’’.

As of 31 December 2014, the Group is primarily owned by USM Group, an indirect controlling shareholder, and TeliaSonera Group, another major shareholder with significant influence over the Group, whose parent is a publicly owned Swedish company.

In August 2014 USM Holdings Limited ("USMHL"), a non-public entity and the parent company of the USM Group, announced a restructuring amongst its shareholders. As a result of this restructuring the voting interest held by Mr Alisher Usmanov, which previously enabled him to control USMHL, has been reduced to a 48% voting interest.

2. Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

2. Basis of preparation (continued)

The consolidated financial statements have been prepared on a historical cost basis, unless disclosed otherwise. The consolidated financial statements are presented in millions of Rubles, except for per share amounts which are in Rubles or unless otherwise indicated.

The consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 10 March 2015.

3. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of 31 December 2014.

Subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

Profit or loss and each component of other comprehensive income ("OCI") are attributed to the equity holders of the Company and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

4. Significant accounting policies

Business combinations and goodwill

The Group applies the acquisition method of accounting and recognises the assets acquired, the liabilities assumed and any non-controlling interest in the acquired company at the acquisition date, measured at their fair values as of that date.

Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset useful lives and market multiples, among other items. Results of subsidiaries acquired and accounted for by the acquisition method have been included in operations from the relevant date of acquisition.

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes in the fair value of the contingent consideration classified as an asset or liability that is a financial instrument within the scope of IAS 39, *Financial Instruments: Recognition and Measurement*, are recognised in accordance with IAS 39 in the

4. Significant accounting policies (continued)

statement of comprehensive income. If the contingent consideration is not within the scope of IAS 39, it is measured in accordance with the appropriate IFRS. Contingent consideration that is classified as equity is not re-measured and subsequent settlement is accounted for within equity.

Goodwill represents the excess of the consideration transferred plus the fair value of any non-controlling interest in the acquired company at the acquisition date over the fair values of the identifiable net assets acquired, and is not amortised, but tested for impairment at least annually.

Acquisition-related costs are expensed as incurred and included in general and administrative expenses.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is allocated from the acquisition date to each of the cash-generating units ("CGUs"), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each CGU or any group of CGUs to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Combination of entities under common control

To account for business combinations between entities under common control the Group uses the acquisition method of accounting as defined in IFRS 3, *Business Combinations* ("acquisition method"), if the transaction has substance from the perspective of the Group. Otherwise the pooling-of-interest method is used. When evaluating whether the transaction has substance, the Group considers the following factors: the purpose of the transaction, the involvement of outside parties in the transaction such as non-controlling interests or other third parties, whether or not the transaction is carried out at fair value, the existing activities of the entities involved in the transaction, and whether or not it is bringing entities together into a reporting entity that did not exist before.

Associates and joint ventures

Investments in associates and joint ventures which are jointly controlled entities are accounted for using the equity method of accounting and are initially recognised at cost. The Group's share of the profits and losses of these companies is included in the share of profit of associates and joint ventures line in the accompanying consolidated statements of comprehensive income with a corresponding adjustment to the carrying amount of the investment.

Unrealised gains on transactions between the Group and its associates or joint ventures are eliminated only to the extent of the Group's interest in the associates or joint ventures. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates or joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

4. Significant accounting policies (continued)

Foreign currency transactions and translation

The Group's consolidated financial statements are presented in Rubles, which is also the functional currency of OJSC MegaFon and its principal subsidiaries.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or fair value measurement where items are re-measured to their fair value. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the 'Foreign exchange gain/(loss), net' line in profit or loss.

The assets and liabilities of foreign operations are translated into Rubles at the rate of exchange prevailing on the reporting date and their statements of comprehensive income are translated at exchange rates prevailing on the dates of the transactions. The exchange differences arising on the translation are recognised in OCI.

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

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for the sale of goods and services in the ordinary course of the Group's activities, net of value added taxes, returns and discounts.

The Group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the applicable entity and when specific criteria have been met for each of the Group's activities as described below. The Group bases its estimate of return on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Service revenue

Service revenue is generally recognised when the services are rendered. In these financial statements the presentation of service revenue has been changed so as to present wireless and wireline revenue combined, in line with the trend of continued integration of these services.

Wireless revenue

The Group earns wireless revenues for usage of its cellular system, which include airtime charges from contract and prepaid subscribers, monthly contract fees, interconnect fees from other wireless and wireline operators, roaming charges, data transfer charges, and charges for value added services ("VAS"). Interconnect revenue includes revenues from wireless and

4. Significant accounting policies (continued)

wireline operators that was earned from terminating traffic from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers using the network of the Group. VAS include SMS, MMS, provision of content and media and commissions for mobile payments.

The revenue from provision of content is presented net of related costs when the Group acts as an agent of the content providers while gross revenues and related costs are recorded when the Group is a primary obligor in the arrangement.

(a) Loyalty programme

The Group operates a loyalty programme which allows customers to accumulate awards for usage of the Group's cellular network. The awards can then be redeemed for free services or products, subject to a minimum number of awards being obtained. The portion of consideration received is allocated to the awards based on their fair value and deferred until the award credits are redeemed or expire. The Group estimates the fair value of awards to a customer by applying a statistical analysis.

(b) Multiple element arrangements

The Group enters into multiple element arrangements in which a customer may purchase a combination of equipment (e.g. USB modems, handsets) and telecommunication services (e.g. airtime, data, and other services). The Group allocates consideration received from subscribers to the separate units of accounting based on their relative fair values but not exceeding the contractual consideration receivable for the delivered element. Revenues allocated to the delivered equipment and related costs are recognised in the accompanying consolidated statements of comprehensive income at the time of sale provided that other conditions for revenue recognition are met. Amounts allocated to telecommunication services are deferred and recognised as revenue over the period of rendering the services.

(c) Roaming rebates

The Group enters into roaming discount agreements with a number of wireless operators. According to the agreements the Group is committed to provide and entitled to receive a discount that is generally dependent on the volume of roaming traffic generated by the respective subscribers. The Group uses actual traffic data to estimate the amounts of rebates to be received or granted. Such estimates are adjusted and updated on a regular basis. The Group accounts for discounts received as a reduction of roaming expenses and rebates granted as reduction of roaming revenue.

The Group takes into account the 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 its consolidated statement of financial position. Amounts of rebates earned from and given to roaming partners are included in trade and other receivables and payables *(Notes 20, 24)*, respectively, in the accompanying consolidated statement of financial position.

4. Significant accounting policies (continued)

Wireline revenue

The Group earns wireline revenues for usage of its fixed-line network, which include payments from individual, corporate and government subscribers for local and long-distance telecommunications and data transfer services. Charges are based upon usage (e.g., minutes of traffic processed), period of time (e.g., monthly service fees) or other established fee schedules. Wireline revenues also include interconnection charges from wireless and wireline operators for terminating calls on the Group's wireline networks. Revenue from service contracts is recognised when the services are rendered. Billings received in advance of service being rendered are deferred and recognised as revenue as the service is rendered.

Sales of equipment and accessories

Revenue from the sale of equipment and accessories is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on delivery of the goods.

Dealer commissions

Dealer commissions for connection of new subscribers are expensed as incurred *(Note 27)*.

The Group's third party dealer arrangements call for provision of post-sales services and revenue sharing. As a result, dealer commissions are recognised as the services are performed, generally during a twelve-month period from the date a new subscriber is activated.

Advertising costs

Advertising costs are expensed as incurred *(Note 27)*.

Government pension funds

The Group contributes to the local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended 31 December 2014 and 2013 were 5,112 and 4,599, respectively.

Taxes

Current income tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in OCI or directly in equity. In this case, the tax is also recognised in OCI or directly in equity, respectively.

The current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries in which the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with

4. Significant accounting policies (continued)

respect to situations in which the applicable tax regulation is subject to interpretation. If the applicable tax regulation is subject to interpretation, it establishes a provision where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax

Deferred income tax is recognised using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Value-added tax

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

Management periodically reviews the recoverability of VAT receivables and believes the amount reflected in the consolidated financial statements is fully recoverable within one year *(Note 18)*.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker ("CODM"). The CODM is responsible for allocating resources and assessing performance of the operating segments. The Company's CEO has been designated as the CODM.

Property and equipment

Property and equipment is stated at cost, less accumulated depreciation and impairment, if any. Cost includes all costs directly attributable to bringing the asset to the location and condition for its intended use. Depreciation is recorded on a straight-line basis over the estimated useful life of the asset.

4. Significant accounting policies (continued)

The estimated useful lives are as follows:

Telecommunications network	3 to 20 years
Buildings and structures	7 to 49 years
Vehicles, office and other equipment	3 to 7 years

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

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date.

Repair and maintenance costs are expensed as incurred. The cost of major renovations and other subsequent expenditure is included in the carrying amount of the asset or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

The present value of the expected cost for the decommissioning of an asset after its use is included in the cost of the respective asset. Please refer to 'Significant accounting policies – Provisions', below, and *Note 23* for further information about the provision for decommissioning liabilities.

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

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset during the construction phase that necessarily takes a substantial period of time are capitalised as part of property and equipment until the asset is ready for use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that the Group incurs in connection with the borrowing of funds.

Leases

Finance leases, that is, leases that transfer substantially all the risks and benefits incidental to ownership of the leased item to the Group, are capitalised at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in finance costs within profit or loss.

A leased asset is depreciated over the lesser of the lease term or the useful life of the asset.

4. Significant accounting policies (continued)

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as of the date of acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and impairment, if any. Intangible assets consist principally of operating licences, frequencies, software, marketing related licences and customer base.

The useful lives of intangible assets are assessed as either finite or indefinite. The Group does not have intangible assets with indefinite useful lives, other than goodwill. All intangible assets, except for 2G standard wireless licences, are amortised on a straight-line basis over the following estimated useful lives:

4G operating licences	20 years
Other operating licences	10 years
Frequencies	10 to 12 years
Software	2 to 5 years
Marketing related intangible assets	4 to 5 years
Customer base	4 to 19 years
Other intangible assets	1 to 10 years

2G licences are amortised on a sum-of-the-years'-digits basis over a period of 10 years *(Note 15)*.

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

Impairment of non-financial assets

Assets, including goodwill, that have indefinite useful lives are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation or amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset’s or CGU’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) an asset’s or CGU’s fair value less costs to sell and (2) value in use. The recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

Impairment losses relating to continuing operations are recognised in profit or loss in the expense categories which are consistent with the function of the impaired asset.

4. Significant accounting policies (continued)

For assets other than goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognised impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss.

Goodwill impairment reviews are undertaken annually as of 1 October or more frequently if events or changes in circumstances indicate potential impairment. Impairment is determined for goodwill by assessing the recoverable amount of each CGU (or group of CGUs) to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment of associated goodwill is recognised immediately as an expense and is not subsequently reversed.

For associates and joint ventures accounted for using the equity method, at each reporting date the Group determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate or joint venture and its carrying value, then recognises the loss as 'Share of profit of an associate and a joint venture' within profit or loss.

Non-current assets held for sale

Non-current assets are classified as assets held for sale ("AHFS") and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through continuing use and the sale is considered highly probable.

Inventory

Inventory, which primarily consists of telephone handsets, portable electronic devices, accessories and USB modems, is stated at the lower of cost and net realisable value. Cost is determined using the weighted-average cost method. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits in banks with original maturities of three months or less.

4. Significant accounting policies (continued)

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Treasury shares

The Company's own issued equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration received upon any subsequent sale is recognised in equity.

Earnings per share

Basic earnings per share ("EPS") are computed by dividing net profit available to shareholders of the Company by the weighted-average number of ordinary shares outstanding for the period.

Diluted earnings per share are computed by dividing adjusted net profit available to shareholders by the weighted-average number of ordinary shares outstanding during the period increased to include the number of additional ordinary shares that would be issued on the conversion of all the potentially dilutive securities into ordinary shares. Potentially dilutive securities include outstanding stock options and convertible debt instruments.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in the provision due to passage of time is recognised as finance costs.

Decommissioning liabilities

The Group has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located upon their being decommissioned. Decommissioning costs are determined by calculating the present value of the expected costs to settle the obligation using estimated cash flows, and are recognised as part of the cost of the particular asset. The cash flows are discounted at the current pre-tax rate that reflects the risks specific to the decommissioning liability. The unwinding of the discount is expensed in profit or loss as finance costs. The estimated future costs of

4. Significant accounting policies (continued)

decommissioning are reviewed annually and adjusted as appropriate. Changes in estimated liability resulting from revisions of the estimated future costs or in the discount rate applied are added to or deducted from the cost of the asset.

Share-based compensation

Equity-settled transactions

The cost of equity-settled transactions, such as stock options under the CEO long-term incentive plan *(Note 25)*, is determined by the fair value at the date when the grant is made using an appropriate valuation model. That cost is recognised, together with a corresponding increase in other reserves in equity, over the period in which the service conditions are fulfilled in employee benefits and related social charges expense *(Note 28)*. No expense is recognised for awards that do not ultimately vest. The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted earnings per share.

Cash-settled transactions

The cost of cash-settled transactions, such as phantom stock options under the 2012 and 2013 long-term incentive plans *(Note 25)*, is measured initially at fair value at the grant date using an appropriate valuation model. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is re-measured to fair value at each reporting date up to, and including the settlement date, with changes in fair value recognised in employee benefts and related social charges expense *(Note 28)*.

Other long-term employee benefits

The Group operates another long-term employee benefits programme *(Note 26)* which is accounted for in accordance with IAS 19, *Employee benefits*. These benefits are unfunded. The amount recognised as a liability for other long-term employee benefits is the present value of the defined benefit obligation at the end of the reporting period. To determine the present value of the defined benefit obligation and the related current service cost, the Group attributes the cost of benefits to years of service on a pro-rata basis. Re-measurements of the defined benefit liability are recognised in profit or loss when they occur.

Financial instruments

Initial recognition and measurement

Financial assets and financial liabilities within the scope of IAS 39 are recognised initially at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability, except for a financial asset or financial liability accounted for at fair value through profit or loss, in which case transaction costs are expensed.

4. Significant accounting policies (continued)

Subsequent measurement of financial assets and liabilities

The subsequent measurement of financial assets and liabilities depends on their classification as described below:

Fair value through profit or loss

Derivatives, including separated embedded derivatives, are classified as held for trading and accounted for at fair value through profit or loss unless they are designated as effective hedging instruments. Financial assets and liabilities accounted for at fair value through profit or loss are carried in the consolidated statement of financial position at fair value with changes in fair value being recognised in profit or loss, in the ‘foreign exchange gain/(loss)’, ‘finance costs’ or ‘gain/(loss) on financial instruments’ lines, depending on the nature of the changes.

Loans and receivables (assets) and loans and borrowings (liabilities)

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables and loans and borrowings are subsequently measured at amortised cost using the effective interest rate (“EIR”) method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The amortisation based on EIR is included in profit or loss.

De-recognition of financial assets

A financial asset is de-recognised when the rights to receive cash flows from the asset have expired; or the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a ‘pass-through’ arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Impairment of financial assets

A financial asset or a group of financial assets is impaired and impairment losses are incurred if there is objective evidence of impairment as a result of an event that occurred subsequent to the initial recognition of the asset. The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of assets may be impaired. For assets carried at amortised cost, the impairment loss is the difference between the asset’s carrying amount and the present value of estimated future cash flows at the original EIR (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Financial assets together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of

4. Significant accounting policies (continued)

an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to the relevant costs in profit or loss.

De-recognition of financial liabilities

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de-recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised within profit or loss.

Fair value of financial instruments

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations, without any deduction for transaction costs. For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques, which include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; a discounted cash flow analysis; or other valuation models.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;

Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

Derivative financial instruments and hedge accounting

Derivative financial instruments which include currency and interest rate swaps are initially recognised in the consolidated statement of financial position at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate. Derivatives are included within financial assets at fair value through profit or loss when fair value is positive and within financial liabilities at fair value through profit or loss when fair value is negative. Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic risks and characteristics are not closely related to those of the host contract and the combined instrument is not measured at fair value, with changes in fair value being recognised in profit or loss.

4. Significant accounting policies (continued)

The Group has derivatives which it designated as cash flow hedges and derivatives which it did not designate as hedges *(Note 17)*. At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. Such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in OCI. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the profit or loss.

The Group uses derivatives to manage interest rate and foreign currency risk exposures. The Group does not hold or issue derivatives for trading purposes.

Changes in accounting policies and disclosures

During 2014 the Group applied the following amendments for the first time:

IAS 32 Offsetting Financial Assets and Financial Liabilities (Amendments)

The amendments to IAS 32, *Offsetting Financial Assets and Financial Liabilities*, specify that an entity has a legally enforceable right to set-off if that right is not contingent on a future event and that right is enforceable both in the normal course of business and in the event of the default, insolvency or bankruptcy of the entity and all counterparties. The amendments are effective for annual periods beginning 1 January 2014, and are to be applied retrospectively. As a result of adoption of the amendments, the Group’s trade and other receivables and trade and other payables have increased as of 31 December 2014 and 31 December 2013 by 2,180 and 1,761, respectively, because the criteria for offsetting were not met *(Notes 20, 24)*. In particular, the current bankruptcy legislation in Russia does not allow offsetting if this has an impact on the scheme of settlements determined by the law.

5. Significant accounting judgments, estimates and assumptions

The preparation of these consolidated financial statements required management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated statement of financial position and the consolidated statement of comprehensive income. Actual results, however, could differ from those estimates.

Critical accounting estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying

5. Significant accounting judgments, estimates and assumptions (continued)

amounts of assets and liabilities within the next financial year are described below. The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Revenue recognition

The Group sells services to other operators in different countries and across borders. Management has to make estimates relating to revenue recognition, relying to some extent on information from other operators on values of services delivered. Management also makes estimates of the final outcome in instances where the other parties dispute the amounts charged.

Management also makes judgments about the reporting of revenue on a net versus gross basis, depending on an analysis of the Group's involvement as either principal or agent.

Allocation of each separable component of a bundled offer based on the individual components' relative fair values also involves estimates and judgment.

The Group estimates the fair value of awards under customer loyalty programmes by applying statistical techniques. Inputs to the models include making assumptions about expected redemption rates, the mix of products that will be available for redemption in the future and customer preferences. Such estimates are subject to significant uncertainty.

Business combinations

The Group has made acquisitions of other businesses in the past *(Note 9)*. The identification of assets acquired and liabilities assumed as a result of those acquisitions as well as the allocation of any contingent consideration between the identified assets and liabilities based on their fair values and quantification of resulting goodwill required significant judgment and estimates. Those estimates were based on comparative market information, entity-specific future cash flow projections, discount rates, terminal growth rates and other assumptions.

Impairment of non-financial assets

The Group tests goodwill for impairment annually and more often if impairment indicators exist, and tests other long-lived assets for impairment when circumstances indicate there may be a potential impairment *(Note 16)*. Estimating recoverable amounts of assets and CGUs is based on management's evaluations, including determining the appropriate CGUs and estimates of applicable multiples, if the market approach is used, or future cash flows, discount rates, terminal growth rates, and assumptions about future market conditions, if the income approach is used. Allocation of the carrying value of the assets being tested between individual CGUs also requires judgment.

5. Significant accounting judgments, estimates and assumptions (continued)

Depreciation and amortisation

Depreciation and amortisation expenses are based on management's estimates of residual value, the depreciation method used and the useful lives of property and equipment and intangible assets. Estimates may change due to technological developments, competition, changes in market conditions and other factors, and may result in changes in estimated useful lives and depreciation and amortisation charges. Critical estimates of useful lives of intangible assets are impacted by estimates of average customer relationship based on churn, remaining licence period and expected developments in technology and markets. The actual economic lives of long-lived assets may be different from the estimated useful lives. A change in estimated useful lives is accounted for prospectively as a change in accounting estimate.

To determine the accounting model for the 4G operating licences acquired in the Scartel business combination *(Note 9)* the Group has evaluated additional factors, such as the ability to extend the Group's licences or obtain new licences and frequencies for a new standard, and international telecommunications carriers' practices of estimating the value of similar licences. The Group determined the useful life of 4G operating licences to be 20 years and applied a straight-line method of amortisation.

Deferred tax assets and uncertain tax positions

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings *(Note 12)*. The ability to recover these taxes depends ultimately on the Group's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. The recognition of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realisation of deferred tax assets and the projected tax payment schedule.

Actual Group income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances. The expected resolution of uncertain tax positions is based upon management's judgment of the likelihood of sustaining a position taken through tax audits, tax courts and/or arbitration, if necessary. Circumstances and interpretations of the amount or likelihood may change through the settlement process.

Fair value of financial instruments

Where the fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position and disclosed in the notes cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

5. Significant accounting judgments, estimates and assumptions (continued)

Share-based payments

The Group measures the cost of equity-settled and cash-settled share-based payment transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. For cash-settled awards the fair value is re-measured every reporting period. Estimating fair value for share-based payment transactions requires a determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payment transactions are disclosed in *Note 25*.

Decommissioning provision

The Group records a provision for decommissioning obligations associated with restoration of rented sites where base stations are installed *(Note 23)*. In determining the fair value of the provision, assumptions and estimates are made in relation to discount rates, the expected cost to dismantle and remove the asset from the site, including long-term inflation forecasts, and the expected timing of those costs.

6. Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements, and are applicable to the Group are disclosed below. The Group intends to adopt these standards when they become effective unless otherwise stated below.

IFRS 15 Revenue from Contracts with Customers

In May 2014 the IASB issued IFRS 15, *Revenue from Contracts with Customers*, a common revenue recognition guidance that replaces the following previous revenue recognition standards: IAS 18, *Revenue,* IAS 11, *Construction Contracts,* IFRIC 13, *Customer Loyalty Programmes,* IFRIC 15, *Agreements for the Construction of Real Estate,* IFRIC 18, *Transfers of Assets from Customers,* SIC-31, *Revenue – Barter Transactions Involving Advertising Services*.

The core principle of the guidance is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

- Step 1: Identify the contract(s) with a customer,
- Step 2: Identify the performance obligations in the contract,
- Step 3: Determine the transaction price,
- Step 4: Allocate the transaction price to the performance obligations in the contract,
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

6. Standards issued but not yet effective (continued)

For a public entity, the Standard is effective for annual reporting periods beginning on or after 1 January 2017. Early application is permitted.

An entity should apply the amendments in this Standard using one of the following two methods:

1. Retrospectively to each prior reporting period presented and the entity may elect any of the following practical expedients:

- For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.
- For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
- For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

2. Retrospectively with the cumulative effect of initially applying this standard recognised at the date of initial application. If an entity elects this transition method it also should provide the additional disclosures in reporting periods that include the date of initial application of:

- The amount by which each financial statement line item is affected in the current reporting period by the application of IFRS 15 as compared to the guidance that was in effect before the change.
- An explanation of the reasons for significant changes.

The Group is currently evaluating the possible effect of the Standard on its financial statements and the best date for its adoption, as well as the transition method to be used.

IFRS 11 Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11

In May 2014, the IASB issued amendments to IFRS 11, *Joint Operations,* which require the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3, *Business Combinations*, to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in IFRS 11. In addition, the acquirer should disclose the information required by IFRS 3 and other IFRSs for business combinations. The amendments are effective for annual periods beginning on or after 1 January 2016. Early adoption is permitted. The Group will adopt the amendments from 1 January 2016. The amendments are not expected to have a material effect on the Group's financial statements.

6. Standards issued but not yet effective (continued)

IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation

In May 2014, the IASB issued amendments to IAS 16, *Property, Plant and Equipment*, and IAS 38, *Intangible Assets*, which clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.

The amendments are effective for annual periods beginning on or after 1 January 2016. Early adoption is permitted. The Group will adopt the amendments from 1 January 2016. The amendments will not impact the Group's financial statements.

IFRS 9 Financial Instruments

In July 2014 the IASB completed its process to replace IAS 39, *Financial Instruments: Recognition and Measurement*, with the issuance of the final amendments to IFRS 9.

The IASB divided its project to replace IAS 39 into three main phases.

- Phase 1: classification and measurement of financial assets and financial liabilities. In November 2009 the IASB issued the chapters of IFRS 9 relating to the classification and measurement of financial assets. Those chapters require financial assets to be classified on the basis of the business model within which they are held and their contractual cash flow characteristics. In October 2010 the IASB added to IFRS 9 requirements related to the classification and measurement of financial liabilities. In July 2014 the IASB made limited amendments to the classification and measurement requirements in IFRS 9 for financial assets.

- Phase 2: impairment methodology. In July 2014 the IASB added to IFRS 9 the impairment requirements related to the accounting for expected credit losses on an entity's financial assets and commitments to extend credit.

- Phase 3: hedge accounting. In November 2013 the IASB added to IFRS 9 the requirements related to hedge accounting.

IFRS 9 (July 2014) is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted. IFRS 9 (July 2014) should be applied retrospectively in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. IFRS 9 (July 2014) should not be applied to items that have been derecognised at the date of initial application.

The Group will adopt IFRS 9 (July 2014) from 1 January 2018. The Group is evaluating the effect of the standard on its financial statements.

6. Standards issued but not yet effective (continued)

Improvements to IFRSs (September 2014)

In September 2014, as a result of the Annual Improvements to IFRSs 2012-2014 Cycle, the IASB issued a number of amendments to

- IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations* (changes in methods of disposal),
- IFRS 7, *Financial Instruments: Disclosures* (servicing contracts),
- IAS 19, *Employee Benefits* (discount rate: regional market issue),
- IAS 34, *Interim Financial Reporting* (disclosure of information 'elswhere in the interim financial report').

The amendments introduced relatively minor changes to clarify guidance in existing standards. The amendments are effective for annual periods beginning on or after 1 January 2016. The Group will adopt the amended standards from 1 January 2016. The Group does not expect these amendments to have a material impact on the Group's financial position or performance.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28

In September 2014 the IASB issued *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28*, which contains narrow-scope amendments to IFRS 10, *Consolidated Financial Statements*, and IAS 28, *Investments in Associates and Joint Ventures*. The main consequence of the amendments is that full gain or loss is recognised when a transaction involves a business (whether it is held in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if those assets are held in a subsidiary.

The amendments are effective for annual periods beginning on or after 1 January 2016. Early adoption is permitted. The Group does not expect these amendments to have a material impact on the Group's financial position or performance.

IAS 1 Disclosure Initiative

In December 2014 the IASB issued, *Disclosure Initiative – Amendments to IAS 1*, which gave more guidance on disclosing information in the financial statements, presenting the line items and aggregating information in the financial statements, including the notes, ordering and grouping of the notes. The amendments are effective for annual periods beginning on or after 1 January 2016. The Group will adopt them from that date. The amendments affect presentation and disclosure only and have no impact on the Group's financial position or performance.

7. Equity

Share capital

As of 31 December 2014 and 2013, the Company had 620,000,000 fully paid and issued authorised ordinary shares with a par value of 0.1 Rubles, comprised of 24,299,033 treasury shares (31 December 2013: 46,940,089) and 595,700,967 (31 December 2013: 573,059,911) outstanding shares. In addition, the Company had 100,000,000,000 authorised ordinary shares with a par value of 0.1 Rubles, which were not issued as of 31 December 2014 and 2013.

The number of treasury shares was reduced by 22,641,056 (or 16,201 at carrying value) in July 2014 following the Group's settlement of the amount due to Garsdale Services Investment Limited ("Garsdale") by using its treasury shares *(Notes 10, 29)*.

Annual dividend payment

On 28 June 2013 the Annual General Meeting of Shareholders of the Company approved the payment of a dividend in the amount of 54.17 Rubles per ordinary share (or GDR) for the second, third and fourth quarters of 2012. On the same date the shareholders also approved the payment of an interim dividend for the first quarter of 2013 in the amount of 10.34 Rubles per ordinary share (or GDR). The total sum allocated to these dividend payments was 36,968, and payment of the dividends was made in July 2013.

On 30 June 2014, the Annual General Meeting of Shareholders of the Company approved a final dividend for the 2013 financial year in the amount of 64.51 Rubles per ordinary share (or GDR). The total dividend payout in 2014 was 38,428. After taking into account the interim dividend for the first quarter of 2013 paid in 2013, total dividends paid with respect to the 2013 financial year amounted to 74.85 Rubles per ordinary share (or GDR).

Other capital reserves

Foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign operations.

Cash flow hedge reserve is used to record the accumulated impact of derivatives designated as cash flow hedges *(Note 17)*.

Share-based compensation reserve is used to recognise the value of equity-settled share-based payment transactions provided to employees, including key management personnel, as part of their remuneration *(Note 25)*.

Reserve on transactions with non-controlling interests is used to record differences arising as a result of transactions with non-controlling interests that do not result in a loss of control.

A reserve fund has been established according to the requirements of Russian law and is used to cover the Company's losses, redemption of its bonds and re-purchase of its own shares in the absence of other capital resources.

7. Equity (continued)

The disaggregation of other capital reserves and changes of other comprehensive income by each type of reserve in equity is shown below:

	Foreign currency translation reserve	Cash flow hedge reserve	Share-based compen-sation reserve	Transac-tions with non-con-trolling interests	Reserve fund	**Total other capital reserves**
As of 1 January 2013	**21**	**(261)**	**175**	**(23)**	**15**	**(73)**
Foreign currency translation	(144)	—	—	—	—	**(144)**
Change in fair value of cash flow hedges *(Note 17)*	—	136	—	—	—	**136**
Sale of treasury shares upon exercise of stock options *(Note 25)*	—	—	(554)	—	—	**(554)**
Share-based compensation *(Note 25)*	—	—	1,178	—	—	**1,178**
As of 31 December 2013	**(123)**	**(125)**	**799**	**(23)**	**15**	**543**
Foreign currency translation	(968)	—	—	—	—	**(968)**
Change in fair value of cash flow hedges *(Note 17)*	—	297	—	—	—	**297**
Share-based compensation *(Note 25)*	—	—	689	—	—	**689**
As of 31 December 2014	**(1,091)**	**172**	**1,488**	**(23)**	**15**	**561**

8. Group information

The consolidated financial statements of the Group include the following significant subsidiaries and joint ventures of OJSC MegaFon:

Legal entity		**Principal activities**	**Country of incorporation**	**% equity interest 2014**	**2013**
OJSC MegaFon Retail	subsidiary	Retail	Russia	100	100
LLC NetByNet Holding	subsidiary	Broadband internet	Russia	100	100
LLC Scartel *(Note 9)*	subsidiary	Wireless services	Russia	100	100
LLC Yota	subsidiary	Wireless services	Russia	—	100
LLC MegaFon Finance	subsidiary	Financing	Russia	100	100
MegaFon Investments (Cyprus) Limited	subsidiary	Transactions with treasury shares	Cyprus	100	100
LLC Euroset-Retail *(Note 10)*	joint venture	Retail	Russia	50	50

LLC Yota was merged into LLC Scartel during 2014.

The Company holds interests in material subsidiaries through a number of intermediary holding companies.

9. Business combinations

Scartel

On 1 October 2013 MegaFon acquired 100% of the shares of Maxiten Co Limited, which holds a 100% interest in a group of subsidiaries (together "Scartel") that provide 4G telecommunication services under the brand "Yota", from the Group's controlling shareholder Garsdale, for a consideration of 55,736 comprised of (1) $1,180 million deferred consideration (38,331 at the exchange rate as of 1 October 2013), of which 50% plus interest at 6% per annum was payable in one year from the date of acquisition and the other 50% plus interest at 6% per annum in two years after the acquisition; (2) settlement of Scartel's indebtedness to Telecominvest Holdings Limited, an indirect subsidiary of Garsdale, in the amount of $477 million (15,483 at the exchange rate as of the payment date) and (3) an effective settlement of a pre-existing cash advance of 1,069 for future services and accounts receivable of 853 for lease of the Group's telecommunications network due from Scartel as of the acquisition date.

On 24 June 2014 the Group prepaid in cash approximately 90% of the deferred consideration due to Garsdale for the acquisition of Scartel, including principal and accrued interest, in the amount of 37,925 *(Note 29)*.

The reasons for the acquisition were to gain a significant increase in network capacity and quality which will strengthen the Group's leadership position in the fast growing mobile data market through enhanced overall service offering and customer experience; to enable the Group to carry out its 4G rollout with reduced capital and operating expenditures per unit of data transmission capacity because of its enhanced spectrum position; and to realise considerable cash flow savings in network rollout and maintenance driven principally by elimination of significant current and future operating costs.

The acquisition of Scartel was accounted for using the acquisition method *(Note 5)*. The valuation of certain acquired assets and liabilities assumed was not finalised as of the date the 2013 consolidated financial statements were authorised for issue; thus, the net assets recognised in the 31 December 2013 financial statements were based on a provisional assessment of their fair value while the Group sought an independent valuation for certain tangible and intangible assets of Scartel.

9. Business combinations (continued)

Values as at the date of acquisition are as follows:

	Provisional amounts	Measurement period adjustments	Final amounts
Assets			
Property and equipment *(Note 14)*	13,833	(1,533)	12,300
Intangible assets *(Notes 5, 15)*	43,315	1,072	44,387
Inventories	52	—	52
Trade and other receivables	297	—	297
Current non-financial assets	2,237	—	2,237
Cash and cash equivalents	278	—	278
	60,012	**(461)**	**59,551**
Liabilities			
Loans and borrowings	(1,288)	—	(1,288)
Deferred tax liabilities	(5,886)	92	(5,794)
Non-current non-fiancial liabilities	(118)	—	(118)
Provisions	(232)	—	(232)
Trade and other payables	(3,590)	—	(3,590)
Current non-financial liabilities	(728)	—	(728)
	(11,842)	**92**	**(11,750)**
Total identifiable net assets at fair value	**48,170**	**(369)**	**47,801**
Goodwill arising on acquisition	7,566	369	7,935
Purchase consideration transferred	**55,736**	—	**55,736**

In 2014, the valuation of certain assets was updated and the acquisition date fair value of the assets changed. The 2013 comparative information was restated to reflect the adjustments to the provisional amounts. The resulting changes in depreciation and amortisation charges from the acquisition date to 31 December 2013 were not material.

The goodwill recognised is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of Scartel. The entire goodwill recognised from Scartel acquisition has been allocated to the integrated telecommunication services group of CGUs *(Note 16)*.

The Group recognised Scartel acquisition-related costs as general and administrative expenses in the amount of 188 for the year ended 31 December 2013 in the consolidated statement of comprehensive income.

The Group has consolidated the financial position and the results of operations of Scartel from 1 October 2013. If the acquisition had taken place at the beginning of the year, profit for the year for the Group would have been 44,622.

9. Business combinations (continued)

2014 acquisitions

In 2014, the Group acquired 100% ownership interests in a number of alternative wireline and broadband internet service providers in certain regions of the Russian Federation for a total purchase consideration of 381.

The table below represents the allocation of the purchase price to the acquired net assets based on their estimated fair values.

	LLC Tele MIG	LLC Aston	CJSC Express Telecom	CJSC Advantage Telecom	Total
Date of acquisition	5 Feb 2014	30 Jun 2014	17 Oct 2014	12 Dec 2014	
Region of operations	Novy Urengoy	Moscow region	Moscow region	Moscow region	
Non-current assets	43	20	26	188	277
Cash	36	2	2	2	42
Current liabilities	(69)	—	(83)	(84)	(236)
Non-current liabilities	—	—	—	(76)	(76)
Total identifiable net assets/(liabilities) at fair value	**10**	**22**	**(55)**	**30**	**7**
Goodwill	133	38	154	49	374
Purchase consideration transferred:	**143**	**60**	**99**	**79**	**381**
Cash	110	60	60	1	231
Contingent consideration	33	—	39	78	150

Contingent consideration is mainly due within one year from the date of acquisition.

10. Investments in associates and joint ventures

Investee	% equity interest	31 December 2014	31 December 2013
LLC Euroset-Retail ("Euroset"), joint venture	50	34,762	35,278
LLC News Tube, associate	38	182	182
Total		**34,944**	**35,460**

Euroset

On 6 December 2012 the Group and Garsdale acquired a 50% interest in Euroset via their jointly-owned subsidiary Lefbord, in which they each held a 50% stake. Pursuant to a sale and purchase agreement with Garsdale, the Group was required to purchase on or before 6 December 2013 (with the possibility for this obligation to be deferred until 6 December 2015) Garsdale's interest in Lefbord for $535 million (16,491 at the exchange rate as of 6 December 2012), plus

10. Investments in associates and joint ventures (continued)

interest at the rate of 8% per annum, plus any earn-out related payments made by Garsdale to Lefbord. The purchase price could be increased by any additional contributions made to Lefbord by Garsdale and reduced by any payments received by Garsdale from Lefbord. The Group had, at its discretion, the option to settle this obligation in cash or in its ordinary shares to be valued at the weighted-average market price for MegaFon GDRs for the six-month period prior to the purchase date which had been recognised as a financial asset through profit or loss *(Note 17)*.

Based on the terms of the obligation to acquire Garsdale's 50% interest in Lefbord, the Group made the judgment that, with respect to both Lefbord and Euroset, Garsdale is its *de facto* agent and therefore that the Group obtained access to future economic benefits and effectively controlled Lefbord from December 2012 and that, via Lefbord, it held 50% of Euroset, rather than only 25%, from December 2012. Accordingly, the Group consolidated Lefbord and classified the obligation payable to Garsdale ("convertible debt instrument") as other current financial liability in the consolidated statement of financial position from December 2012 *(Note 17)*. The transactions referred to above result in the holding by the Group of a 50% interest in Euroset. The remaining 50% of Euroset is indirectly owned by VimpelCom, a Russian telecommunications operator. Lefbord and VimpelCom exercise joint control over Euroset with each having substantive approval rights allowing them to effectively participate in all of the significant decisions of Euroset.

The liability and purchased put option components of the convertible debt instrument were accounted for separately. The fair value of the put option asset was 1,611 immediately prior to the decision about settlement described below.

In December 2013 the obligation to purchase Garsdale's interest in Lefbord was deferred for one year. On 9 July 2014 the Group elected to complete the purchase earlier and to settle the amount due to Garsdale for its interest in Euroset. At the date of settlement, the total amount due to Garsdale for its 50% interest in Euroset was $657 million (22,628 at the exchange rate as of the date of settlement). The Group also elected to settle the amount due to Garsdale in treasury shares and, as stipulated in the sale and purchase agreement, the treasury shares were valued at the weighted-average market price for the Company's GDRs for the immediately preceding six-month period. Following the transaction, the number of treasury shares was reduced by 22,641,056 (or 16,201 at carrying value) *(Note 7)*.

The Group measured the treasury shares transferred to Garsdale at the carrying value of the liability to Garsdale as of the date the liability was extinguished, or 22,628, reduced by the fair value of the purchased put option asset on the date preceding the date of the decision to accelerate settlement of the liability, or 1,611 (less tax effect of 322). The net effect of settlement of 5,138 is recognised directly in retained earnings. This transaction was accounted for as transaction with shareholders acting in their capacity of a controlling party at carrying value through equity.

The Euroset joint venture is accounted for using the equity method in the consolidated financial

10. Investments in associates and joint ventures (continued)

statements. The primary reason for the investment in Euroset was to realise benefits from synergies related to a reduction of subscriber acquisition costs of the Group due to implementation of a revenue sharing model, procurement savings and prominent marketing of MegaFon services in Euroset outlets.

The reconciliation of summarised financial information of Euroset to the carrying amount of the Group's interest in the joint venture is presented below:

	31 December	
	2014	**2013**
Assets		
Non-current assets	38,934	42,717
Cash and cash equivalents	12,711	5,455
Other current assets	17,135	20,977
	68,780	**69,149**
Liabilities		
Non-current financial liabilities	(8,660)	—
Other non-current liabilities	(6,928)	(7,034)
Current financial liabilities	(1,371)	(10,021)
Other current liabilities	(22,326)	(21,567)
	(39,285)	**(38,622)**
Total identifiable net assets	**29,495**	**30,527**
The Group's share in the joint venture	50%	50%
The Group's share of identifiable net assets	14,748	15,264
Excess of the consideration transferred over the Group's share in the fair value of identifiable net assets	20,014	20,014
Carrying amount of the Group's interest	**34,762**	**35,278**

The composition of the Group's share of loss of the joint venture accounted for using the equity method is as follows:

	Year ended 31 December	
	2014	**2013**
Loss before tax	**(792)**	**(367)**
Income tax expense	(239)	(37)
Loss and total comprehensive loss of the joint venture	**(1,031)**	**(404)**
The Group's share in the joint venture	50%	50%
The Group's share of the loss and total comprehensive loss of the joint venture	**(516)**	**(202)**

11. Segment information

The Group manages its business primarily based on eight geographical operating segments within Russia, which provide a broad range of voice, data and other telecommunication services, including wireless and wireline services, interconnection services, data transmission services and value added services ("VAS"). The CODM *(Note 4)* evaluates the performance of the Group's operating segments based on revenue and operating income before depreciation and amortisation ("OIBDA"). Total assets and liabilities are not allocated to operating segments and not analysed by the CODM.

Operating segments with similar economic characteristics have been aggregated into an integrated telecommunication services segment, which is the only reportable segment. Around 1% of the Group's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

Reconciliation of consolidated OIBDA to consolidated profit before tax for the years ended 31 December:

	2014	**2013**
OIBDA	**138,520**	**132,592**
Depreciation	(47,431)	(44,851)
Amortisation	(7,827)	(6,131)
Loss on disposal of non-current assets	(1,437)	(1,200)
Finance costs	(13,792)	(12,184)
Finance income	1,155	1,888
Share of loss of associates and joint ventures	(516)	(202)
Other non-operating loss	(1,370)	(81)
(Loss)/gain on financial instruments, net	(50)	269
Foreign exchange loss, net	(16,884)	(2,914)
Profit before tax	**50,368**	**67,186**

12. Income taxes

The following presents the significant components of the Group's income tax expense for the years ended 31 December:

	2014	**2013**
Current income tax:		
Current income tax charge	9,069	16,212
Adjustments recognised for current tax of prior periods	(648)	669
Deferred tax	4,947	(1,465)
Income tax expense	**13,368**	**15,416**

Income tax is calculated at 20% of taxable profit for the years ended 31 December 2014 and 2013, respectively.

12. Income taxes (continued)

The reconciliation between the average effective income tax rate and the applicable Russian enacted statutory tax rate is as follows:

	2014	2013
Statutory income tax rate	**20.0%**	**20.0%**
Deferred tax assets write-off	3.0%	—
Non-deductible expenses	2.9%	1.5%
Effect of intra-group transactions	1.6%	1.6%
Effect of income tax preferences	(0.7%)	(0.2%)
Other	(0.3%)	—
Effective income tax rate	**26.5%**	**22.9%**

The increase in effective income tax rate during 2014 is primarily attributable to derecognition of deferred tax assets related to the investment in Euroset and the acquisition of Scartel as well as an increase in the effect of non-deductible expenses. The effect of intragroup transactions, in the table above, represents taxable intra-group income.

Deferred tax relates to the following:

	Statement of financial position as of 31 December		**Statement of comprehensive income (profit and loss) for the years**	
	2014	**2013 Restated** *(Note 9)*	**2014**	**2013**
Property and equipment	(12,810)	(10,557)	2,253	(400)
Intangible assets	(9,233)	(9,368)	(135)	(698)
Derivative financial instruments	(624)	(235)	711	65
Loss carry-forwards	2,322	2,706	384	(9)
Revenue recognition	622	733	111	376
Accrued employee benefits	378	1,184	806	(166)
Accrued expenses	(127)	781	908	198
Investments in joint ventures and subsidiaries	(45)	725	770	(571)
Other movements and temporary differences	727	(48)	(861)	(260)
Deferred tax (benefit)/expense			**4,947**	**(1,465)**
Net deferred tax liabilities	**(18,790)**	**(14,079)**		
Reflected in the statement of financial position as follows:				
Deferred tax assets	**782**	**3,673**		
Deferred tax liabilities	**(19,572)**	**(17,752)**		

The Group recognises deferred tax assets in respect of tax losses carried forward to the extent that realisation of tax losses against future taxable profit is probable. Deferred tax assets related to tax losses of the Group's subsidiaries are recognised based on the tax planning opportunities that would be implemented, if necessary, to prevent unused tax losses.

12. Income taxes (continued)

The Group recognised deferred tax assets in respect of the tax losses of the following subsidiaries:

	2014	2013
Scartel	1,664	1,985
MegaFon Retail	658	721
Balance at end of year	**2,322**	**2,706**

In order to utilise tax losses the Group is able to implement appropriate tax planning strategies depending on the results of these subsidiaries in subsequent periods. The tax planning strategies may include, among others, merging of the respective subsidiaries with OJSC MegaFon which is expected to have sufficient pretax income to utilise the accumulated tax losses of these subsidiaries.

Unrecognised deferred tax assets in the consolidated statement of financial position as of 31 December 2014 and 2013 amounted to 2,202 and 463, respectively. An increase in unrecognised deferred tax assets is due to the difference between the accounting and tax bases of the Euroset investment which is not expected to be realised due to lack of appropriate taxable profits. The remaining part is related to unused tax losses. Tax loss carry-forwards available for utilisation by the Group expire in 2018-2024.

Reconciliation of net deferred tax liabilities for the years ended 31 December is as follows:

	2014	2013
Balance at beginning of year	(14,079)	(9,760)
Tax benefit/(expense) during the year	(4,947)	1,465
Translation adjustment of foreign operations	(86)	10
Change through equity *(Note 10)*	322	—
Acquisition of subsidiaries *(Note 9)*	—	(5,794)
Balance at end of year	**(18,790)**	**(14,079)**

13. Earnings per share

The following table sets forth the computation of basic and diluted EPS for the years ended 31 December:

	2014	2013
Numerator:		
Net profit attributable to equity holders of the Company	36,726	51,608
Add back: interest expense and foreign exchange loss on convertible debt instrument and gain on revaluation of purchased put option *(Note 10)*	—	1,120
Net profit attributable to equity holders of the Company, adjusted	**36,726**	**52,728**
Denominator:		
Weighted-average ordinary shares outstanding	583,915,212	570,151,007
Effect of dilutive securities:		
Employee stock options *(Note 25)*	3,652,843	5,532,897
Assumed debt conversion *(Note 10)*	—	18,454,992
Weighted-average diluted shares outstanding, adjusted	**587,568,055**	**594,138,896**
EPS – basic, Rubles	**63**	**91**
EPS – diluted, Rubles	**63**	**89**

14. Property and equipment

Property and equipment is as follows:

	Telecom-munications network	Buildings and structures	Vehicles, office and other equipment	Construction in-progress	**Total**
Cost as of					
1 January 2013	**304,143**	**65,709**	**23,062**	**24,059**	**416,973**
Additions	—	—	63	43,082	**43,145**
Acquisitions *(Note 9)*	8,994	176	370	2,760	**12,300**
Disposals	(10,480)	(3,154)	(1,460)	(1,265)	**(16,359)**
Transfer to AHFS *(Note 22)*	—	(1,405)	—	(323)	**(1,728)**
Put into use	35,471	2,591	2,187	(40,249)	**—**
Translation	238	90	88	42	**458**
31 December 2013 as restated, *(Note 9)*	**338,366**	**64,007**	**24,310**	**28,106**	**454,789**
Additions	—	—	—	49,841	**49,841**
Acquisitions *(Note 9)*	225	4	2	7	**238**
Disposals	(8,915)	(438)	(1,738)	(287)	**(11,378)**
Transfer from AHFS *(Note 22)*	—	1,405	—	—	**1,405**
Put into use	46,159	2,971	3,397	(52,527)	**—**
Translation	2,332	808	777	1,102	**5,019**
31 December 2014	**378,167**	**68,757**	**26,748**	**26,242**	**499,914**
Depreciation as of					
1 January 2013	**(168,881)**	**(16,530)**	**(16,013)**	**—**	**(201,424)**
Charge for the year	(36,488)	(4,541)	(3,822)	—	(44,851)
Disposals	10,024	438	1,339	—	11,801
Transfer to AHFS (*Note 22)*	—	212	—	—	212
Translation	(148)	(38)	(69)	—	(255)
31 December 2013	**(195,493)**	**(20,459)**	**(18,565)**	**—**	**(234,517)**
Charge for the year	(39,676)	(4,364)	(3,391)	—	**(47,431)**
Disposals	7,824	297	1,371	—	**9,492**
Transfer from AHFS (*Note 22)*	—	(212)	—	—	**(212)**
Translation	(1,585)	(317)	(689)	—	**(2,591)**
31 December 2014	**(228,930)**	**(25,055)**	**(21,274)**	**—**	**(275,259)**
Net book value:					
31 December 2013	**142,873**	**43,548**	**5,745**	**28,106**	**220,272**
31 December 2014	**149,237**	**43,702**	**5,474**	**26,242**	**224,655**

Included in construction in-progress are advances to suppliers of network equipment of 1,601 and 2,673 as at 31 December 2014 and 2013, respectively.

Assets purchased under certain contracts with deferred payment terms in the amount of 1,252 (2013: 950) are pledged as security for the related liabilities.

15. Intangible assets

Intangible assets are as follows:

	4G operating licences	Other operating licences	Frequen-cies	Software	Marketing related intangible assets	Customer base	Other intangible assets	**Total**
Cost as of								
1 January 2013	—	**18,795**	**5,309**	**9,486**	**3,535**	**2,889**	**6,277**	**46,291**
Additions	—	28	1,323	2,063	—	—	585	**3,999**
Acquisitions *(Note 9)*	42,879	—	—	556	—	844	108	**44,387**
Disposals	—	(7)	(427)	(495)	—	(153)	(628)	**(1,710)**
Transfer	—	(2)	—	21	—	(28)	9	—
Translation	—	17	—	—	—	—	—	**17**
31 December 2013 as restated *(Note 9)*	**42,879**	**18,831**	**6,205**	**11,631**	**3,535**	**3,552**	**6,351**	**92,984**
Additions	—	87	1,298	3,633	137	—	1,476	**6,631**
Acquisitions *(Note 9)*	—	—	—	—	—	—	38	**38**
Disposals	—	(14)	(344)	(588)	(226)	—	(566)	**(1,738)**
Transfer	—	—	(71)	—	—	—	71	—
Translation	—	162	—	—	—	—	3	**165**
31 December 2014	**42,879**	**19,066**	**7,088**	**14,676**	**3,446**	**3,552**	**7,373**	**98,080**
Amortisation as of								
1 January 2013	—	**(14,955)**	**(1,731)**	**(5,881)**	**(2,184)**	**(951)**	**(3,598)**	**(29,300)**
Charge for the year	(524)	(791)	(607)	(2,469)	(682)	(288)	(770)	**(6,131)**
Disposals	—	1	341	437	—	29	499	**1,307**
Translation	—	(12)	—	—	—	—	—	**(12)**
31 December 2013	**(524)**	**(15,757)**	**(1,997)**	**(7,913)**	**(2,866)**	**(1,210)**	**(3,869)**	**(34,136)**
Charge for the year	(2,144)	(702)	(783)	(2,424)	(720)	(543)	(511)	**(7,827)**
Disposals	—	—	248	552	140	—	516	**1,456**
Translation	—	(143)	—	—	—	—	(3)	**(146)**
31 December 2014	**(2,668)**	**(16,602)**	**(2,532)**	**(9,785)**	**(3,446)**	**(1,753)**	**(3,867)**	**(40,653)**
Net book value:								
31 December 2013	**42,355**	**3,074**	**4,208**	**3,718**	**669**	**2,342**	**2,482**	**58,848**
31 December 2014	**40,211**	**2,464**	**4,556**	**4,891**	**—**	**1,799**	**3,506**	**57,427**
Weighted-average remaining amortisation period, years	19	7	6	2	—	3	7	15

Operating licences and frequencies

Operating licences and frequencies provide the Group with the exclusive right to utilise certain radio frequency spectrum to provide wireless communication services.

Operating licences primarily consist of
- several 2G licences,
- a nationwide 3G licence,

15. Intangible assets (continued)

- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (10x10 MHz band) awarded to OJSC MegaFon in 2012, and
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (30x30 MHz band) acquired in the Scartel business combination *(Note 9)*.

These licences are integral to the wireless operations of the Group and any inability to extend existing licences on the same or comparable terms could materially affect the Group's business. While operating licences are issued for a fixed period, renewals of these licences previously had occurred routinely and at nominal cost. The Group determines that there are currently no legal, regulatory, contractual, competitive, economic or other factors that could result in delays in licence renewal, or even an outright refusal to renew.

2G licences are amortised on a sum-of-the-years'-digits basis over a period of 10 years which reflects the pattern in which the economic benefits of these operating licences are expected to be consumed or otherwise used up and assumes a gradual decrease in the number of 2G subscribers *(Note 5)*. At 31 December 2014 the weighted-average period until the next renewal date of 2G licences is approximately 1.5 years.

Nationwide 3G and 4G licences were obtained by OJSC MegaFon at nominal cost in 2007 and 2012, respectively, but require the Company to meet certain conditions, including capital commitments and coverage requirements *(Note 31)*.

Scartel, the Company's subsidiary since October 2013, was licensed to use the 2.5–2.7 GHz spectrum (30x30 MHz band), a frequency band three times broader than the Company's 4G frequency band licensed in 2012, and any of its competitors' licences in Russia. These 4G licences are amortised on a straight-line basis over their estimated useful lives of 20 years.

Marketing related intangible assets

Marketing related intangible assets primarily represent the rights and licences to use Olympic symbols and the title of the General Mobile Partner of the Games acquired in 2009 from the Organisational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi. The assets have been fully amortised by 31 December 2014.

Other intangible assets

The Group accelerated amortisation of numbering capacity in 2013 due to the introduction of mobile number portability in Russia. As of 1 January 2013 the gross book value and accumulated amortisation of numbering capacity were 1,839 and 1,622, respectively.

15. Intangible assets (continued)

Goodwill

The changes in the carrying value of goodwill, net of accumulated impairment losses of nil, for the years ended 31 December 2014 and 2013 are as follows:

	2014	2013
Balance at beginning of year	31,899	23,950
Acquisitions *(Note 9)*	374	7,935
Measurement period adjustments	19	14
Balance at end of year	**32,292**	**31,899**

16. Impairment test

(a) Goodwill

The Group performs its annual goodwill impairment test as of 1 October of each year using data that is appropriate at that time. The test has been further updated as at 31 December 2014 considering the external indicators observed in the market at the end of 2014.

The Group considers the relationship between market capitalisation and its book value, among other factors, when reviewing for indicators of impairment. As of 31 December 2014, the market capitalisation of the Group was not below the book value of its equity.

As a result of the annual test, no impairment of goodwill was identified in 2014 or 2013.

Goodwill acquired through business combinations has been allocated to related CGUs and groups of CGUs as follows:

	31 December	
	2014	**2013 Restated** *(Note 9)*
Integrated telecommunication services (group of CGUs)	25,262	17,327
Broadband internet CGU	6,812	6,419
Other	218	218
Total allocated goodwill	**32,292**	**23,964**
Unallocated:		
Scartel *(Note 9)*	—	7,935
Total goodwill	**32,292**	**31,899**

In assessing whether goodwill has been impaired, the carrying values of the CGUs (including goodwill) were compared with their estimated recoverable amounts.

16. Impairment test (continued)

Integrated telecommunication services (group of CGUs)

The recoverable amount of the integrated telecommunication services group of CGUs has been determined based on its fair value less costs to sell (Level 3). The fair value was estimated based on a multiple of earnings, which is 4 times OIBDA, which represents a lower point of the range observed in the market for acquisitions of similar businesses. The fair value was reduced by 5% as an estimate of costs to sell the business.

Management believes that a change in any of these key assumptions which currently could be reasonably anticipated would not cause the aggregate carrying amount of the integrated telecommunication services group of CGUs to exceed the aggregate recoverable amount of this unit.

Broadband internet CGU

The recoverable amount of the broadband internet CGU has been determined based on its value in use. The value in use was estimated using cash flow projections from financial budgets approved by senior management covering 2015 and further seven-year projections. Due to less favourable economic environment foreseen for the next two years, the extended forecast period has been used for testing to take into account different growth rates forecasted in the long term.

The calculation of value in use for the broadband internet unit is most sensitive to the following assumptions: average monthly revenue per user ("ARPU"), discount rates, market share in Moscow, salary growth index and capital expenditures ("CAPEX") to revenues ratio. The key assumptions used in the forecast are as follows:

	31 December	
	2014	**2013**
Growth/(reduction) of ARPU for retail customers during the forecast period by	5.0%	(3.0%)
Pre-tax discount rate	16.3%	12.9%
Market share in Moscow (in terms of retail customer base)	7.1%	8.0%
Annual salary growth rate during the forecast period	7.5%	4.5-7.1%
CAPEX/Revenue ratio from 2018	10.5%	10.0-10.5%

Revenue growth is projected based on market share, traffic growth and other factors.

The discount rate represents the current market assessment of the risks specific to the CGU, taking into consideration the time value of money and individual risks of the underlying assets that have not been incorporated in the cash flow estimates. The discount rate calculation is based on the specific circumstances of the Group and its operating segments and is derived from its weighted average cost of capital ("WACC"). The WACC takes into account both debt and equity. The cost of equity is derived from the expected return on investment by the Group's investors. The cost of debt is based on the interest-bearing borrowings the Group is obliged to service. Segment-specific risk is incorporated by applying individual beta factors. The beta factors are evaluated annually based on publicly available market data.

16. Impairment test (continued)

Annual salary growth is projected based on inflation estimates.

Sensitivity to changes in key assumptions

The estimated recoverable amount of the broadband internet unit exceeds its carrying value by 2,015. The following changes in the key assumptions made independently, with all other assumptions constant, would result in impairment for the broadband internet unit:

Growth of ARPU for retail customers during the forecast period reducing to	3.5%
Pre-tax discount rate increasing to	17.9%
Market share in Moscow reducing to	2.9%
Annual salary growth rate during the forecast period increasing to	10.1%
CAPEX/Revenue ratio from 2018 increasing to	15.1%

There are no reasonably possible changes in other assumptions that could result in impairment for the broadband internet unit.

(b) Investment in Euroset joint venture

Following the adverse changes in economic environment and the decline in the market observed at the end of 2014 an impairment test has been performed for the investment in Euroset as at 31 December 2014.

As a result of the test, no impairment of investment has been identified.

The recoverable amount of investment has been determined based on its value in use. The value in use was estimated using cash flow projections from financial budgets approved by senior management covering 2015 and further seven-year projections, including estimates of synergy effects from the Group’s dealer commission savings which were incorporated into the purchase cost of the investment for the acquisition of Euroset, as the primary reason for the investment in Euroset was to realise benefits from synergies related to a reduction of subscriber acquisition costs of the Group due to implementation of a revenue sharing model, procurement savings and prominent marketing of MegaFon services in Euroset outlets. Due to less favourable economic environment foreseen for the next two years, the extended forecast period has been used for testing to take into account different growth rates forecasted in the long term.

The assessment of value in use for the investment is most sensitive to the following assumptions:

- ability to realise synergy related to savings on dealers’ commissions in the long run,
- discount rate applied for synergy effect estimation,
- annual dealer commission savings as compared to pre-deal market rates.

The key assumptions used in the forecast as at 31 December 2014 are as follows:

Pre-tax discount rate applied for synergy effects estimation	14.6%
Euroset pre-tax discount rate	17.8%
Annual dealer commission savings	48.0%

16. Impairment test (continued)

The discount rate applied for synergy effects estimation represents the current market assessment of the risks specific to the Group and the investee, taking into consideration the time value of money and individual risks of the underlying assets that have not been incorporated in the cash flow estimates. The discount rate calculation is based on the specific circumstances of the Group and the investee and is derived from their WACC. The WACC takes into account both debt and equity. The cost of equity is derived from the expected return on investment by the Group's and Euroset investors. The cost of debt is based on the interest-bearing borrowings the Group and Euroset is obliged to service. Segment-specific risk is incorporated by applying individual beta factors. The beta factors are evaluated annually based on publicly available market data.

Dealer commission savings are estimated based on the level of market commissions prior to the acquisition of share in Euroset and the decrease of the Group's dealer commission put into effect after the deal. The Group's management expects to realise the synergies in the long term.

Sensitivity to changes in key assumptions

The estimated recoverable amount of the investment exceeds its carrying value by 5,012. The following changes in the key assumptions made independently, with all other assumptions constant, would result in impairment for the investment in Euroset:

Pre-tax discount rate applied for synergy effects estimation increasing to	16.6%
Euroset pre-tax discount rate increasing to	19.8%
Annual dealer commission savings reducing to	44.0%

The key management judgment underlying this impairment model is whether the above synergies can be realised in perpetuity. If related synergies are not realized and sustained, a significant impairment loss would be recorded.

There are no reasonably possible changes in other assumptions that could result in impairment for the investment.

17. Financial assets and liabilities

Financial assets

	31 December 2014	31 December 2013 Restated *(Note 4)*
Trade and other receivables *(Note 20)*	16,260	12,493
Other financial assets:		
Financial assets at fair value through profit or loss:		
Cross-currency swap not designated as hedge	1,533	300
Euroset settlement put option *(Note 10)*	—	1,176
Total financial assets at fair value through profit or loss	**1,533**	**1,476**
Financial assets at fair value through OCI:		
Cross-currency swap designated as cash flow hedge	2,082	125
Total financial assets at fair value through OCI	**2,082**	**125**
Loans and receivables:		
Short-term bank deposits in Rubles	15,730	3,855
Short-term bank deposits in HK dollars	27,458	—
Short-term bank deposits in US dollars	4,346	34,265
Bank promissory notes	601	—
Total loans and receivables	**48,135**	**38,120**
Total other financial assets	**51,750**	**39,721**
Other current financial assets	**(48,887)**	**(39,296)**
Other non-current financial assets	**2,863**	**425**
Total financial assets	**68,010**	**52,214**
Total current financial assets	**(65,147)**	**(51,789)**
Total non-current financial assets	**2,863**	**425**

17. Financial assets and liabilities (continued)

Financial liabilities

	31 December 2014	31 December 2013 Restated *(Note 4)*
Trade and other payables *(Note 24)*	36,622	35,636
Financial liabilities at amortised cost:		
Loans and borrowings:		
Bank loans	95,140	75,342
Equipment financings	74,964	46,063
Ruble bonds	37,364	30,604
Total loans and borrowings	**207,468**	**152,009**
Total current loans and borrowings	**(51,149)**	**(21,184)**
Total non-current loans and borrowings	**156,319**	**130,825**
Other financial liabilities at amortised cost:		
Deferred consideration for Scartel *(Note 9)*	7,257	39,198
Long-term accounts payable	1,252	950
Contingent consideration *(Note 9)*	150	—
Due to employees and related social charges, non-current	5	283
Convertible debt instrument *(Note 10)*	—	20,678
Liability for marketing related licences *(Note 15)*	—	177
Total financial liabilities at amortised cost	**216,132**	**213,295**
Other financial liabilities at fair value:		
Financial liabilities at fair value through profit or loss:		
Cross-currency swap not designated as hedge	16	—
Total financial liabilities at fair value through profit and loss	**16**	**—**
Financial liabilities at fair value through OCI:		
Interest rate swaps designated as cash flow hedges	215	209
Cross-currency swaps designated as cash flow hedges	33	128
Total financial liabilities at fair value through OCI	**248**	**337**
Total other financial liabilities	**8,928**	**61,623**
Other current financial liabilities	**(7,658)**	**(40,785)**
Other non-current financial liabilities	**1,270**	**20,838**
Total financial liabilities	**253,018**	**249,268**
Total current financial liabilities	**(95,429)**	**(97,605)**
Total non-current financial liabilities	**157,589**	**151,663**

17. Financial assets and liabilities (continued)

Loans and borrowings

Principal amounts outstanding under loans and borrowings are as follows:

	Weighted-Average Interest Rate	Maturity	31 December 2014	31 December 2013
Bank loans:				
Ruble loans – fixed rates	9.48%	2015-2020	92,072	73,579
US dollar loans – floating rates	LIBOR+2.53%	2015	3,375	1,963
Total bank loans			**95,447**	**75,542**
Equipment financings:				
Ruble loans – fixed rates	10.00%	2015-2018	734	—
US dollar loans – fixed rates	2.27%	2015-2022	9,521	7,202
US dollar loans – floating rates	LIBOR+2.30%	2015-2022	61,339	35,241
Euro loans – fixed rates	3.74%	2015	310	613
Euro loans – floating rates	EURIBOR+2.05%	2015-2019	3,785	3,552
Total equipment financings			**75,689**	**46,608**
Ruble bonds	8.68%	2022-2024 with a put option in 2015-2018	**36,751**	**30,000**
Total			**207,887**	**152,150**
Total current			**(50,299)**	**(20,483)**
Total non-current			**157,588**	**131,667**

Ruble revolving credit facilities

In July 2014 the Group signed a 3-year revolving credit facility agreement for up to 12,000. To date, no amount has been drawn under this credit facility.

In December 2014 the Group drew 15,000 under its existing 30,000 revolving credit facility agreement. The tranche has a term of two years. The funds will be used to finance current activities and, in particular, to provide additional liquidity to mitigate revaluation risks for short-term, foreign currency denominated liabilities.

Equipment financing facilities

In February 2014 the Group signed a new credit facility agreement for up to $150 million (8,439 at the exchange rate as of 31 December 2014). The credit facility must be used to finance purchases of equipment and related services and requires the Group to make semi-annual payments, plus accrued interest, during the period from 2014 to 2022. An equivalent of 2,684 at the year-end exchange rate has been drawn and is outstanding at 31 December 2014 under this credit facility.

17. Financial assets and liabilities (continued)

In October 2014 the Group signed a new loan facility agreement for up to 1,350. The loan facility agreement must be used to finance purchases of equipment. At 31 December 2014, 734 has been drawn under this loan facility.

In December 2014 the Group signed a Term Loan Facility Agreement for up to $500 million (28,129 at the exchange rate as of 31 December 2014), with a 7-year-tenor. The proceeds will be used to finance purchases of equipment and related services *(Note 31)*. To date, no amount has been drawn under this loan facility.

Ruble bonds

On 20 May 2014 the Group placed its Series BO-04 Ruble denominated exchange bonds, in an aggregate principal amount of 15,000. The bonds are due for repayment in full in May 2024 subject to a put option exercisable by the bond holders on the first anniversary of the placement. The coupon rate was set at 9.45% per annum, paid semiannually, and will be revised in one year from the bonds' placement. The net proceeds of the bonds were used to partially repay the liability for deferred consideration for Scartel *(Note 29)*.

On 14 October 2014 the Group re-purchased 8,249,296 Series 05 bonds (out of 10,000,000 initially issued in October 2012) at their nominal value of 1,000 Rubles each under a mandatory put option exercisable by the bond holders following a coupon rate reset on 24 September 2014. At 31 December 2014 the bonds are kept in treasury and may be further placed in the market should the Group decide to. The rest of the Series 05 bonds will continue trading in the market with a coupon rate of 9.85% p.a. for a period of eighteen months, after which the rate will be subject to further reset and the bonds will be subject to a further put option.

Covenant requirements

Majority of financing facilities contain restrictive covenants, which, among other things, with permitted exceptions, limit the Group's ability to incur debt, encumber assets, undertake mergers and acquisitions and make material changes in the nature of the business without prior consent from the required majority of lenders. In addition, these financing facilities require the Group to meet various financial covenants.

Capitalised borrowing costs

Interest capitalised was 1,789 (out of the total interest expense of 15,581) and 1,382 (out of the total interest expense of 13,566) for the years ended 31 December 2014 and 2013, respectively. The rate used to determine the amount of borrowing costs eligible for capitalisation was 7.2% for the years ended 31 December 2014 and 2013. The interest capitalised has been paid in cash during the respective periods.

Hedging activities and derivatives

In the normal course of business, the Group is exposed to certain risks related to fluctuations in

17. Financial assets and liabilities (continued)

interest rates and foreign currency exchange rates. The Group uses derivative contracts, primarily interest rate swaps and foreign currency swaps, to manage those risks.

The Group had the following outstanding interest rate swaps and cross-currency swaps stated at their notional amounts:

		31 December 2014		31 December 2013	
	Original currency	**Millions, original currency**	**Millions, Rubles**	**Millions, original currency**	**Millions, Rubles**
Interest rate swaps:					
designated as cash flow hedge	US Dollar	460	25,879	576	18,852
designated as cash flow hedge	Euro	—	—	11	495
Total interest rate swaps			**25,879**		**19,347**
Cross-currency swaps:					
designated as cash flow hedge	US Dollar	76	4,276	107	3,502
not designated as cash flow hedge	US Dollar	464	26,104	278	9,079
Total cross-currency swaps			**30,380**		**12,581**

Cash flow hedges of interest rate risk

The Group's objective in using interest rate derivatives is to add certainty and stability to its interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Group primarily uses interest rate swaps as part of its interest rate risk management strategy.

Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for the Group making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

The interest rate swaps have been designated and qualified as cash flow hedges of interest rate risk. There has been no ineffective portion in the reporting period.

Cross-currency swap designated as a cash flow hedge

At 31 December 2014 the Group had a fixed-to-fixed rate cross-currency swap agreement in place that limits the exposure from changes in US dollar exchange rates on certain long-term debt.

The swap has been designated and qualified as a cash flow hedge of foreign currency risk. There has been no ineffective portion in the reporting period.

17. Financial assets and liabilities (continued)

Derivatives not designated as hedging instruments

In March 2014 the Group entered into a cross-currency swap agreement with a notional amount of $243 million (13,671 at the exchange rate as of 31 December 2014) that limits the exposure from changes in US dollar exchange and interest rates on certain long-term debt.

The terms of the swap agreement did not meet the requirements for hedge accounting, therefore the Group has reported all gains and losses from the change in fair value of this derivative financial instrument directly in the consolidated profit and loss.

Accordingly, at 31 December 2014 the Group had two cross-currency swap agreements in place that were not designated as cash flow hedges.

The table below presents the effect of the Group's derivative financial instruments designated as cash flow hedges on the consolidated statements of comprehensive income for the years ended 31 December:

	2014	2013
Interest rate swaps:		
Amount of loss recognised in cash flow hedge reserve	(61)	(48)
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	216	139
Deferred tax on movements in OCI	(31)	34
	124	**125**
Cross-currency swap:		
Amount of gain/(loss) recognised in cash flow hedge reserve	1,981	(2)
Amount of gain reclassified from accumulated cash flow hedge reserve into foreign exchange loss, net	(1,899)	(47)
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	134	63
Deferred tax on movements in OCI	(43)	(3)
	173	**11**
Total in OCI	**297**	**136**

At 31 December 2014, the amount recorded in OCI which is expected to be reclassified to profit and loss in the next twelve months is 604 (gain), the remaining gain of 1,305 is expected to affect the earnings in 2016-2017.

17. Financial assets and liabilities (continued)

(Loss)/gain on financial instruments

Gains and losses on other financial intruments are recognised in profit and loss as follows:

	2014	2013
Change in fair value of financial instruments measured through profit or loss:		
Euroset settlement put option	435	58
Cross-currency swaps not designated as hedges	(485)	(52)
Gain from settlement of Synterra contingent consideration	—	263
Total (loss)/gain on financial instruments, net	**(50)**	**269**

On 2 August 2013 the Group settled the contingent consideration which was due under the sale and purchase agreement dated 2 June 2010 for the acquisition of CJSC Synterra. In full settlement, the Group transferred to the sellers its 60% interest in CJSC Synterra-Media (a provider of telecommunication services to TV broadcasters), its 100% interest in CJSC Absolut (the owner of the Group's head office building in Moscow) and a cash payment of $7 million (231 at the exchange rate as of 2 August 2013). The resulting gain of 263 was recognised in the consolidated statement of comprehensive income within profit and loss.

Foreign exchange loss

Net foreign exchange loss recognised for the years ended 31 December arose from the following financial assets and liabilities denominated in foreign currencies:

	2014	2013
Financial assets:		
Loans and receivables	14,031	1,842
Cash and cash equivalents	4,769	108
Trade and other receivables	191	10
Other financial assets	3,824	414
Financial liabilities:		
Loans and borrowings	(30,617)	(3,449)
Trade and other payables	(3,282)	13
Other financial liabilities	(5,800)	(1,852)
Total foreign exchange loss, net	**(16,884)**	**(2,914)**

17. Financial assets and liabilities (continued)

Fair values

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments and certain non-financial assets that are carried in the financial statements:

		Carrying amount		Fair value	
		31 December		**31 December**	
		2014	**2013**	**2014**	**2013**
Financial assets;					
Financial assets at fair value through profit or loss:					
Cross-currency swap not designated as hedge	Level 2	1,533	300	1,533	300
Euroset settlement put option	Level 3	—	1,176	—	1,176
Financial assets at fair value through OCI:					
Cross-currency swap designated as cash flow hedge	Level 2	2,082	125	2,082	125
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	47,534	38,120	47,534	38,120
Bank promissory note	Level 2	601	—	601	—
Total financial assets		**51,750**	**39,721**	**51,750**	**39,721**
Assets held for sale	Level 3	—	1,516	—	1,851
Financial liabilities;					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	170,104	121,405	161,981	124,523
Ruble bonds	Level 1	37,364	30,604	34,664	29,980
Deferred consideration for Scartel	Level 3	7,257	39,198	7,257	39,198
Long-term accounts payable	Level 3	1,252	950	1,252	950
Contingent consideration	Level 3	150	—	150	—
Convertible debt instrument (Due to Garsdale for Euroset, *Note 10*)	Level 2	—	20,678	—	20,678
Liability for marketing related licences	Level 3	—	177	—	177
Financial liabilities at fair value through profit or loss:					
Cross-currency swap not designated as hedge	Level 2	16	—	16	—
Financial liabilities at fair value through OCI:					
Interest-rate swaps designated as cash flow hedges	Level 2	215	209	215	209
Cross-currency swaps designated as cash flow hedges	Level 2	33	128	33	128
Due to employees and related social charges, non-current	Level 3	5	283	5	283
Total financial liabilities		**216,396**	**213,632**	**205,573**	**216,126**

17. Financial assets and liabilities (continued)

Management has determined that cash, short-term deposits, trade receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

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

Fair values of the Group’s loans and borrowings, except for market quoted bonds, are determined by using a discounted cash flow method using a discount rate that reflects the issuer’s borrowing rate as at the end of the reporting period. The own nonperformance risk as at 31 December 2014 was assessed to be insignificant.

Interest-rate swaps and cross-currency swaps are valued using valuation techniques which employ the use of market observable inputs. The most frequently applied valuation techniques include swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, yield curves of the respective currencies, currency basis spreads between the respective currencies and interest rate curves.

The Group, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Group manages these risks and monitors their exposure on a regular basis *(Note 30).*

17. Financial assets and liabilities (continued)

The following tables summarise the valuation of financial assets and liabilities measured at fair value on a recurring basis by the fair value hierarchy:

	Euroset settlement put option	Cross-currency swaps	**Total financial assets**	Interest rate/cross-currency swaps	**Total financial liabilities**
31 December 2014					
Level 1	—	—	—	—	—
Level 2	—	3,615	**3,615**	(264)	**(264)**
Level 3	—	—	—	—	—
Total as of 31 December 2014	—	**3,615**	**3,615**	**(264)**	**(264)**
31 December 2013					
Level 1	—	—	—	—	—
Level 2	—	425	**425**	(337)	**(337)**
Level 3	1,176	—	**1,176**	—	—
Total as of 31 December 2013	**1,176**	**425**	**1,601**	(337)	**(337)**

During the years ended 31 December 2014 and 31 December 2013 there were no transfers between levels of the fair value hierarchy.

The table below presents a reconciliation of the beginning and ending balances of financial instrument having fair value measurements based on significant unobservable inputs (Level 3) for the years ended 31 December:

	Euroset settlement put option	
	2014	**2013**
Balance at beginning of year	1,176	1,118
Realised gains/(losses) recognised in profit or loss	—	—
Unrealised gains recognised in profit or loss (Gain on financial instruments line)	435	58
Settlements *(Note 10)*	(1,611)	—
Balance at end of year	—	**1,176**

18. Non-financial assets and liabilities

Current non-financial assets are as follows:

	31 December 2014	31 December 2013
Prepayments for services	2,473	2,113
VAT receivable	1,274	2,857
Deferred costs	1,096	478
Prepaid taxes, other than income tax	235	231
Prepayments for inventory	83	281
Total current non-financial assets	**5,161**	**5,960**

Non-current non-financial assets are as follows:

	31 December 2014	31 December 2013
Deferred costs, non-current	1,581	968
Long-term advances	472	332
Total non-current non-financial assets	**2,053**	**1,300**

Current non-financial liabilities are as follows:

	31 December 2014	31 December 2013
Advances from customers	11,414	10,035
VAT payable	5,596	4,581
Current portion of deferred revenue	1,894	3,064
Taxes payable, other than income tax	1,573	1,759
Other current liabilities	16	51
Total current non-financial liabilities	**20,493**	**19,490**

Non-current non-financial liabilities are as follows:

	31 December 2014	31 December 2013
Deferred revenue	1,309	750
Advance received for sale of property and equipment	327	359
Other non-current liabilities	76	61
Total non-current non-financial liabilities	**1,712**	**1,170**

19. Inventory

Inventory is as follows:

	31 December 2014	31 December 2013
Handsets	3,968	5,396
Electronic devices and accessories	1,156	1,205
USB modems	433	1,013
SIM-cards	310	287
Other	617	475
Total inventory	**6,484**	**8,376**

The amount of inventory write-down to net realisable value and other inventory losses recognised in 'Cost of equipment and accessories' line in the statement of comprehensive income for the year ended 31 December 2014 is 2,202 (2013: 1,560).

20. Trade and other receivables

Trade and other receivables are as follows:

	31 December 2014	31 December 2013 Restated *(Note 4)*
Local subscribers	7,154	5,245
Interconnection charges	4,398	3,612
Rebates receivable	1,917	1,605
Dealers	1,731	1,921
Content providers	521	114
Property and equipment sold	462	226
Roaming charges receivable	440	414
Other receivables	1,159	818
Impairment allowance	(1,522)	(1,462)
Total trade and other receivables	**16,260**	**12,493**

The ageing analysis of financial assets that are neither past due nor impaired is as follows:

	31 December 2014	31 December 2013 Restated *(Note 4)*
Neither past due nor impaired	14,342	11,047
Past due but not impaired:		
Less than 30 days	703	722
30 - 90 days	768	457
More than 90 days	447	267
Total trade and other receivables	**16,260**	**12,493**

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

20. Trade and other receivables (continued)

The following table summarises the changes in the impairment allowance for trade and other receivables for the years ended 31 December:

	2014	2013
Balance at beginning of year	1,462	1,259
Change in the impairment allowance	1,216	1,163
Accounts receivable written off	(1,156)	(960)
Balance at end of year	**1,522**	**1,462**

21. Cash and cash equivalents

Cash and cash equivalents are as follows:

	31 December	
	2014	**2013**
Cash at bank and on hand in		
Rubles	4,264	1,984
US dollars	4,866	119
HK dollars	1,919	—
Euros	110	36
Short-term bank deposits in		
Rubles	2,411	1,549
US dollars	5,825	6,251
HK dollars	2,828	—
Total cash and cash equivalents	**22,223**	**9,939**

22. Assets held for sale

In December 2013 the Group decided to sell its office building in Saint Petersburg with the carrying value of 1,405 at the date of classification as held for sale *(Note 14)*. Following the slowdown in the real estate market, in December 2014, the Group decided to change the initial plan and retain the building. Accordingly, the building has been reclassified from assets held for sale back to property and equipment. The Group recognised depreciation that would have been accumulated had the asset not been classified as held for sale in the amount of 33 in the consolidated statement of comprehensive income for the year ended 31 December 2014.

23. Provisions

Decommissioning provision

The following table describes the changes to the decommissioning provision for the years ended 31 December:

	2014	2013
Balance at beginning of year	5,355	5,724
Revisions in estimated cash flows	(1,234)	(1,445)
Acquisitions *(Note 9)*	—	232
Additions	289	256
Unwinding of discount	548	588
Balance at end of year	**4,958**	**5,355**

Revisions in estimated cash flows during the years ended 31 December 2014 and 2013 in the table above mainly relate to a decrease in expected decommissioning costs per item, as well as an increase in discounting rate and long-term inflation forecast, which also reduced buildings and structures cost in property and equipment *(Note 14)*.

24. Trade and other payables

Trade and other payables are as follows:

	31 December	
	2014	**2013 Restated** *(Note 4)*
Equipment suppliers	11,243	10,989
Interconnection charges	5,078	3,800
Due to employees	4,875	5,916
Inventory	3,971	2,384
Dealers	1,708	968
Rent and utilities	1,661	1,677
Social charges	1,362	1,366
Channels rental	1,105	663
Content providers	832	934
Advertising	640	2,754
Network repairs and maintenance	627	722
Roaming charges payable	571	268
Roaming rebates given	570	368
Other payables	2,379	2,827
Total trade and other payables	**36,622**	**35,636**

25. Share-based compensation

Long-term incentive programme 2013

In August 2013 the Company's Board of Directors approved a long-term motivation and retention program for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of the Company (equal to 7,000,000 phantom shares) at the base price of $24.25 per share. The plan has a three-year duration and the awarded share options vest in April-May 2015 and April-May 2016 and are settled in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted-average price of the Company's shares in the period between 15 January and 15 March of the relevant year of vesting. Vesting of the options is generally contingent upon the recipient's continuing employment with the Group.

In June 2014 a total number of 2,192,000 phantom share options were granted to certain key executive and senior level employees under the 2013 long-term incentive programme.

The respective awards are classified as a liability. The fair value of the options has been estimated using the Monte Carlo model. The fair value of each grant is estimated at the end of each reporting period. The expected volatility is estimated based on the average historical volatility of publicly traded guideline companies over the period equal to the expected life of the options granted. The dividend yield is included in the model based on expected dividend payments. The risk free rate is determined on the basis of U.S. Treasury yield curve rates with a remaining term to maturity equal to the expected life of the options. The expected term of the options equals their vesting term as the options are settled in cash at the end of the vesting period.

The fair value of options outstanding at 31 December 2014 is 8 Rubles per option. The carrying amount of the liability relating to these awards at 31 December 2014 is 5. The employee benefits expense recognised during the year ended 31 December 2014 in the consolidated statement of comprehensive income is 5, including related social charges.

Long-term incentive programme 2012

In October 2012 the Company's Board of Directors approved a long-term motivation and retention programme for certain key executive and senior level employees under which the parties who are selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options available for award is 1.1% of the share capital of the Company (equal to 7,000,000 phantom shares) at the base price of $17.86 per share. The plan has a three-year duration and the awarded share options vest in April-May 2014 and April-May 2015 and are settled in cash upon vesting, based on the difference between the base price and the weighted-average price of the Company's shares in the period between 15 January and 15 March in the relevant year of vesting. Vesting of the options is generally contingent upon the recipient's continued employment with the Group.

In February 2013 a total number of 2,133,000 phantom share options were granted to certain key executive and senior level employees under the 2012 long-term incentive programme.

25. Share-based compensation (continued)

The respective awards are classified as a liability. The valuation technique is described in 'Long-term incentive programme 2013 above'.

The following table illustrates the major assumptions of the Monte Carlo model for the options for the years ended 31 December:

	31 December 2014	31 December 2013
Expected term, years	0.2	0.3-1.3
Expected volatility	59%	24%-26%
Expected dividend yield	7.0%	7.5%
Risk free interest rate	0.07%	0.21%

In May 2014, 788,400 phantom share options vested and were exercised. During the year ended 31 December 2014, using its discretion under the plan, Group management permitted employees leaving the Group, who were considered deserving, to exercise a total of 45,000 options, notwithstanding the requirements of the plan set forth above.

The following table summarises the share price and number of options:

	Number of options
Granted in February 2013	2,133,000
Exercised at $33.52 (1,091 Rubles) per option	(60,000)
Forfeited	(88,000)
Outstanding as of 31 December 2013	**1,985,000**
Exercisable as of 31 December 2013	—
Exercised at $29.34 (1,045 Rubles) per option	(833,400)
Forfeited	(28,400)
Outstanding as of 31 December 2014	**1,123,200**
Exercisable as of 31 December 2014	—

The fair value of options outstanding at 31 December 2014 is nil (2013: 458) Rubles per option. The carrying amount of the liability relating to these awards at 31 December 2014 is nil (2013: 493) as options became out-of-money due to reduction in the Company's US Dollar-denominated share price. The respective reversal of liability has reduced the employee benefits expense recognised during the year ended 31 December 2014 in the consolidated statement of comprehensive income by 186 (2013: 557 expense), including related social charges.

CEO long-term incentive plan

As part of a long-term incentive plan approved by the Company's Board of Directors in November 2012, Mr. Ivan Tavrin, the CEO of the Company, agreed to purchase, within 30 days of the Group's IPO, 7,750,000 of the Group's ordinary shares (or 1.25% of the total issued shares) at the IPO price of $20 per share. Mr Tavrin exercised the option in December 2012.

25. Share-based compensation (continued)

Pursuant to the plan, Mr. Tavrin was also given three options to buy up to a further 1.25% of the total issued shares on each of his employment anniversary dates in May 2013, May 2014 and May 2015 at the IPO price. The options can be exercised, in whole or in part, on those dates or subsequently, up till May 2017, when any unexercised portion will lapse. Their exercise is subject to Mr. Tavrin's continued employment with the Group and Mr. Tavrin holding at least a 1.25% interest in the Company on the relevant exercise date. Mr Tavrin exercised the first of these three options in May 2013 and transferred a consideration of 4,869 to the Group.

On 4 March 2014 the Board of Directors of the Company agreed unanimously to amend the terms of the CEO long-term incentive plan and to accelerate the vesting of Mr. Tavrin's final two options to acquire a 1.25% interest in the Company, so that all the remaining options may now be exercised at any time after 1 May 2014. The change resulted in an additional employee benefits charge of 380 for the year ended 31 December 2014 due to the accelerated vesting, including incremental fair value in the amount of 111, recognised in the first half of 2014. In addition, the Board agreed to remove a restriction on Mr. Tavrin holding more than 5% of the authorised share capital of the Company at any time prior to May 2017.

The awards are classified as equity. The following table summarises the share prices and number of options:

	Number of options
Outstanding as of 1 January 2013	**23,250,000**
Exercised at $23.88 (735 Rubles) per option	(7,750,000)
Outstanding as of 31 December 2013	**15,500,000**
Exercisable as of 31 December 2013	—
Outstanding as of 31 December 2014	**15,500,000**
Exercisable as of 31 December 2014	15,500,000

On 30 December 2014 Mr. Tavrin exchanged his 2.5% interest in the Company and the 15,500,000 unexercised options for an interest in USMHL *(Note 29)*.

26. Long-term incentive programme

In April 2008 the Group's Board of Directors approved a long-term motivation and retention programme. Under this programme certain key executive and senior level employees are eligible for cash benefits that depend on the increases in the Company's value which is based on formula driven calculation. These benefits vest every two years over a four-year period and are contingent upon the recipient's continuing employment with the Group and an increase in the value of the Group as calculated. These benefits are accounted for as other long-term employee benefits with accrued liabilities included in trade and other payables *(Note 24)* and non-current financial liabilities *(Note 17)* in the accompanying consolidated financial statements as of 31 December 2014 and 2013 in the amounts of 80 and 320, respectively. Current service costs and related social charges recognised as employee benefits cost under the programme for the years ended 31 December 2014 and 2013, included in general and administrative expenses *(Note 28)*, totaled 10 and 176, respectively.

27. Sales and marketing expenses

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

	2014	2013
Advertising	6,598	8,797
Dealer commissions for connection of new subscribers	5,864	5,805
Cash collection and other commissions	3,994	4,085
Total sales and marketing expenses	**16,456**	**18,687**

During the year ended 31 December 2014, advertising costs reflect the de-recognition of approximately 1,200 of amounts accrued in previous periods.

28. General and administrative expenses

General and administrative expenses for the years ended 31 December are as follows:

	2014	2013
Employee benefits and related social charges	27,605	27,866
Rent	15,711	13,184
Operating taxes	6,828	7,106
Network repairs and maintenance	6,231	5,622
Radio frequency fees	5,488	4,163
Utilities	5,061	4,372
Office maintenance	2,227	1,882
Change in the impairment allowance account for trade and other receivables and advances to suppliers	1,398	2,037
Professional services	1,025	1,213
Vehicle costs	805	696
Materials and supplies	244	194
Insurance	65	81
Other expenses	2,502	2,142
Total general and administrative expenses	**75,190**	**70,558**

29. Related parties

The following tables provide the total amount of transactions that have been entered into with related parties and balances of accounts with them for the relevant financial years:

	For the years ended 31 December	
	2014	**2013**
Revenues from USM Group	31	764
Revenues from TeliaSonera Group	838	465
Revenues from Euroset	167	240
	1,036	**1,469**
Services from USM Group	883	1,233
Services from TeliaSonera Group	1,817	1,129
Services from Euroset	1,274	1,145
	3,974	**3,507**

	31 December	
	2014	**2013**
Due from USM Group	13	20
Due from TeliaSonera Group	388	72
Due from Euroset	379	184
	780	**276**
Due to USM Group	7,476	60,275
Due to TeliaSonera Group	638	149
Due to Euroset	3	293
	8,117	**60,717**

Terms and conditions of transactions with related parties

Outstanding balances at the years ended 31 December 2014 and 2013 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 31 December 2014 and 2013, the Group has not recorded any impairment of receivables relating to amounts owed by related parties. This assessment is undertaken each financial year by examining the financial position of the related party and the market in which the related party operates.

USM Group

The outstanding balances and transactions with USM Group relate to operations with Garsdale, the Group's parent, USMHL, an indirect owner of Garsdale, and their consolidated subsidiaries.

The Group has entered into an agreement with Telecominvest, a member of the USM Group, for provision of legal and personnel services effective in 2013 and 2014. In addition, the Group purchased billing system and related support services from PeterService, another member of the USM Group, in the amount of 1,979 and 1,880 during 2014 and 2013, respectively.

29. Related parties (continued)

On 1 October 2013 MegaFon acquired Scartel *(Note 9)*. Before that date, Scartel was a related party of the Group as both MegaFon and Scartel were indirect subsidiaries of Garsdale.

Amounts due to USM Group mainly represent the convertible debt instrument related to its investment in Euroset made in 2012 *(Notes 10, 17)* and the deferred consideration for the Scartel acquisition (*Notes 9, 17*). On 24 June 2014 the Group prepaid in cash approximately 90% of the deferred consideration due to Garsdale for the acquisition of Scartel, including principal and accrued interest, in the amount of 37,925. On 9 July 2014 the Group settled the amount due to Garsdale for its interest in Euroset with its own shares pursuant to the terms of the convertible debt instrument.

The Group is a member of the Not-for-profit Partnership "Development, Innovations, Technologies" (the "Partnership") which was established by companies in the USM Group. The Partnership is required to incur education, science and other social costs as well as to maintain certain social infrastructure assets in Skolkovo Innovation Centre which are not owned by MegaFon and not recorded in the consolidated statement of financial position. The Group accrued 1,089 of contributions made to the Partnership during 2014 (2013: nil) and 1,826 subsequently in January 2015.

TeliaSonera Group

The outstanding balances and transactions with TeliaSonera Group relate to operations with various companies in the TeliaSonera Group. Revenues and cost of services principally related to roaming agreements between MegaFon and members of the TeliaSonera Group located outside Russia and a wireline interconnection agreement with TeliaSonera International Carrier Russia.

Euroset

Euroset is the Group's joint venture with OJSC VimpelCom *(Note 10)*. The Group has a dealership agreement with Euroset which qualifies as a related party transaction.

Compensation to key management personnel

Members of the Board of Directors and the Management Board of the Company are the key management personnel. The amounts recognised as employee benefits expense to key management personnel of the Group for the years ended 31 December are as follows:

	2014	**2013**
Short-term employee benefits	603	632
Share-based compensation *(Note 25)*	593	1,491
Long-term incentive programme *(Note 26)*	12	63
Total	**1,208**	**2,186**

30. Financial risk management

The Group's principal financial liabilities, other than derivatives, comprise loans and borrowings, and trade and other payables. The main purpose of these financial liabilities is to finance the Group's operations. The Group has trade and other receivables, and cash and short-term deposits that derive directly from its operations. The Group also enters into derivative transactions.

The Group is exposed to market risk, credit risk and liquidity risk. The Group's senior management oversees the management of these risks. The Group's senior management is supported by the Finance and Strategy Committee of the Board of Directors that advises on financial risks and the appropriate financial risk governance framework for the Group. The Finance and Strategy Committee provides assurance to the Group's senior management that the Group's financial risk-taking activities are governed by appropriate policies and procedures and that financial risks are identified, measured and managed in accordance with the Group's policies. All derivative activities for risk management purposes are carried out by specialist teams that have the appropriate skills, experience and supervision. It is the Group's policy that no trading in derivatives for speculative purposes shall be undertaken.

The Company's Board of Directors reviews and agrees policies for managing each of these risks, which are summarised below.

Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market price risks that mostly impact the Group comprise two types of risk: interest rate risk and currency risk. Financial instruments affected by market risk include: loans and borrowings, deposits and derivative financial instruments.

The sensitivity analyses in the following sections relate to the position as of 31 December in 2014 and 2013. The sensitivity analyses have been prepared on the basis that the amount of net debt, the ratio of fixed-to-floating interest rates of the debt and derivatives and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 December 2014 and 2013.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates.

The Group manages its interest rate risk by having a balanced portfolio of fixed and variable rate loans and borrowings. To manage this, the Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount. These swaps are designated to hedge underlying debt obligations.

30. Financial risk management (continued)

At 31 December 2014, after taking into account the effect of interest rate swaps, approximately 86% of the Group's borrowings are at a fixed rate of interest (2013: 86%).

Interest rate sensitivity

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on loans and borrowings, after the impact of hedge accounting. With all other variables held constant, the Group's profit before tax is affected through the impact on floating rate borrowings, as follows:

	Increase/decrease in basis points	Effect on profit before tax
Year ended 31 December 2014		
US Dollar	+2	(7)
US Dollar	-2	7
Year ended 31 December 2013		
US Dollar	+3	(5)
US Dollar	-3	5

The analysis is prepared assuming the amount of variable rate liability outstanding at the balance sheet date was outstanding for the whole year.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's financing activities (when cash deposits and loans and borrowings are denominated in a different currency from the Group's functional currency).

A significant portion of the Group's liabilities is denominated in US dollars or Euro. If the Ruble continued to decline dramatically against the US dollar or Euro, this could negatively impact the Group's earnings.

To the extent permitted by Russian law, the Group keeps part of its cash and cash equivalents in US dollar and Euro interest bearing accounts to manage against the risk of Ruble decline or devaluation, and also to match its foreign currency liabilities.

To minimise its foreign exchange exposure to fluctuations in foreign currency exchange rates, the Group is migrating most of its foreign currency linked costs to Ruble based costs to balance assets and liabilities and revenues and expenses denominated in Rubles. In order to manage the foreign currency risk the Group is also focused on increasing the proportion of Ruble loans through refinancing and hedging activities.

30. Financial risk management (continued)

During 2014 and 2013, the Group entered into three long-term cross-currency swaps *(Note 17).* These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain of the Group's long-term debts denominated in foreign currencies *(Note 17).*

Overall, the share of Ruble loans (including the effect of cross-currency swaps) amounted to 65% as of 31 December 2014 (76% at 31 December 2013).

In accordance with the Group's policies, the Group does not enter into any treasury management transactions of a speculative nature.

Foreign currency sensitivity

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar, HK dollar and Euro exchange rates, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value and future cash flows of monetary assets and liabilities including non-designated foreign currency derivatives) after the impact of hedge accounting. The Group's exposure to foreign currency changes for all other currencies is not material.

	Change in foreign exchange rates	Effect on profit before tax
Year ended 31 December 2014		
US Dollar	+30%	(18,372)
US Dollar	-30%	18,372
Euro	+30%	(1,307)
Euro	-30%	1,307
HK Dollar	+30%	9,644
HK Dollar	-30%	(9,644)
Year ended 31 December 2013		
US Dollar	+10%	(5,078)
US Dollar	-10%	5,078
Euro	+10%	(462)
Euro	-10%	462

The movement in the pre-tax effect is a result of a change in the fair value of derivative financial instruments not designated in a hedging relationship and monetary assets and liabilities denominated in currencies other than the functional currency of the Company. Although the derivatives have not been designated in a hedge relationship, they act as a commercial hedge and will offset the underlying transactions when they occur.

30. Financial risk management (continued)

Credit risk

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss. The Group is exposed to credit risk from its operating activities (primarily for trade receivables) and from its financing activities, including deposits with banks and financial institutions and other financial instruments.

The Group deposits available cash with various banks in the Russian Federation. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within the Russian Federation. To manage the concentration of credit risk, the Group allocates available cash to domestic branches of international banks and a limited number of Russian banks. A majority of these Russian banks are either owned or controlled by the Russian government.

The Group extends credit to certain counterparties, principally international and national telecommunications operators, for roaming services, and to certain dealers. The Group minimises its exposure to the risk by ensuring that credit risk is spread across a number of counterparties, and by continuously monitoring the credit standing of counterparties based on their credit history and credit ratings reviews. Other preventative measures to minimise credit risk include obtaining advance payments, bank guarantees and other security.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in *Note 17*. The Group evaluates the concentration of risk with respect to trade receivables as low, as its customers are located in several jurisdictions and industries and operate in largely independent markets. Concentrations of credit risk with respect to trade receivables are limited given that the Group's customer base is large and unrelated. Due to this management believes there is no further credit risk provision required in excess of the normal impairment allowance for trade and other receivables.

Liquidity risk

The Group monitors its risk relating to a shortage of funds using a recurring liquidity planning tool. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans. Approximately 24% of the Group's loans and borrowings will mature in less than one year at 31 December 2014 (2013: 13%) based on the carrying value of borrowings reflected in the financial statements. The Group assessed the concentration of risk with respect to refinancing its debt and concluded it to be low.

As of 31 December 2014 and 2013, the Group has net current liability position. The Group believes it will continue to be able to generate significant operating cash flows and that adequate access to sources of funding and significant amount of available credit lines are sufficient to meet the Group's requirements. Additionally, the Group can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, Group management believes that cash flows from operating and financing activities will be sufficient for the Group to meet its obligations as they become due.

30. Financial risk management (continued)

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments.

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
31 December 2014					
Loans and borrowings	64,445	85,361	78,125	23,036	**250,967**
Trade and other payables	36,622	—	—	—	**36,622**
Deferred consideration	7,257	—	—	—	**7,257**
Long-term accounts payable	—	1,200	27	54	**1,281**
Derivative financial liabilities	263	—	—	—	**263**
Total 31 December 2014	**108,587**	**86,561**	**78,152**	**23,090**	**296,390**
31 December 2013					
Loans and borrowings	31,180	48,510	74,234	43,274	**197,198**
Deferred consideration	20,469	21,627	—	—	**42,096**
Trade and other payables	33,875	—	—	—	**33,875**
Convertible debt instrument	22,101	—	—	—	**22,101**
Long-term accounts payable	193	543	289	—	**1,025**
Derivative financial liabilities	312	72	—	—	**384**
Liability for marketing related licences	177	—	—	—	**177**
Total 31 December 2013	**108,307**	**70,752**	**74,523**	**43,274**	**296,856**

Capital management

Capital includes equity attributable to the Group's shareholders. The primary objective of the Group's capital management is to ensure that it maintains a healthy credit rating and healthy capital ratios in order to secure access to debt and capital markets at all times and maximise shareholder value. The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions.

The Net debt to OIBDA ratio is an important measure to assess the capital structure in light of the need to maintain a strong credit rating. Net debt represents the carrying amount of interest-bearing loans and borrowings less cash and cash equivalents and current and non-current bank deposits. As of 31 December 2014 the Net Debt to OIBDA ratio was 0.98 (2013: 0.77).

Some loan agreements also have covenants based on Net Debt to OIBDA ratios. The Group believes it has complied with all the capital requirements imposed by external parties.

Collateral

The Group did not pledge collateral as security for its financial liabilities at 31 December 2014 or 2013, except assets purchased under deferred payment terms *(Note 14)*.

31. Commitments, contingencies and uncertainties

Russian operating environment

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

In 2014, the Russian economy was negatively impacted by a significant drop in crude oil prices and a significant devaluation of the Russian Ruble, as well as sanctions imposed on Russia by several countries. In December 2014, the Ruble interest rates have increased significantly after the Central Bank of Russia raised its key rate to 17%.The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

4G/LTE licence capital commitments

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted OJSC MegaFon a licence and allocated frequencies to provide services under the 4G/LTE standard in Russia.

Under the terms and conditions of this licence, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Company is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed, to clear frequencies currently allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401. In 2012, the Company has fully paid the compensation due to the other operators. It is currently not able to reasonably estimate the amount of the cost of clearing military frequencies.

Equipment purchases agreements

In April 2014 and December 2014, the Group entered into two separate 7-year agreements with two suppliers to purchase equipment and software for 2G/3G/4G network construction and modernisation. The software usage agreements contain various termination options, however the Group is specifically committed under the agreements to pay at least 3 years' worth of fees plus 50-60% worth of fees for years four-seven for each base station in use as at the date of termination after taking into account fees already paid. The amount of the commitments at 31 December 2014 is 9,206.

Social infrastructure expenses

From time to time, the Group may determine to maintain certain social infrastructure assets which are not owned by the Group and not recorded in the consolidated financial statements as

31. Commitments, contingencies and uncertainties (continued)

well as to incur education, science and other social costs. Such activities may be conducted in collaboration with non-governmental organisations. These expenses are presented in other non-operating loss in the consolidated statement of comprehensive income.

Taxation

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

Russian transfer pricing legislation, which came into force on 1 January 2012, allows the Russian tax authorities to control transaction prices for the purpose of taxation and impose additional profits tax liabilities in respect of certain transactions if the transaction price differs from the market level of prices. Because of the lack of clarity in the current Russian transfer pricing legislation and the absence of court precedent, consequencies of litigations with the Russian tax authorities with respect to the level of prices applied by the Group cannot be reliably assessed. However, those consequences might affect the Group's consolidated financial statements.

In 2014 a law "On controlled foreign companies" ("CFC rules") aimed at the fiscal stimulation of decreasing the number of the entities registered abroad in the Russian economy were issued, and took effect on January 1, 2015. Under CFC rules retained profits of foreign companies and non-corporate structures controlled by Russian tax residents (companies and individuals) may be subject to Russian taxation. Russian taxpayers (controlling parties) must inform the tax authorities of the foreign companies controlled by them, while the tax authorities may impose additional tax liabilities to the taxpayers failing to include retained profit of the foreign controlled companies in their taxable base, where necessary.

The Group's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Group's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ.

As of 31 December 2014 the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 925.

31. Commitments, contingencies and uncertainties (continued)

Operating lease commitments

The Group normally enters into operating leases with a term not exceeding one year. Accordingly, the Group's operating lease commitments at 31 December 2014 approximate the annual rent expense (*Note 28*).

Litigation

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

32. Events after the reporting date

Credit ratings

On 5 February 2015 Standard and Poor's Ratings Services ("S&P") took several actions on the Group's credit ratings, following its downgrade of the sovereign rating on Russia. S&P affirmed the local currency rating of the Group at the BBB- level. At the same time, S&P downgraded the Group's foreign currency rating to BB+, explaining that this action reflected constraints imposed by the agency's Transfer and Convertibility assessment of Russia.

On 25 February 2015 Moody's Investor Service ("Moody's") downgraded the Group's credit rating from Baa3 to Ba1. The rating action reflected the earlier downgrade by Moody's of the Russia's sovereign credit rating and subsequent lowering of Russia's country rating ceilings to Ba1 levels.

Long-term incentive programme 2012

On 10 March 2015 the Board of Directors of the Company approved an amendment to the terms of the Long-term incentive programme 2012 *(Note 25)* to change the base price and the strike price for the awards outstanding as at 31 December 2014 with a payment due in April-May 2015, so that the base price is denominated in Rubles and becomes 555 Rubles per share, and the weighted-average price of the Company's shares is based on prices on the Moscow Exchange over the period between 15 January and 15 March in the relevant year of vesting. As a result of the change the fair value of options outstanding at 10 March 2015 increased to approximately 440 Rubles per option.