MegaFon

CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2015

Contents

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Auditors' Report

To the Shareholders and Board of Directors

PJSC MegaFon

We have audited the accompanying consolidated financial statements of PJSC MegaFon (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2015, and the consolidated statements of comprehensive income, changes in equity and cash flows for 2015, and notes, comprising 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.

Auditors' Responsibility

Our responsibility is to express an opinion on the fair presentation of these consolidated financial statements based on our audit. We conducted our audit in accordance with Russian Federal Auditing Standards and 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 accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

Entity: PJSC MegaFon

Registered by Committee of external economic relations under the Saint Petersburg Town Council on 17 June 1993, Registration No. AOL 51-92.

Entered in the Unified State Register of Legal Entities on 15 July 2002 by Saint Petersburg Central District Inspectorate of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027809169585, Certificate series 78 No. 004009033.

30 Kadashevskaya Emb., Moscow 115035.

Independent auditor: JSC "KPMG", a company incorporated under the Laws of the Russian Federation, a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered by the Moscow Registration Chamber on 25 May 1992, Registration No. 011.585.

Entered in the Unified State Register of Legal Entities on 13 August 2002 by the Moscow Inter-Regional Tax Inspectorate No.39 of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027700125628, Certificate series 77 No. 005721432.

Member of the Non-commercial Partnership "Chamber of Auditors of Russia". The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No.10301000804.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2015, and its financial performance and its cash flows for 2015 in accordance with International Financial Reporting Standards.

Akylbek Y. A.

Director, power of attorney dated 16 March 2015 No. 77/15

JSC "KPMG"

16 March 2016

Moscow, Russian Federation

Consolidated statement of comprehensive income

(In millions of Rubles)

	Note	Years ended 31 December 2015	2014
Revenue	2.1	313,383	314,795
Operating expenses			
Cost of revenue		84,410	84,629
Sales and marketing expenses	2.2	18,122	16,456
General and administrative expenses	2.3	78,494	75,190
Depreciation	3.1, 3.8	48,173	47,431
Amortisation	3.2	7,313	7,827
Loss on disposal of non-current assets		913	1,437
Total operating expenses		**237,425**	**232,970**
Operating profit		**75,958**	**81,825**
Finance costs		(14,779)	(13,792)
Finance income		2,508	1,155
Share of loss of associates and joint ventures	3.3	(649)	(516)
Other non-operating loss	5.2	(2,949)	(1,370)
Gain/(loss) on financial instruments, net	3.4.3	1,502	(50)
Foreign exchange loss, net		(10,041)	(16,884)
Profit before tax		**51,550**	**50,368**
Income tax expense	2.4	12,334	13,368
Profit for the year		**39,216**	**37,000**

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 2015	2014
Other comprehensive income/(loss) items that may be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax of nil		(1,068)	(1,288)
Net movement on cash flow hedges, net of tax	3.4.3	(2)	297
Net other comprehensive loss that may be reclassified to profit or loss in subsequent periods		**(1,070)**	**(991)**
Total comprehensive income for the year, net of tax		**38,146**	**36,009**
Profit for the year			
Attributable to equity holders of the Company		39,041	36,726
Attributable to non-controlling interest		175	274
		39,216	**37,000**
Total comprehensive income/(loss) for the year			
Attributable to equity holders of the Company		38,247	36,055
Attributable to non-controlling interest		(101)	(46)
		38,146	**36,009**
Earnings per share, Rubles			
Basic, profit for the year attributable to equity holders of the Company	2.5	66	63
Diluted, profit for the year attributable to equity holders of the Company	2.5	66	63

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 2015	As of 31 December 2014
Assets			
Non-current assets			
Property and equipment	3.1	234,417	224,655
Intangible assets, other than goodwill	3.2.1	61,800	57,427
Goodwill	3.2.2	33,909	32,292
Investments in associates and joint ventures	3.3	47,885	34,944
Non-current financial assets	3.4	4,102	2,863
Non-current non-financial assets	3.7	2,894	2,053
Deferred tax assets	2.4	832	782
Total non-current assets		**385,839**	**355,016**
Current assets			
Inventory	3.6	8,684	6,484
Current non-financial assets	3.7	6,649	5,161
Prepaid income taxes	2.4	2,641	3,713
Trade and other receivables	3.5	21,156	16,260
Other current financial assets	3.4	26,973	48,887
Cash and cash equivalents	3.4.1	17,449	22,223
Total current assets		**83,552**	**102,728**
Total assets		**469,391**	**457,744**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	4	147,898	157,689
Non-controlling interests		(147)	144
Total equity		**147,751**	**157,833**
Non-current liabilities			
Loans and borrowings	3.4	172,643	156,319
Other non-current financial liabilities	3.4	5,033	1,270
Non-current non-financial liabilities	3.7	2,435	1,712
Provisions	3.8	4,603	4,958
Deferred tax liabilities	2.4	20,358	19,572
Total non-current liabilities		**205,072**	**183,831**
Current liabilities			
Trade and other payables	3.4	45,961	36,549
Loans and borrowings	3.4	47,037	51,149
Other current financial liabilities	3.4	2,900	7,731
Current non-financial liabilities	3.7	20,567	20,493
Income taxes payable	2.4	103	158
Total current liabilities		**116,568**	**116,080**
Total equity and liabilities		**469,391**	**457,744**

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

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 4)	Total	Non-controlling interests	Total equity
As of 1 January 2014		**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	4	—	—	—	—	—	(38,428)	—	(38,428)	—	(38,428)
Share-based compensation	5.1	—	—	—	—	—	—	689	689	—	689
Settlement of convertible debt		—	—	(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**
Net profit		—	—	—	—	—	39,041	—	39,041	175	39,216
Other comprehensive loss		—	—	—	—	—	—	(794)	(794)	(276)	(1,070)
Total comprehensive income		**—**	**—**	**—**	**—**	**—**	**39,041**	**(794)**	**38,247**	**(101)**	**38,146**
Dividends	4	—	—	—	—	—	(48,038)	—	(48,038)	—	(48,038)
Contribution of non-controlling interest		—	—	—	—	—	—	—	—	7	7
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(197)	(197)
As of 31 December 2015		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**152,425**	**(233)**	**147,898**	**(147)**	**147,751**

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

Consolidated statement of cash flows

(In millions of Rubles)

	Note	Years ended 31 December 2015	2014
Operating activities			
Profit before tax		51,550	50,368
Adjustments to reconcile profit before tax to net cash flows:			
Depreciation	3.1	48,173	47,431
Amortisation	3.2	7,313	7,827
Loss on disposal of non-current assets		913	1,437
(Gain)/loss on financial instruments, net		(1,502)	50
Net foreign exchange loss		10,041	16,884
Share of loss of associates and joint ventures	3.3	649	516
Change in impairment allowance for receivables and other non-financial assets		2,100	1,398
Finance costs		14,779	13,792
Finance income		(2,508)	(1,155)
Equity-settled share-based compensation		—	689
Working capital adjustments:			
(Increase)/decrease in inventory		(2,188)	1,900
Increase in trade and other receivables		(6,405)	(6,048)
Increase in current non-financial assets		(1,692)	(416)
Increase/(decrease) in trade and other payables		6,040	(2,314)
Decrease in current non-financial liabilities		(1,788)	273
Change in VAT, net		(1,121)	2,122
Income tax received		619	427
Income tax paid		(11,095)	(10,052)
Interest received		2,571	1,183
Interest paid, net of interest capitalised		(13,100)	(12,009)
Net cash flows from operating activities		**103,349**	**114,303**
Investing activities			
Purchase of property, equipment and intangible assets		(64,455)	(58,146)
Proceeds from sale of property and equipment		304	751
Purchase of interest in joint venture and of loans receivable	3.3	(15,759)	—
Acquisition of subsidiaries, net of cash acquired	5.3	(1,495)	(189)
Escrow cash deposit	5.3	(690)	—
Payment of deferred and contingent consideration		(9,046)	(36,330)
Net change in short-term demand deposits		32,033	165
Net cash flows used in investing activities		**(59,108)**	**(93,749)**
Financing activities			
Proceeds from borrowings, net of fees paid		68,007	48,522
Repayment of borrowings		(75,299)	(22,868)
Dividends paid to equity holders of the Company	4	(48,038)	(38,428)
Dividends paid to non-controlling interests		(197)	(132)
Payment of liability for marketing related licences		—	(184)
Other		7	51
Net cash flows used in financing activities		**(55,520)**	**(13,039)**
Net (decrease)/increase in cash and cash equivalents		(11,279)	7,515
Net foreign exchange difference		6,505	4,769
Cash and cash equivalents at beginning of year		22,223	9,939
Cash and cash equivalents at end of year	**3.4.1**	**17,449**	**22,223**

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

Notes to the consolidated financial statements

(In millions of Rubles)

1. General

1.1. About the Company

Public 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.

MegaFon lists 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 2015, 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.

1.2. 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").

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 16 March 2016.

Foreign currency translation

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

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.

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 other comprehensive income ("OCI").

1.3. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of 31 December 2015.

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 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.

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.

Notes to the consolidated financial statements (continued)

1.4. 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, the consolidated statement of comprehensive income and the accompanying disclosures. Subsequent revisions or corrections made of these assumptions and estimates hereafter could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

In the process of applying the Group's accounting policies, management has made various judgments. Those which management has assessed to have the most significant effect on the amounts recognised in the consolidated financial statements have been discussed in the individual notes of the related financial statement line items: revenue, income taxes, property and equipment, intangible assets, investments in associates and joint ventures, financial assets and liabilities, provisions, share-based compensation, and business combinations.

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 amounts of assets and liabilities within the next financial year, are also described in the individual notes of the related financial statement line items 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 that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

1.5. Significant accounting policies

The significant accounting policies have been discussed in the individual notes of the related financial statement line items.

Changes in accounting policies and disclosures

During 2015 the Group applied a number of amendments to accounting standards for the first time which do not have a material impact on the Group's consolidated financial statements. These amendments are described below:

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

The amendments 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 and disclosure in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in IFRS 11. The amendments did not impact the Group's consolidated financial statements.

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

The amendments 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 did not impact the Group's consolidated financial statements.

Improvements to IFRSs (September 2014)

The amendments issued as a result of the Annual Improvements to IFRSs 2012-2014 Cycle introduced relatively minor changes to clarify guidance in existing standards. The amendments did not impact the Group's consolidated financial statements.

1.6. 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 consolidated 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*, and 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.

Notes to the consolidated financial statements (continued)

1.6. Standards issued but not yet effective (continued)

During 2015 the IASB issued an amendment to IFRS 15, which deferred the effective date of the Standard by one year to 1 January 2018. Early application is permitted. The Standard provides a choice of transition methods.

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

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. 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 consolidated financial statements.

IFRS 16 Leases

In January 2016 the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces previous guidance on leases. The Standard requires lessees to present right-of-use assets and lease liabilities on the balance sheet for all leases (with limited exceptions).

The Standard is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15, *Revenue from Contracts with Customers*, at or before the date of initial application of IFRS 16.

A lessee should apply IFRS 16 to its leases either: (a) retrospectively to each prior reporting period presented applying IAS 8; or (b) retrospectively with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application.

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

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.

Originally, the amendments were effective for annual periods beginning on or after 1 January 2016. In December 2015 the IASB issued amendments which extended the effective date to a date to be determined by the IASB. The Group does not expect these amendments to have a material impact on the Group's consolidated financial statements.

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, and 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.

IAS 7 Disclosure Initiative

In February 2016 the IASB issued, *Disclosure Initiative – Amendments to IAS 7*, which requires companies to provide information about changes in their financing liabilities. The amendments will help investors to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. The amendments are effective for annual periods beginning on or after 1 January 2017. 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.

Notes to the consolidated financial statements (continued)

2. Income Statement

2.1. Revenue

Accounting policies

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.

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 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. The reporting of revenue on a net versus gross basis, depending on an analysis of the Group's involvement as either principal or agent, involves management's judgment.

(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, 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. Inputs to the models include making assumptions about expected redemption rates, the mix of services that will be available for redemption in the future and customer preferences. Such estimates are subject to significant uncertainty.

(b) Multiple element arrangements

The Group enters into multiple element arrangements in which a customer may purchase a combination of equipment (e.g. 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. Allocation of each separable component of a bundled offer based on the individual components' relative fair values involves estimates and judgment.

(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.

Notes to the consolidated financial statements (continued)

2.1. Revenue (continued)

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, respectively, in the accompanying consolidated statement of financial position.

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.

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.

Change in presentation

In these consolidated financial statements the presentation of revenue has been changed so as to present service revenue and revenue from the sale of equipment and accessories combined, in line with growing trend of bundled offerings (e.g. handsets and telecommunication services).

2.2. Sales and marketing expenses

Accounting policies

Dealer commissions for connection of new subscribers are expensed as incurred. 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 are expensed as incurred.

2.3. General and administrative expenses

Included in general and administrative expenses for the years ended 31 December are:

	2015	2014
Employee benefits and related social charges	28,095	27,605
Operating lease expense	16,866	15,711

Government pension funds

The Group contributes to 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 2015 and 2014 were 5,514 and 5,112, respectively.

Notes to the consolidated financial statements (continued)

2.4. Income taxes

Accounting policies

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 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.

Significant estimates

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings. 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.

Disclosures

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

	2015	2014
Current income tax:		
Current income tax charge	11,450	9,069
Adjustments recognised for current tax of prior periods	223	(648)
Deferred tax	661	4,947
Income tax expense	**12,334**	**13,368**

Income tax is calculated at 20% of taxable profit for the years ended 31 December 2015 and 2014, respectively.

Notes to the consolidated financial statements (continued)

2.4. Income taxes (continued)

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

	2015	2014
Statutory income tax rate	**20.0%**	**20.0%**
Non-deductible expenses	2.9%	2.9%
Effect of intra-group transactions	0.9%	1.6%
Deferred tax assets write-off	0.2%	3.0%
Effect of income tax preferences	(0.3%)	(0.7%)
Other	0.2%	(0.3%)
Effective income tax rate	**23.9%**	**26.5%**

In 2014 the effective income tax rate was higher primarily due to derecognition of deferred tax assets related to the investment in Euroset and the acquisition of Scartel. 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	
	2015	2014	2015	2014
Property and equipment	(15,087)	(12,810)	2,202	2,253
Intangible assets	(8,991)	(9,233)	(242)	(135)
Derivative financial instruments	(659)	(624)	35	711
Investments in joint ventures and subsidiaries	(94)	(45)	49	770
Tax loss carry-forwards	2,779	2,322	(457)	384
Revenue recognition	641	622	(19)	111
Accrued employee benefits	461	378	(83)	806
Accrued expenses	821	(127)	(948)	908
Other movements and temporary differences	603	727	124	(861)
Deferred tax (benefit)/expense			**661**	**4,947**
Net deferred tax liabilities	**(19,526)**	**(18,790)**		
Reflected in the consolidated statement of financial position as follows:				
Deferred tax assets	**832**	**782**		
Deferred tax liabilities	**(20,358)**	**(19,572)**		

The Group recognises deferred tax assets in respect of tax loss carry-forwards 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.

Deferred tax assets in respect of the tax losses are attributable to the following subsidiaries:

	2015	2014
Scartel	2,180	1,664
MegaFon Retail	599	658
Balance at end of year	**2,779**	**2,322**

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 PJSC MegaFon which is expected to have sufficient pretax income to utilise the accumulated tax losses of these subsidiaries. Tax loss carry-forwards available for utilisation by the Group expire in 2019-2025.

Notes to the consolidated financial statements (continued)

2.4. Income taxes (continued)

Unrecognised deferred tax assets in the consolidated statement of financial position as of 31 December 2015 and 2014 amounted to 2,716 and 2,202, respectively. Unrecognised deferred tax assets arose on the acquisition of subsidiaries due to the difference between the accounting and tax bases of the acquisitions and are not expected to be realised due to lack of appropriate taxable profits.

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

	2015	2014
Balance at beginning of year	18,790	14,079
Tax expense during the year	661	4,947
Translation adjustment of foreign operations	60	160
Acquisition of subsidiaries *(Note 5.3)*	14	—
Deferred tax on cash flow hedges in OCI	1	(74)
Change through equity	—	(322)
Balance at end of year	**19,526**	**18,790**

2.5. Earnings per share

Accounting policies

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.

Disclosures

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

	2015	2014
Numerator:		
Net profit attributable to equity holders of the Company	39,041	36,726
Denominator:		
Weighted-average ordinary shares outstanding	595,700,967	583,915,212
Effect of dilutive securities:		
Employee stock options *(Note 5.1)*	—	3,652,843
Weighted-average diluted shares outstanding, adjusted	**595,700,967**	**587,568,055**
EPS – basic, Rubles	**66**	**63**
EPS – diluted, Rubles	**66**	**63**

3. Assets and Liabilities

3.1. Property and equipment

Accounting policies

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.

Depreciation expenses are based on management's estimates of residual value, the depreciation method used and the useful lives of property and equipment. 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 charges. 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.

The estimated useful lives are as follows:

Telecommunications network	3 to 20 years
Buildings and structures	7 to 50 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 *Note 3.8* 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.

Finance 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.

The Group has entered into long-term leases of telecommunication assets. The Group has determined that, based on an evaluation of the terms and conditions of the arrangements, such as the lease term constituting a major part of the economic life of the asset, it obtains all the significant risks and rewards of ownership of these assets. Accordingly, it accounts for the contracts as finance leases.

At the commencement of the lease term the Group recognises finance leases as assets and liabilities at the present value of the minimum lease payments. In determining the present value of the minimum lease payments, assumptions and estimates are made in relation to discount rates, the expected costs for services and taxes to be paid by and reimbursed to the lessor, and long-term inflation forecasts where the lease agreements include provisions to adjust the lease payments for inflation.

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.

Notes to the consolidated financial statements (continued)

3.1. Property and equipment (continued)

Capitalised 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.

Impairment

The Group tests long-lived assets, other than goodwill, for impairment when circumstances indicate there may be a potential impairment. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Estimating recoverable amounts of assets is based on management's evaluations, including estimates of applicable market rates, 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.

Disclosures

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 2014	**338,366**	**64,007**	**24,310**	**28,106**	**454,789**
Additions	—	—	—	49,841	49,841
Acquisitions *(Note 5.3)*	225	4	2	7	238
Disposals	(8,915)	(438)	(1,738)	(287)	(11,378)
Transfer from AHFS	—	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**
Additions	—	—	—	58,278	58,278
Acquisitions *(Note 5.3)*	320	—	3	14	337
Disposals	(9,119)	(197)	(1,525)	(764)	(11,605)
Put into use	53,562	5,583	2,378	(61,523)	—
Translation	2,232	723	905	292	4,152
31 December 2015	**425,162**	**74,866**	**28,509**	**22,539**	**551,076**
Depreciation as of 1 January 2014	**(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	—	(212)	—	—	(212)
Translation	(1,585)	(317)	(689)	—	(2,591)
31 December 2014	**(228,930)**	**(25,055)**	**(21,274)**	**—**	**(275,259)**
Charge for the year	(41,226)	(4,636)	(3,094)	—	(48,956)
Disposals	8,441	58	1,500	—	9,999
Translation	(1,563)	(290)	(590)	—	(2,443)
31 December 2015	**(263,278)**	**(29,923)**	**(23,458)**	**—**	**(316,659)**
Net book value:					
31 December 2014	**149,237**	**43,702**	**5,474**	**26,242**	**224,655**
31 December 2015	**161,884**	**44,943**	**5,051**	**22,539**	**234,417**

3.1. Property and equipment (continued)

Included in construction in-progress are advances to suppliers of network equipment of 1,293 and 1,601 as at 31 December 2015 and 2014, respectively.

Assets purchased under certain contracts with deferred payment terms in the amount of 1,351 (2014: 1,252) are pledged as security for the related liabilities.

Finance leases

The carrying value of buildings and structures and telecommunications network held under finance leases at 31 December 2015 was 3,116 (2014: nil) and 66 (2014: nil), respectively. Leased assets are pledged as security for the related finance lease liabilities.

Capitalised borrowing costs

Capitalised borrowing costs were 1,499 (out of the total interest expense of 16,278) and 1,789 (out of the total interest expense of 15,581) for the years ended 31 December 2015 and 2014, respectively. The rate used to determine the amount of borrowing costs eligible for capitalisation was 7.0% and 7.2% for the years ended 31 December 2015 and 2014, respectively.

3.2. Intangible assets

3.2.1. Intangible assets, other than goodwill

Accounting policies

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 are amortised on a straight-line basis over the following estimated useful lives:

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

Amortisation expenses are based on management's judgment as to the amortisation method to be used and its estimates of the useful lives of the 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 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 the 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.

Change in estimate

During the year the Group changed its method of amortisation of 2G licences from sum-of-the-years'-digits basis to straight-line basis. In the past the Group assumed a gradual decrease in the number of 2G subscribers and chose the method that best reflected the pattern in which the economic benefits of these operating licences were expected to be consumed or otherwise used up. Considering the growing trend of technology neutrality, which means that certain spectrum frequency can be used for a number of technologies, i.e. spectrum that was used for 2G can now be used for 3G or 4G technologies, the Group concluded that the straight-line method better reflects the pattern of consumption of the economic benefits of these licences. The change has been accounted for as a change in accounting estimate and resulted in an additional profit of approximately 200.

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.

3.2.1. Intangible assets, other than goodwill (continued)

Impairment

Assets that are subject to 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 carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) an asset'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.

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 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.

Estimating recoverable amounts of assets is based on management's evaluations, including estimates of applicable market rates, 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.

Disclosures

Intangible assets, other than goodwill, are as follows:

	4G operating licences	Other operating licences	Frequen-cies	Software	Customer base	Other intangible assets	Total
Cost as of 1 January 2014	**42,879**	**18,831**	**6,205**	**11,631**	**3,552**	**9,886**	**92,984**
Additions	—	87	1,298	3,633	—	1,613	6,631
Acquisitions *(Note 5.3)*	—	—	—	—	—	38	38
Disposals	—	(14)	(344)	(588)	—	(792)	(1,738)
Transfer	—	—	(71)	—	—	71	—
Translation	—	162	—	—	—	3	165
31 December 2014	**42,879**	**19,066**	**7,088**	**14,676**	**3,552**	**10,819**	**98,080**
Additions	—	6,973	1,218	2,030	215	1,450	11,886
Acquisitions *(Note 5.3)*	—	—	—	17	425	16	458
Disposals	—	(30)	(398)	(2,401)	—	(3,738)	(6,567)
Translation	—	108	—	—	—	2	110
31 December 2015	**42,879**	**26,117**	**7,908**	**14,322**	**4,192**	**8,549**	**103,967**
Amortisation as of 1 January 2014	**(524)**	**(15,757)**	**(1,997)**	**(7,913)**	**(1,210)**	**(6,735)**	**(34,136)**
Charge for the year	(2,144)	(702)	(783)	(2,424)	(543)	(1,231)	(7,827)
Disposals	—	—	248	552	—	656	1,456
Translation	—	(143)	—	—	—	(3)	(146)
31 December 2014	**(2,668)**	**(16,602)**	**(2,532)**	**(9,785)**	**(1,753)**	**(7,313)**	**(40,653)**
Charge for the year	(2,143)	(510)	(906)	(2,480)	(588)	(686)	(7,313)
Disposals	—	4	304	1,869	—	3,729	5,906
Translation	—	(105)	—	—	—	(2)	(107)
31 December 2015	**(4,811)**	**(17,213)**	**(3,134)**	**(10,396)**	**(2,341)**	**(4,272)**	**(42,167)**
Net book value:							
31 December 2014	**40,211**	**2,464**	**4,556**	**4,891**	**1,799**	**3,506**	**57,427**
31 December 2015	**38,068**	**8,904**	**4,774**	**3,926**	**1,851**	**4,277**	**61,800**
Weighted-average remaining amortisation period, years	19	7	5	2	3	6	14

3.2.1. Intangible assets, other than goodwill (continued)

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,
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (10x10 MHz band) awarded to PJSC 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.

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 believes 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.

Nationwide 3G and 4G licences were obtained by PJSC MegaFon at nominal cost in 2007 and 2012, respectively, but require the Company to meet certain conditions, including capital commitments and coverage requirements *(Note 5.7)*.

Acquisitions

In August 2015 MegaFon acquired 900/1,800 MHz band spectrum in the Samara, Astrakhan, Yaroslavl regions and the Chuvash Republic through the purchase of 100% of the shares of JSC SMARTS-Samara, CJSC Astrakhan GSM, CJSC Yaroslavl GSM and CJSC SMARTS-Cheboksary (together "SMARTS"), the subsidiaries of Russian regional mobile operator JSC SMARTS. The Group's management concluded that assets and activities of the acquired companies are not capable of being conducted and managed as a business, accordingly the acquisition of SMARTS was accounted for as an acquisition of assets. The purchase price totaled 5,745 at the date of acquisition, consisting of cash consideration of 5,505 and a deferred payment with a fair value of 240 payable within six months from the date of acquisition *(Note 3.4)*.

In October 2015 the Company successfully bid for 1800 MHz band spectrum in the Republic of Dagestan and the Karachay-Cherkess Republic pursuant to a frequency distribution auction conducted by the Federal Service for Supervision of Communications, Information Technology, and Mass Media of the Russian Federation ("Roskomnadzor"). The total consideration for the spectrum is 1,260.

3.2.2. Goodwill

Accounting policies

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.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Disclosures

The changes in the carrying value of goodwill, net of accumulated impairment losses of nil, for the years ended 31 December 2015 and 2014 are as follows:

	2015	2014
Balance at beginning of year	32,292	31,899
Acquisitions *(Note 5.3)*	1,641	374
Measurement period adjustments	(24)	19
Balance at end of year	**33,909**	**32,292**

3.2.3. Goodwill impairment

Accounting policies

Goodwill is not subject to amortisation and is tested annually for impairment as of 1 October or more frequently whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

3.2.3. Goodwill impairment (continued)

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. The Group has identified and recognised the following CGUs: 1) integrated telecominucation services group of CGUs and 2) broadband internet CGU. 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.

An impairment loss of associated goodwill is recognised for the amount by which the CGU's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) a CGU's fair value less costs to sell and (2) value in use. The recognised impairment loss is not subsequently reversed.

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.

Goodwill impairment test

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 2015, 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 2015 or 2014.

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

	31 December	
	2015	2014
Integrated telecommunication services (group of CGUs)	25,384	25,480
Broadband internet CGU	6,927	6,812
Total allocated goodwill	**32,311**	**32,292**
Unallocated:		
GARS *(Note 5.3)*	1,598	—
Total goodwill	**33,909**	**32,292**

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

Integrated telecommunication services (group of CGUs)

Investment in the Euroset joint venture *(Note 3.3)* and the net assets of the Company's own retail network have been allocated to the integrated telecommunication services group of CGUs. In 2015 the management of the Group conducted an analysis of Euroset's operations and concluded that it shall be allocated to the integrated telecommunication services group of CGUs starting from 2015. This was due to the increasing control over and integration with retail network leading to reduction of subscriber acquisition costs and realisation of synergies together with integration of handsets and telecommunication services (bundled offerings). Thus, cash flows of Euroset and the Company's own retail network are no longer considered largely independent of those from the 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 operating income before depreciation and amortisation ("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 any change in any of these key assumptions which can currently 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.

3.2.3. Goodwill impairment (continued)

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 2016 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 better 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	
	2015	2014
Growth of ARPU for retail customers during the forecast period by	1.0%-5.0%	5.0%
Pre-tax discount rate	12.8%	16.3%
Market share in Moscow (in terms of retail customer base)	6.6%-6.9%	7.1%
Annual salary growth rate during the forecast period	5.9%-8.2%	7.5%
CAPEX/Revenue ratio from 2020/2018	10.5%	10.5%

Revenue growth is projected based on market share dynamics, ARPU 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 to 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. The discount rate decreased since last year consistent with the general decrease in market interest rates over the year.

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 321. 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 in each region during the forecast period reducing to	0.2%
Pre-tax discount rate increasing to	13.0%
Market share in Moscow reducing to	6.0%
Annual salary growth rate during the forecast period increasing to	7.1%
CAPEX/Revenue ratio from 2020 increasing to	11.1%

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

3.3. Investments in associates and joint ventures

Accounting policies

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/(loss) 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 to the extent of the Group's interest 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.

Notes to the consolidated financial statements (continued)

3.3. Investments in associates and joint ventures (continued)

Impairment

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 Group's investment in associate or joint venture and its carrying value, then recognises its share of the loss as 'Share of profit/(loss) of associates and joint ventures' within profit or loss.

Disclosures

Investments in associates and joint ventures are as follows:

Investee	% equity interest	31 December 2015	31 December 2014
LLC Euroset-Retail ("Euroset"), joint venture	50.000	34,174	34,762
CJSC Sadovoe Koltso ("Garden Ring"), joint venture	49.999	13,529	—
Other investments - associates		182	182
Total		**47,885**	**34,944**

Garden Ring

On 9 October 2015 MegaFon acquired 49.999% of the shares of Glanbury Investments Limited ("Glanbury"), which holds 100% of the shares of CJSC Sadovoe Koltso ("Garden Ring"), which owns and operates an office building in the center of Moscow.

Under the transaction, the Group is required to pay approximately $282 million (17,550 at the exchange rate as of the date of acquisition) for its share in Glanbury and loans receivable from Garden Ring transferred from seller as part of the deal *(Note 3.4)*. By 31 December 2015 the Group has paid $252 million (15,759 at the exchange rates as of the payment dates) to the seller, including purchase of Garden Ring debt of $63.6 million (3,960 at the exchange rates as of the payment date), and the remaining portion of the consideration is being deferred for up to one year with interest charged at 2.5% per annum.

Simultaneously MegaFon has entered into a joint venture agreement for the operation of the building with Sberbank Investments Limited, a subsidiary of PJSC Sberbank ("Sberbank"), which owns another 49.999% in Glanbury, and with Woodsworth Investments Limited, an independent real estate developer, which owns the remaining 0.002% in Glanbury.

MegaFon has signed a ten-year lease agreement with Garden Ring for a part of the building. This building will become the new corporate headquarters of the Group, permitting the consolidation of the Group's operations in Moscow into a single location. At 31 December 2015 the amount of the commitment in relation to this lease is approximately 16,000. The remaining part of the building will be leased by Sberbank.

The Garden Ring joint venture is accounted for using the equity method in the consolidated financial statements.

The reconciliation of summarised financial information of Garden Ring to the carrying amount of the Group's interest in the joint venture as of 31 December 2015 is presented below:

Assets	
Non-current assets	49,295
Cash and cash equivalents	1,630
Other current assets	770
	51,695
Liabilities	
Non-current financial liabilities	(22,350)
Other non-current liabilities	(5,714)
Current financial liabilities	(4,437)
	(32,501)
Total identifiable net assets	**19,194**
The Group's share in the joint venture	49.999%
The Group's share of identifiable net assets	9,597
Excess of the consideration transferred over the Group's share in the fair value of identifiable net assets	3,932
Carrying amount of the Group's interest as of 31 December 2015	**13,529**

Notes to the consolidated financial statements (continued)

3.3. Investments in associates and joint ventures (continued)

The composition of the Group's share of loss of the joint venture accounted for using the equity method from 9 October to 31 December 2015 is as follows:

Loss and total comprehensive loss of Garden Ring	(65)
Amortisation of the Group's purchase price allocation adjustments and application of the Group's accounting policies	(57)
Loss and total comprehensive loss of the joint venture	**(122)**
The Group's share in the joint venture	49.999%
The Group's share of the loss and total comprehensive loss of Garden Ring	**(61)**

Euroset

Euroset is a retail chain, whose primary activities are sales of mobile phones, audio devices, other portable gadgets and accessories, and provision of customer subscription and payment collection services for major telecommunication operators in Russia.

The Euroset joint venture is accounted for using the equity method in the consolidated financial 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 the opportunity for prominent marketing of MegaFon services in Euroset outlets *(Note 3.2.3).*

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

	31 December	
	2015	2014
Assets		
Non-current assets	34,970	38,934
Cash and cash equivalents	8,363	12,711
Other current assets	18,733	17,135
	62,066	**68,780**
Liabilities		
Non-current financial liabilities	(1,340)	(8,660)
Other non-current liabilities	(5,365)	(6,928)
Current financial liabilities	(8,690)	(1,371)
Other current liabilities	(18,352)	(22,326)
	(33,747)	**(39,285)**
Total identifiable net assets	**28,319**	**29,495**
The Group's share in the joint venture	50%	50%
The Group's share of identifiable net assets	14,160	14,748
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	**34,174**	**34,762**

3.3. Investments in associates and joint ventures (continued)

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

	Year ended 31 December	
	2015	2014
Profit of Euroset	1,481	868
Amortisation of the Group's purchase price allocation adjustments and application of the Group's accounting policies	(2,604)	(1,899)
Loss of the joint venture	**(1,123)**	**(1,031)**
Other comprehensive loss of Euroset	(54)	—
Total comprehensive loss of the joint venture	**(1,177)**	**(1,031)**
The Group's share in the joint venture	50%	50%
The Group's share of the loss and total comprehensive loss of Euroset	**(588)**	**(516)**

3.4. Financial assets and liabilities

Accounting policies

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.

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 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.

3.4. Financial assets and liabilities (continued)

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.

Disclosures

Financial assets are as follows:

	31 December	
	2015	2014
Trade and other receivables *(Note 3.5)*	21,156	16,260
Other financial assets:		
Financial assets at fair value through profit or loss:		
Cross-currency swap not designated as hedge	1,456	1,533
Total financial assets at fair value through profit or loss	**1,456**	**1,533**
Financial assets at fair value through OCI:		
Cross-currency swap designated as cash flow hedge	1,903	2,082
Total financial assets at fair value through OCI	**1,903**	**2,082**
Loans and receivables at amortised cost:		
Short-term bank deposits in Rubles	12	15,730
Short-term bank deposits in US dollars	20,224	4,346
Short-term bank deposits in HK dollars	—	27,458
Loans receivable from Garden Ring *(Notes 3.3, 5.2)*	4,061	—
Other deposits	3,419	—
Bank promissory notes	—	601
Total loans and receivables at amortised cost	**27,716**	**48,135**
Total other financial assets	**31,075**	**51,750**
Other current financial assets	**(26,973)**	**(48,887)**
Other non-current financial assets	**4,102**	**2,863**
Total financial assets	**52,231**	**68,010**
Total current financial assets	**(48,129)**	**(65,147)**
Total non-current financial assets	**4,102**	**2,863**

Other deposits

Other deposits consist of cash advances received under certain contracts with customers and reserved in bank accounts as well as cash reserved for deferred and contingent consideration settlements under the sale and purchase agreement with the sellers of GARS *(Note 5.3).*

3.4. Financial assets and liabilities (continued)

Financial liabilities are as follows:

	31 December	
	2015	2014
Trade and other payables	45,961	36,549
Financial liabilities at amortised cost:		
Loans and borrowings:		
Bank loans	96,390	95,140
Equipment financings	85,717	74,964
Ruble bonds	37,573	37,364
Total loans and borrowings	**219,680**	**207,468**
Total current loans and borrowings	**(47,037)**	**(51,149)**
Total non-current loans and borrowings	**172,643**	**156,319**
Other financial liabilities at amortised cost:		
Finance lease obligations *(Notes 3.1, 5.7)*	3,504	—
Deferred and contingent consideration *(Notes 3.3, 5.3)*	3,209	7,407
Long-term accounts payable	1,048	1,325
Due to employees and related social charges, non-current	109	5
Total financial liabilities at amortised cost	**227,550**	**216,205**
Other financial liabilities at fair value:		
Financial liabilities at fair value through profit or loss:		
Cross-currency swap not designated as hedge	7	16
Total financial liabilities at fair value through profit or loss	**7**	**16**
Financial liabilities at fair value through OCI:		
Interest rate swaps designated as cash flow hedges	41	215
Cross-currency swaps designated as cash flow hedges	15	33
Total financial liabilities at fair value through OCI	**56**	**248**
Total other financial liabilities	**7,933**	**9,001**
Other current financial liabilities	**(2,900)**	**(7,731)**
Other non-current financial liabilities	**5,033**	**1,270**
Total financial liabilities	**273,574**	**253,018**
Total current financial liabilities	**(95,898)**	**(95,429)**
Total non-current financial liabilities	**177,676**	**157,589**

Settlement of Scartel deferred consideration

On 1 October 2015 the Group fully paid the deferred consideration for Scartel acquisition. The payment was in the amount of $120 million plus interest at 6% per annum accrued thereon from the closing date, 1 October 2013 (8,863 as of the payment date).

3.4.1. Cash and cash equivalents

Accounting policies

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

3.4.1. Cash and cash equivalents (continued)

Disclosures

Cash and cash equivalents are as follows:

	31 December 2015	31 December 2014
Cash at bank and on hand in		
Rubles	4,012	4,264
US dollars	777	4,866
Euros	77	110
HK dollars	19	1,919
Short-term bank deposits in		
Rubles	2,251	2,411
US dollars	10,313	5,825
HK dollars	—	2,828
Total cash and cash equivalents	**17,449**	**22,223**

3.4.2. Loans and borrowings

Principal amounts outstanding under loans and borrowings are as follows:

	Weighted-Average Interest Rate	Maturity	31 December 2015	31 December 2014
Bank loans:				
Ruble loans – fixed rates	10.62%	2016-2020	96,047	92,072
US dollar loans – floating rates	LIBOR+5.2%	2016	729	3,375
Total bank loans			**96,776**	**95,447**
Equipment financings:				
Ruble loans – fixed rates	10.00%	2016-2019	846	734
US dollar loans – fixed rates	2.24%	2016-2022	14,047	9,521
US dollar loans – floating rates	LIBOR+2.28%	2016-2022	68,016	61,339
Euro loans – floating rates	EURIBOR+2.05%	2016-2019	3,433	3,785
Euro loans – fixed rates	3.64%		—	310
Total equipment financings			**86,342**	**75,689**
Ruble bonds	9.48%	2022-2024 with a put option in 2016-2018	**36,751**	**36,751**
Total			**219,869**	**207,887**
Total current			**(46,072)**	**(50,299)**
Total non-current			**173,797**	**157,588**

Bank loans

In December 2015 the Group signed a new revolving credit loan for up to 30,000 for up to a five-year term. The facility can be used for general operating purposes. In December 2015 the Group drew down 15,000 for three years at a fixed rate. The amounts have been used to refinance more expensive loans.

In December 2015 the Group signed a new credit facility agreement for up to $300 million (21,865 at the exchange rate as of 31 December 2015). The credit facility must be used to refinance a portion of the Group's existing debt, and is repayable in the period from December 2018 to December 2021. As of 31 December 2015 no amount has been drawn under this credit facility.

3.4.2. Loans and borrowings (continued)

Equipment financing facilities

In March 2015 the Group drew down approximately $93.5 million (6,815 at the exchange rate as of 31 December 2015) under the $150 million agreement for equipment financing signed in February 2014. As of 31 December 2015, this credit facility has been fully drawn.

In June 2015 the Group signed a new credit facility agreement for up to Euro 150 million (11,955 at the exchange rate as of 31 December 2015). The credit facility must be used to finance purchases of equipment and related services and requires the Group to make semi-annual payments, including accrued interest, over the period from 2016 to 2024. As of 31 December 2015 no amount has been drawn under this credit facility.

In December 2015 the Group signed a new credit facility agreement for up to $300 million (21,865 at the exchange rate as of 31 December 2015) in total. The credit facility must be used to finance purchases of equipment and related services, and is for an eight-year term. As of 31 December 2015 no amount has been drawn under this credit facility.

In December 2015 the Group signed a new credit facility agreement for a Ruble equivalent of up to Euro 70 million (5,579 at the exchange rate as of 31 December 2015). The credit facility must be used to finance purchases of equipment and related services, and is repayable in the period from December 2017 to December 2025. As of 31 December 2015 no amount has been drawn under this credit facility.

In December 2015 the Group drew down approximately $40.9 million (2,981 at the exchange rate as of 31 December 2015) under $500 million (36,441 at the exchange rate as of 31 December 2015) agreement for equipment financing signed in June 2011. As of 31 December 2015 this credit facility has been fully drawn.

Ruble bonds

In April 2015 the Group decided to repay its Series BO-04 Ruble bonds in full on the second anniversary of the placement date. The payment of the principal amount of 15,000 was made in full in May 2015.

In October 2015 the Group placed its Series BO-05 Ruble denominated exchange bonds, in an aggregate principal amount of 15,000. The bonds have a term of 10 years following placement, subject to a put option exercisable by the bondholders on the second anniversary of the placement date. The coupon rate was set at 11.4% per annum, payable semiannually, and will be revised in two years from the bonds' placement. Proceeds from the bonds will be used for general corporate purposes, including the refinancing of the Group's existing liabilities.

Covenant requirements

The majority of the Company's 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.

3.4.3. Derivative financial instruments and hedging activities

Accounting policies

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.

The Group has derivatives which it designated as cash flow hedges and derivatives which it did not designate as hedges. 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.

3.4.3. Derivative financial instruments and hedging activities (continued)

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

Disclosures

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

		31 December 2015		31 December 2014	
	Original currency	Millions, original currency	Millions, Rubles	Millions, original currency	Millions, Rubles
Interest rate swaps:					
designated as cash flow hedge	US Dollar	217	15,816	460	25,879
Total interest rate swaps			**15,816**		**25,879**
Cross-currency swaps:					
designated as cash flow hedge	US Dollar	46	3,353	76	4,276
not designated as cash flow hedge	US Dollar	225	16,399	464	26,104
Total cross-currency swaps			**19,752**		**30,380**

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 2015 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.

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:

	2015	2014
Interest rate swaps:		
Amount of loss recognised in cash flow hedge reserve	(35)	(61)
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	216	216
Deferred tax on movements in OCI	(36)	(31)
	145	**124**
Cross-currency swap:		
Amount of gain recognised in cash flow hedge reserve	825	1,981
Amount of gain reclassified from accumulated cash flow hedge reserve into foreign exchange loss, net	(1,067)	(1,899)
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	58	134
Deferred tax on movements in OCI	37	(43)
	(147)	**173**
Total in OCI	**(2)**	**297**

3.4.3. Derivative financial instruments and hedging activities (continued)

At 31 December 2015 the amount recorded in OCI which is expected to be reclassified to profit or loss in the next twelve months is 1,254 (gain), the remaining gain of 651 is expected to affect the earnings in 2017.

Derivatives not designated as hedging instruments

At 31 December 2015 the Group had two cross-currency swap agreements that limit the exposure from changes in US dollar exchange and interest rates on certain long-term debt.

In February 2015 the Group amended its cross-currency swap agreement with a remaining notional amount of $204 million (14,868 at the exchange rate as of 31 December 2015) by changing the swap rate for all the remaining swap payments.

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

Gain/(loss) on financial instruments

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

	2015	2014
Change in fair value of financial instruments measured through profit or loss:		
Cross-currency swaps not designated as hedges	1,502	(485)
Euroset settlement put option	—	435
Total gain/(loss) on financial instruments, net	**1,502**	**(50)**

3.4.4. Fair values

Accounting policies

The fair value of financial instruments recorded in the consolidated statement of financial position and/or disclosed in the notes 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 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.

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.

3.4.4. Fair values (continued)

Disclosures

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 consolidated financial statements:

		Carrying amount		Fair value	
		31 December		31 December	
		2015	2014	2015	2014
Financial assets:					
Financial assets at fair value through profit or loss:					
Cross-currency swaps not designated as hedge	Level 2	1,456	1,533	1,456	1,533
Financial assets at fair value through OCI:					
Cross-currency swap designated as cash flow hedge	Level 2	1,903	2,082	1,903	2,082
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	20,236	47,534	20,236	47,534
Loans receivable from Garden Ring *(Note 5.2)*	Level 2	4,061	—	4,061	—
Other deposits	Level 2	3,419	—	3,178	—
Bank promissory note	Level 2	—	601	—	601
Total financial assets		**31,075**	**51,750**	**30,834**	**51,750**
Financial liabilities:					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	182,107	170,104	185,841	161,981
Ruble bonds	Level 1	37,573	37,364	35,696	34,664
Deferred and contingent consideration	Level 3	3,209	7,407	3,209	7,407
Finance lease obligations	Level 3	3,504	—	3,504	—
Long-term accounts payable	Level 3	1,048	1,325	1,200	1,325
Financial liabilities at fair value through profit or loss:					
Cross-currency swap not designated as hedge	Level 2	7	16	7	16
Financial liabilities at fair value through OCI:					
Interest-rate swaps designated as cash flow hedges	Level 2	41	215	41	215
Cross-currency swaps designated as cash flow hedges	Level 2	15	33	15	33
Due to employees and related social charges, non-current	Level 3	109	5	109	5
Total financial liabilities		**227,613**	**216,469**	**229,622**	**205,646**

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.

The GARS escrow account (included in 'Other deposits' in the above table) holds cash reserved for deferred and contingent consideration settlements under the sale and purchase agreement with the sellers of GARS *(Note 5.3)*. The fair value of the account approximates its carrying value.

The fair value of the Group's other deposits relating to cash received under certain contracts with customers is determined by using a discounted cash flow method using a discount rate that reflects the bank deposit rates the Group would get in the market as at the end of the reporting period.

The fair values of the Group's loans and borrowings and other liabilities carried at amortised cost, 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 2015 and 2014 was assessed to be insignificant.

Notes to the consolidated financial statements (continued)

3.4.4. Fair values (continued)

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 5.4).*

Valuation techniques and assumptions

The fair values of interest rate swaps and cross-currency swaps are based on a forward yield curve and represent the estimated amount the Group would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, foreign exchange spot and forward rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

The Group estimated the fair value of the GARS contingent consideration of 314 and the SMARTS deferred consideration of 240 using a probability-weighted cash flow model. These fair value measurements are based on significant inputs not observable in the market and thus represent a Level 3 measurement. The fair value of the Garden Ring deferred consideration approximates its carrying value.

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

	Cross-currency swaps	Total financial assets	Interest rate/cross-currency swaps	Total financial liabilities
31 December 2015				
Level 1	—	—	—	—
Level 2	3,359	3,359	(63)	(63)
Level 3	—	—	—	—
Total as of 31 December 2015	**3,359**	**3,359**	**(63)**	**(63)**
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)**

During the years ended 31 December 2015 and 31 December 2014 there were no transfers between levels of the fair value hierarchy.

3.5. Trade and other receivables

The ageing analysis of trade and other receivables that are not impaired is as follows:

	31 December	
	2015	2014
Neither past due nor impaired	17,675	14,342
Past due but not impaired:		
Less than 30 days	2,159	703
30 - 90 days	1,037	768
More than 90 days	285	447
Total trade and other receivables	**21,156**	**16,260**

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

	2015	2014
Balance at beginning of year	1,522	1,462
Change in the impairment allowance	1,643	1,216
Accounts receivable written off	(948)	(1,156)
Balance at end of year	**2,217**	**1,522**

Notes to the consolidated financial statements (continued)

3.6. Inventory

Accounting policies

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.

Disclosures

The amount of inventory write-down to net realisable value and other inventory losses recognised in 'Cost of revenue' line in the statement of comprehensive income for the year ended 31 December 2015 is 2,004 (2014: 2,202).

3.7. Non-financial assets and liabilities

Accounting policies

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.

Disclosures

Current non-financial assets are as follows:

	31 December	
	2015	2014
Prepayments for services	3,994	2,473
VAT receivable	1,481	1,274
Deferred costs	972	1,096
Prepaid taxes, other than income tax	163	235
Prepayments for inventory	39	83
Total current non-financial assets	**6,649**	**5,161**

Non-current non-financial assets are as follows:

	31 December	
	2015	2014
Deferred costs, non-current	2,441	1,581
Long-term advances	453	472
Total non-current non-financial assets	**2,894**	**2,053**

Notes to the consolidated financial statements (continued)

3.7. Non-financial assets and liabilities (continued)

Current non-financial liabilities are as follows:

	31 December	
	2015	2014
Advances from customers	12,809	11,414
VAT payable	4,482	5,596
Current portion of deferred revenue	1,677	1,894
Taxes payable, other than income tax	1,542	1,573
Other current liabilities	57	16
Total current non-financial liabilities	**20,567**	**20,493**

Non-current non-financial liabilities are as follows:

	31 December	
	2015	2014
Deferred revenue	2,377	1,309
Advance received for sale of property and equipment	—	327
Other non-current liabilities	58	76
Total non-current non-financial liabilities	**2,435**	**1,712**

3.8. Provisions

Accounting policies

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 provision

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 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, except where a reduction in the provision is greater than the unamortised capitalised cost, in which case the capitalised cost is reduced to nil and the remaining adjustment is recognised in the statement of comprehensive income.

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.

3.8. Provisions (continued)

Disclosures

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

	2015	2014
Balance at beginning of year	4,958	5,355
Revisions in estimated cash flows	(1,097)	(1,234)
Net additions	140	289
Unwinding of discount	602	548
Balance at end of year	**4,603**	**4,958**

Revisions in estimated cash flows during the years ended 31 December 2015 and 2014 in the table above mainly relate to a decrease in expected decommissioning costs per item, which reduced buildings and structures cost in property and equipment *(Note 3.1)* by 314 (2014: 889) and depreciation expense in profit or loss by 783 (2014: 345).

4. Equity

Accounting policies

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.

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.

Disclosures

Share capital

As of 31 December 2015 and 2014, the Company had 100,000,000,000 authorised ordinary shares with a par value of 0.1 Rubles, of which 595,700,967 were issued and outstanding and 24,299,033 were issued treasury shares (held through its wholly owned subsidiary, MegaFon Investments (Cyprus) Limited).

Annual dividend payment

On 30 June 2015 the Annual General Meeting of Shareholders of the Company approved the payment of dividends for the 2014 financial year in the amount of 9,609, or 16.13 Rubles per ordinary share (or GDR). Such dividends were paid in full in August 2015.

On 11 December 2015 an Extraordinary General Meeting of Shareholders of the Company approved an additional 38,428 dividend payment, equivalent to 64.51 Rubles per ordinary share (or GDR), which was fully paid in December 2015.

Accordingly, the total amount of dividends distributed in 2015 is 48,038, or 80.64 Rubles per ordinary share (or GDR).

4. Equity (continued)

Other capital reserves

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 compensation reserve	Transactions with non-controlling interests	Reserve fund	Total other capital reserves
As of 1 January 2014	**(123)**	**(125)**	**799**	**(23)**	**15**	**543**
Foreign currency translation	(968)	—	—	—	—	**(968)**
Change in fair value of cash flow hedges *(Note 3.4.3)*	—	297	—	—	—	**297**
Share-based compensation *(Note 5.1)*	—	—	689	—	—	**689**
As of 31 December 2014	**(1,091)**	**172**	**1,488**	**(23)**	**15**	**561**
Foreign currency translation	(792)	—	—	—	—	**(792)**
Change in fair value of cash flow hedges *(Note 3.4.3)*	—	(2)	—	—	—	**(2)**
As of 31 December 2015	**(1,883)**	**170**	**1,488**	**(23)**	**15**	**(233)**

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

The cash flow hedge reserve is used to record the accumulated impact of derivatives designated as cash flow hedges *(Note 3.4.3)*.

The 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 5.1)*.

The 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.

The 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.

5. Additional Notes

5.1. Share-based compensation

Accounting policies

Equity-settled transactions

The cost of equity-settled transactions, such as stock options under the CEO long-term incentive plan, 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 2.3)*. 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, 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 benefits and related social charges expense *(Note 2.3)*.

5.1. Share-based compensation (continued)

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 below.

Disclosures

Long-term incentive programmes 2012 and 2013

In 2012 and 2013 the Company's Board of Directors approved two long-term incentive programmes (LTI 2012 and LTI 2013) for certain key executive and senior level employees under which the parties selected to participate are awarded rights to phantom shares. The maximum number of phantom shares which could be awarded under each plan was 1.1% of the share capital of the Company (or 14,000,000 phantom shares in the aggregate) at the base price of $17.86 per share under LTI 2012 and $24.25 per share under LTI 2013.

Each plan had a three year duration and rights to phantom shares vest, and payments due to awardees are settled, in the second and third years. Awardees receive payments on the basis of the difference between the base price and the weighted-average price of the Company's shares n the period between January 15 and March 15 in the relevant year of vesting (the strike price).

In 2015 the Board of Directors of the Company approved an amendment to the terms of LTI 2012 and LTI 2013 to change the base price and the strike price for the awards outstanding as at 31 December 2014 and 2015 to 555 Rubles per share and 744 Rubles per share, respectively, for which settlement was due in April-May 2015 and April-May 2016.

The respective awards under LTI 2012 and LTI 2013 are classified as liabilities. The fair value of the phantom share rights had 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 the Group over the period equal to the expected life of the rights granted. The dividend yield is included in the model based on expected dividend payments. The risk free rate is determined on the basis of the key rate of the Central Bank of Russia with a remaining term to maturity equal to the expected life of the rights. The expected term of the rights equals their vesting term as the rights are settled in cash at the end of the relevant vesting period.

	LTI 2012		LTI 2013	
	2015	2014	2015	2014
Employee benefits expense/(reversal) recognised during the year ended 31 December, including related social charges	569	(186)	98	5
The fair value of rights outstanding at 31 December, Rubles per right to phantom share	—	—	102	8
The carrying amount of the liability at 31 December, including related social charges	—	—	102	5

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 purchased 2.5% of the Group's total issued shares at the IPO price of $20 per share in 2012 and 2013. The remaining 15,500,000 options to buy up to a further 2.5% of the total issued shares at the IPO price could be exercised in May 2014 and May 2015 or subsequently, up till May 2017.

In 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 2.5% interest in the Company, so that all the remaining options became exercisable 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 2014.

In December 2014 Mr. Tavrin exchanged his 2.5% interest in the Company and the 15,500,000 unexercised options for an interest in USM Holdings Limited ("USMHL") *(Note 5.2)*.

5.2. Related parties

In August 2014 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.

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	
	2015	2014
Revenues from USM Group	52	31
Revenues from TeliaSonera Group	640	838
Revenues from Euroset	110	167
	802	**1,036**
Services from USM Group	979	883
Services from TeliaSonera Group	1,436	1,817
Services from Euroset	1,228	1,274
Services from Garden Ring	320	—
	3,963	**3,974**

	31 December	
	2015	2014
Due from USM Group	477	13
Due from TeliaSonera Group	305	388
Due from Euroset	403	379
Due from Garden Ring	4,643	—
	5,828	**780**
Due to USM Group	809	7,476
Due to TeliaSonera Group	414	638
Due to Euroset	12	3
Due to Garden Ring	63	—
	1,298	**8,117**

Terms and conditions of transactions with related parties

Outstanding balances at the years ended 31 December 2015 and 2014 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 31 December 2015 and 2014, 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 2015 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 5,343 and 1,979 during 2015 and 2014, respectively.

Amounts due to USM Group as of 31 December 2014 mainly represent the deferred consideration for the Scartel acquisition *(Note 3.4).*

5.2. Related parties (continued)

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’s accrued contributions to the Partnership of 1,826 during the year ended 31 December 2015 (2014: 1,089) are included into other non-operating expenses in the consolidated statement of comprehensive income.

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 PJSC VimpelCom *(Note 3.3)*. The Group has a dealership agreement with Euroset which qualifies as a related party transaction.

Garden Ring

Garden Ring is the Group’s joint venture with Sberbank *(Note 3.3)*. The Group has a lease agreement with Garden Ring which qualifies as a related party transaction. The Group also has loan receivable from Garden Ring which it acquired together with the shares of Glanbury. The balance due from Garden Ring at 31 December 2015 consists of the loan receivable and an advance payment under the lease agreement.

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:

	2015	2014
Short-term employee benefits	520	603
Share-based compensation *(Note 5.1)*	246	593
Long-term incentive programme	179	12
Total	**945**	**1,208**

5.3. Business combinations

Accounting policies

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.

The identification of assets acquired and liabilities assumed as a result of those acquisitions, determining the fair value of assets acquired and liabilities assumed as well as any contingent consideration and quantification of resulting goodwill 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, terminal growth 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 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.

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

Notes to the consolidated financial statements (continued)

5.3. Business combinations (continued)

2015 acquisitions

GARS

On 18 September 2015 the Group acquired 100% of the shares of GARS Holding Limited ("GARS"), which is a building local exchange carrier providing a full range of fixed-line telecommunication services to the tenants of business centers in Moscow and Saint Petersburg, for a total consideration having a fair value of 2,213 at the date of acquisition, consisting of cash consideration of 1,542 and deferred and contingent consideration of 671.

The primary reason for the acquisition was to further enhance the Group's position in the fixed-line telecommunications market in Moscow and Saint Petersburg.

Contingent consideration, whose payment depends on the satisfaction of certain conditions, has been ascribed a fair value of $5 million (314 at the exchange rate as of 18 September 2015), approximating the maximum possible amount which is payable within eight months from the date of acquisition. Deferred consideration of approximately $5 million (357 at the exchange rate as of 18 September 2015) is payable on or prior to the second anniversary of the acquisition date.

The acquisition of GARS was accounted for using the acquisition method. The valuation of certain acquired assets and liabilities assumed has not been finalised as of the date these consolidated financial statements were authorised for issue; thus, the provisional measurements of certain intangible and tangible assets, deferred taxes and goodwill are subject to change.

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

Assets	
Property and equipment	328
Intangible assets	458
Deferred tax assets	24
Other current assets	179
Cash and cash equivalents	75
	1,064
Liabilities	
Loans and borrowings	158
Deferred tax liabilities	80
Non-current non-fiancial liabilities	17
Current liabilities	194
	449
Total identifiable net assets at fair value	**615**
Goodwill arising on acquisition	1,598
Purchase consideration transferred	**2,213**

The goodwill recognised is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of GARS.

From the date of acquisition, GARS contributed 392 to revenue and 38 to profit before tax of the Group. If the combination had taken place at the beginning of the year, revenue of the Group for the year ended 31 December 2015 would have been 314,281 and profit before tax would have been 51,942.

The Group recognised GARS acquisition-related costs as general and administrative expenses in the amount of 7 for the year ended 31 December 2015 in the consolidated statement of comprehensive income.

5.3. Business combinations (continued)

Startel

In December 2015 the Group acquired 100% interest in CJSC Startel, which provides a full range of fixed-line telecommunication services to business clients in Moscow and Tver, for a cash consideration of 48, of which 21 is deferred for up to one year. The resulting goodwill is 43.

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 cash consideration of 381, of which 150 was contingent consideration deferred for up to one year. In 2015, the contingent consideration was reduced by 26 and the remaining 124 was fully paid by the Group. Goodwill on these acquisitions amounted to 374.

5.4. 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 2015 and 2014. 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 2015 and 2014.

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, under 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.

At 31 December 2015, after taking into account the effect of interest rate swaps, approximately 78% of the Group's borrowings are at a fixed rate of interest (2014: 86%).

Notes to the consolidated financial statements (continued)

5.4. Financial risk management (continued)

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 2015		
US Dollar	+95	(418)
US Dollar	-95	418
Year ended 31 December 2014		
US Dollar	+2	(7)
US Dollar	-2	7

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.

Before 2015 the Group entered into three long-term cross-currency swaps. 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 3.4)*.

Overall, the share of Ruble loans (including the effect of cross-currency swaps) amounted to 63% as of 31 December 2015 (65% at 31 December 2014).

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.

5.4. Financial risk management (continued)

	Change in foreign exchange rates	Effect on profit before tax
Year ended 31 December 2015		
US Dollar	+50%	(24,807)
US Dollar	-50%	24,807
Euro	+50%	(2,063)
Euro	-50%	2,063
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)

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.

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, to certain dealers and to customers on post-paid tariff plans. 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 3.4.* 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 21% of the Group's loans and borrowings will mature in less than one year at 31 December 2015 (2014: 24%) based on the carrying value of borrowings reflected in the consolidated 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 2015 and 2014, 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.

Notes to the consolidated financial statements (continued)

5.4. 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 2015					
Loans and borrowings	61,582	147,587	48,135	4,248	261,552
Trade and other payables	45,961	—	—	—	45,961
Deferred consideration	2,865	399	—	—	3,264
Finance lease obligations	387	925	925	5,986	8,223
Long-term accounts payable	—	986	107	—	1,093
Derivative financial liabilities	63	—	—	—	63
Total 31 December 2015	**110,471**	**148,972**	**48,242**	**4,248**	**311,933**
31 December 2014					
Loans and borrowings	64,445	85,361	78,125	23,036	**250,967**
Trade and other payables	36,549	—	—	—	**36,549**
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	**108,514**	**86,561**	**78,152**	**23,090**	**296,317**

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 2015 the Net Debt to OIBDA ratio was 1.37 (2014: 0.98).

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 2015 or 2014, except certain assets purchased under finance leases or on deferred payment terms *(Note 3.1 and 3.4).*

100% of the shares of Garden Ring *(Note 3.3)* have been pledged as security for loans received by Garden Ring from Sberbank, which are due to be repaid in 2026.

5.5. Group information

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

Legal entity		Principal activities	Country of incorporation	% equity interest	
				2015	2014
OJSC MegaFon Retail	subsidiary	Retail	Russia	100	100
LLC NetByNet Holding	subsidiary	Broadband internet	Russia	100	100
LLC Scartel	subsidiary	Wireless services	Russia	100	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 3.3)*	joint venture	Retail	Russia	50	50
CJSC Sadovoe Koltso *(Note 3.3)*	joint venture	Corporate office	Russia	49.999	—

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

5.6. Segment information

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.

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 VAS. The CODM evaluates the performance of the Group's operating segments based on revenue and OIBDA. Total assets and liabilities are not allocated to operating segments and not analysed by the CODM.

Operating segments with similar economic characteristics, such as forecasted OIBDA, have been aggregated into an integrated telecommunication services segment, which is the only reportable segment. Around 1.6% 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:

	2015	2014
OIBDA	**132,357**	**138,520**
Depreciation	(48,173)	(47,431)
Amortisation	(7,313)	(7,827)
Loss on disposal of non-current assets	(913)	(1,437)
Finance costs	(14,779)	(13,792)
Finance income	2,508	1,155
Share of loss of associates and joint ventures	(649)	(516)
Other non-operating loss	(2,949)	(1,370)
Gain/(loss) on financial instruments, net	1,502	(50)
Foreign exchange loss, net	(10,041)	(16,884)
Profit before tax	**51,550**	**50,368**

5.7. 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.

During 2014 and 2015, the Russian economy was negatively impacted by a significant drop in crude oil prices and a devaluation of the Russian Ruble, as well as sanctions imposed on Russia by several countries. The Ruble interest rates have fluctuated significantly and as of 31 December 2015 the key rate of the Central Bank of Russia was at 11%.

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 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 allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401. As of the date these consolidated financial statements were authorised for issue the Group was fully compliant with these capital expenditure commitments.

5.7. Commitments, contingencies and uncertainties (continued)

Equipment purchases agreements

In 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 an amount equal to 50-60% of the fees for years four through seven of the agreements for each base station in use as at the date of termination while receiving a credit against these commitments for fees already paid. The amount of the commitments at 31 December 2015 is 14,406 (31 December 2014: 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 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 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.

In 2014 a law "On controlled foreign companies" (the "CFC law") was enacted aimed at fiscal stimulation by decreasing the number of the entities involved in the Russian economy but registered abroad, and took effect on 1 January 2015. Under the CFC law 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 on 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 2015 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 being taken by them, to be in the amount of up to approximately 966.

Finance lease commitments

The Group has finance lease contracts for various items of telecommunications assets. Under these leases the lessor retains title to the leased assetson security for the Group's obligation thereunder. Future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of 31 December 2015 are as follows:

	Minimum payments	Present value of payments
Within one year	387	387
After one year but not more than five years	1,590	1,109
More than five years	6,245	2,008
Total minimum lease payments	**8,222**	**3,504**
Less amounts representing finance charges	(4,718)	—
Present value of minimum lease payments	**3,504**	**3,504**

5.7. Commitments, contingencies and uncertainties (continued)

Operating lease commitments

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.

The Group normally enters into operating leases with a term not exceeding one year. Accordingly, the Group's operating lease commitments at 31 December 2015 and 2014 approximate the annual rent expense *(Note 2.3).*

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.

5.8. Events after the reporting date

On 8 February 2016 the Group granted Strafor Commercial Ltd a loan in the amount of $43.8 million (3,192 at the exchange rate as of 31 December 2015). The loan is repayable on 28 February 2018 together with interest at 7% per annum.

On 17 February 2016 the Company successfully bid for 2,570-2,595 MHz band spectrum in 40 regions of the Russian Federation pursuant to a frequency distribution auction conducted by Roskomnadzor. Under the terms and conditions of these spectrum licences, the Company is obligated to compensate other operators for surrendering frequencies in an aggregate amount of 378. The total consideration for the spectrum including the compensation due to the other operators is 2,199.