MEGAFON

Consolidated financial statements

For the year ended 31 December 2013

Contents

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улучшаем мир

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Independent auditors' report

The Board of Directors and Shareholders of OJSC MegaFon

We have audited the accompanying consolidated financial statements of OJSC MegaFon and its subsidiaries, which comprise the consolidated statement of financial position as of 31 December 2013, and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC MegaFon and its subsidiaries as at 31 December 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

4 March 2014

Consolidated statement of comprehensive income

(In millions of Rubles)

	Note	Years ended 31 December 2013	2012
Revenues			
Wireless services		260,459	241,074
Wireline services		18,628	17,938
Sales of equipment and accessories		18,142	13,324
Total revenues		**297,229**	**272,336**
Operating expenses			
Cost of services		57,563	54,555
Cost of equipment and accessories		17,829	12,399
Sales and marketing expenses	27	18,687	19,747
General and administrative expenses	28	70,558	68,486
Depreciation	14	44,851	45,508
Amortisation	15	6,131	6,046
Loss on disposal of non-current assets		1,200	1,713
Total operating expenses		**216,819**	**208,454**
Operating profit		**80,410**	**63,882**
Finance costs	17	(12,184)	(7,718)
Finance income		1,888	1,193
Share of profit/(loss) of associates and joint ventures	10	(202)	213
Other non-operating income/(loss)		(81)	191
Gain on financial instruments, net	17	269	6,348
Foreign exchange loss, net		(2,914)	(8,196)
Profit before tax		**67,186**	**55,913**
Income tax expense	12	15,416	11,466
Profit for the year		**51,770**	**44,447**

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 2013	2012
Other comprehensive income/(loss)			
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax		(188)	88
Net movement on cash flow hedges, net of tax	17	136	(261)
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		**(52)**	**(173)**
Total comprehensive income for the year, net of tax		**51,718**	**44,274**
Profit for the year			
Attributable to equity holders of the Company		51,608	44,393
Attributable to non-controlling interest		162	54
Total comprehensive income for the year			
Attributable to equity holders of the Company		51,600	44,198
Attributable to non-controlling interest		118	76
Earnings per share, Rubles			
Basic, profit for the year attributable to ordinary equity holders of the Company	13	91	79
Diluted, profit for the year attributable to ordinary equity holders of the Company	13	89	79

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

MegaFon

Consolidated statement of financial position

(In millions of Rubles)

	Note	As of 31 December 2013	2012
Assets			
Non-current assets			
Property and equipment	14	221,805	215,549
Intangible assets, other than goodwill	15	57,776	16,991
Goodwill	9, 15	31,530	23,950
Investments in associates and joint ventures	10	35,460	35,662
Non-current financial assets	17	425	—
Non-current non-financial assets	18	1,300	1,956
Deferred tax assets	12	3,673	2,573
Total non-current assets		**351,969**	**296,681**
Current assets			
Inventory	19	8,376	5,277
Current non-financial assets	18	5,960	4,963
Prepaid income taxes	12	2,777	5,066
Trade and other receivables	20	10,732	13,542
Other current financial assets	17	39,296	23,449
Cash and cash equivalents	21	9,939	2,387
Total current assets		**77,080**	**54,684**
Assets held for sale	22	1,516	—
Total assets		**430,565**	**351,365**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	7	138,034	117,355
Non-controlling interests		271	518
Total equity		**138,305**	**117,873**
Non-current liabilities			
Loans and borrowings	17	130,825	125,575
Other non-current financial liabilities	17	20,838	501
Non-current non-financial liabilities	18	1,170	1,843
Provisions	23	5,355	5,724
Deferred tax liabilities	12	17,844	12,333
Total non-current liabilities		**176,032**	**145,976**
Current liabilities			
Trade and other payables	24	33,875	23,723
Loans and borrowings	17	21,184	20,457
Other current financial liabilities	17	40,785	23,282
Current non-financial liabilities	18	19,490	20,037
Income taxes payable	12	894	17
Total current liabilities		**116,228**	**87,516**
Total equity and liabilities		**430,565**	**351,365**

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	Total	Non-controlling interests	Total equity
As of 1 January 2012		**620,000,200**	**526**	—		**12,567**	**260,957**	**(53)**	**273,997**	**523**	**274,520**
Net profit		—	—	—	—	—	44,393		**44,393**	54	**44,447**
Other comprehensive loss		—	—	—	—	—	—	(195)	**(195)**	22	**(173)**
Total comprehensive income		—	—	—	—	—	**44,393**	**(195)**	**44,198**	**76**	**44,274**
Dividends	7	—	—	—	—	—	(151,863)	—	**(151,863)**	—	**(151,863)**
Purchase of treasury shares	7	—	—	89,279,700	(63,883)	—	—	—	**(63,883)**	—	**(63,883)**
Sale of treasury shares in IPO	7	—	—	(26,839,411)	19,205	—	(3,033)	—	**16,172**	—	**16,172**
Settlement of IPO-related written put option liability, net	17	—	—	—	—	—	(6,348)	—	**(6,348)**	—	**(6,348)**
Sale of treasury shares upon exercise of stock options	25	—	—	(7,750,000)	5,545	—	(638)	(140)	**4,767**	—	**4,767**
Share-based compensation	25	—	—	—	—	—	—	315	**315**	—	**315**
Retirement of treasury shares	7	(200)	—	(200)	—	—	—	—	**—**	—	—
Dividends to non-controlling interests		—	—	—	—	—	—	—	**—**	(81)	**(81)**
As of 31 December 2012		**620,000,000**	**526**	**54,690,089**	**(39,133)**	**12,567**	**143,468**	**(73)**	**117,355**	**518**	**117,873**
Net profit		—	—	—	—	—	51,608	—	51,608	162	**51,770**
Other comprehensive loss		—	—	—	—	—	—	(8)	(8)	(44)	**(52)**
Total comprehensive income							**51,608**	**(8)**	**51,600**	**118**	**51,718**
Dividends	7	—	—	—	—	—	(36,968)	—	(36,968)	—	**(36,968)**
Share-based compensation	25	—	—	—	—	—	—	1,178	1,178	—	**1,178**
Sale of treasury shares upon exercise of stock options	25	—	—	(7,750,000)	5,545	—	(122)	(554)	4,869	—	**4,869**
Sale of interest in Synterra-Media	17	—	—	—	—	—	—	—	—	(233)	**(233)**
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(132)	**(132)**
As of 31 December 2013		**620,000,000**	**526**	**46,940,089**	**(33,588)**	**12,567**	**157,986**	**543**	**138,034**	**271**	**138,305**

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

MegaFon

Consolidated statement of cash flows

(In millions of Rubles)

	Note	Years ended 31 December 2013	2012
Operating activities			
Profit before tax		67,186	55,913
Non-cash adjustment to reconcile profit before tax to net cash flows:			
Depreciation	14	44,851	45,508
Amortisation	15	6,131	6,046
Loss on disposal of non-current assets		1,200	1,713
Gain on financial instruments, net	17	(269)	(6,348)
Net foreign exchange loss		2,914	8,196
Share of (profit)/loss of associates and joint ventures	10	202	(213)
Change in impairment allowance for receivables and other non-financial assets	28	2,037	1,319
Finance costs		12,184	7,718
Finance income		(1,888)	(1,193)
Equity-settled share-based compensation		1,178	315
Other non-operating (income)/loss		81	(191)
Working capital adjustments:			
Increase in inventory		(3,050)	(724)
(Increase)/decrease in trade and other receivables		1,154	(1,650)
(Increase)/decrease in current non-financial assets		2,078	(7,874)
Increase in trade and other payables		3,947	670
Increase/(decrease) in current non-financial liabilities		(851)	4,565
Change in VAT, net		(3,103)	4,020
Income tax received		2,393	6,984
Income tax paid		(16,344)	(13,675)
Interest received		1,687	3,941
Interest paid, net of interest capitalised	17	(9,025)	(5,630)
Net cash flows from operating activities		**114,693**	**109,410**
Investing activities			
Purchase of property, equipment and intangible assets		(43,022)	(46,674)
Proceeds from sale of property and equipment		2,514	521
Acquisition of subsidiaries, net of cash acquired	9	(15,219)	(8,257)
Proceeds from sale of Synterra-Media, net of cash	17	76	—
Payment of deferred and contingent consideration	17	(5,878)	(1,490)
Purchase of interests in associates, joint ventures and related put option	10	—	(16,673)
Net change in short-term demand deposits	17	(14,148)	58,313
Net cash flows used in investing activities		**(75,677)**	**(14,260)**
Financing activities			
Proceeds from borrowings, net of fees paid	17	32,200	216,545
Repayment of borrowings	17	(31,193)	(116,795)
Dividends paid to equity holders of the Company	7	(36,968)	(151,863)
Purchase of treasury shares	7	—	(63,883)
Payment of liability for marketing related licences	15	(539)	(369)
(IPO transaction fees paid)/IPO proceeds, net of transaction fees paid	7	(212)	16,384
Proceeds from exercise of stock options	25	4,869	4,768
Dividends paid to non-controlling interests		(132)	(81)
Other		403	—
Net cash flows used in financing activities		**(31,572)**	**(95,294)**
Net increase/(decrease) in cash and cash equivalents		7,444	(144)
Net foreign exchange difference		108	(356)
Cash and cash equivalents at beginning of year		2,387	2,887
Cash and cash equivalents at end of year		**9,939**	**2,387**

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

1. General

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

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

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates on the dual band GSM 900/1800 standard. In May 2007 the Group was awarded a licence that expires in May 2017 for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. In July 2012 the Group was awarded a licence which expires in July 2022 for the provision of fourth-generation ("4G") technology services under the Long Term Evolution ("LTE") standard throughout the entire territory of Russia. As of 31 December 2013, the Group is providing and expanding 3G services in almost all of the regions in which it operates throughout Russia and provides 4G services in Moscow and in 173 other cities and towns throughout Russia, following its acquisition of LLC Scartel ("Scartel") in October 2013 *(Note 9).* The Group also holds licences for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the whole territory of Russia. The Group has its own land-line and leased satellite transmission network capacities.

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

As of 31 December 2013, the Group is controlled by Garsdale Services Investment Limited ("Garsdale"), which indirectly owns 50% of the issued share capital plus 100 ordinary shares of the Company. Garsdale is indirectly owned by USM Holdings Limited, a non-public entity, which is ultimately controlled by Mr. Alisher Usmanov.

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"), effective at the date these consolidated financial statements were prepared.

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 4 March 2014.

3. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of 31 December 2013.

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

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

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

4. Significant accounting policies

Business combinations and goodwill

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

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

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes in the fair value of the contingent consideration classified as an asset or liability that is a financial instrument within the scope of IAS 39, *Financial Instruments: Recognition and Measurement*, are recognised in accordance with IAS 39 in the statement of comprehensive income. If the contingent consideration is not within the scope of IAS 39, it is measured in accordance with the appropriate IFRS. Contingent consideration that is classified as equity is not re-measured and subsequent settlement is accounted for within equity.

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

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

4. Significant accounting policies (continued)

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

Combination of entities under common control

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

Associates and joint ventures

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

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

Foreign currency transactions and translation

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

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

4. Significant accounting policies (continued)

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

Revenue recognition

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

The Group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the 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.

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 rendering traffic termination 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.

Service revenue is generally recognised when the services are rendered.

Loyalty programme

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

4. Significant accounting policies (continued)

Multiple element arrangements

The Group enters into multiple element arrangements in which a customer may purchase a combination of equipment (e.g. USB modems, handsets) and telecommunication services (e.g. airtime, data, and other services). The Group allocates consideration received from subscribers to the separate units of accounting based on their relative fair values. 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.

Roaming rebates

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

The Group takes into account the terms of the various roaming discount agreements in order to determine the appropriate presentation of the amounts receivable from and payable to its roaming partners in its consolidated statement of financial position. Amounts of rebates earned from and given to roaming partners are included in trade and other receivables and payables *(Notes 20, 24)*, respectively, in the accompanying consolidated statement of financial position.

Wireline revenue

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

Sales of equipment and accessories

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

Dealer commissions

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

4. Significant accounting policies (continued)

During 2012 the Group introduced changes to its third party dealer arrangements for provision of post-sales services and revenue sharing. As a result, dealer commissions are recognised as the services are performed, generally during a six-month or a twelve-month period from the date a new subscriber is activated.

Advertising costs

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

Government pension funds

The Group contributes to the local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended 31 December 2013 and 2012 were 4,599 and 4,308, respectively.

Taxes

Current income tax

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

The current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the country 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 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 by 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.

4. Significant accounting policies (continued)

Value-added tax

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

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

Segment reporting

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

Property and equipment

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

The estimated useful lives are as follows:

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

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

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. Refer to Significant accounting policies – Provisions and *Note 23* for further information about the recorded decommissioning provision.

4. Significant accounting policies (continued)

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

Borrowing costs

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

Leases

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

Intangible assets

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

The useful lives of intangible assets are assessed as either finite or indefinite. The Group does not have intangible assets with indefinite useful lives, other than goodwill. All intangible assets, except for GSM 900/1800 standard wireless licences *(Note 15)*, are amortised on a straight-line basis over the following estimated useful lives:

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

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.

4. Significant accounting policies (continued)

Impairment of non-financial assets

Assets, including goodwill, that have indefinite useful lives are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation or amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's or CGU's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and 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, including impairment on inventories, 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 or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

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

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

Non-current assets held for sale

Non-current assets are classified as assets held for sale 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.

4. Significant accounting policies (continued)

Inventory

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

Cash and cash equivalents

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

Ordinary shares

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

Treasury shares

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

Earnings per share

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

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

Provisions

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

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

4. Significant accounting policies (continued)

Decommissioning liabilities

The Group has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located. 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 the estimated future costs or in the discount rate applied are added to or deducted from the cost of the asset.

Share-based compensation

Equity-settled transactions

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

Cash-settled transactions

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

Other long-term employee benefits

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

4. Significant accounting policies (continued)

Financial instruments

Initial recognition and measurement

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

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.

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

4. Significant accounting policies (continued)

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.

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 in the statement of profit or loss.

Fair value of financial instruments

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

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

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

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

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

Derivative financial instruments and hedge accounting

Derivative financial instruments which include currency and interest rate swaps are initially recognised in the consolidated statement of financial position at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate. Derivatives are included within financial assets at fair value through profit or loss when fair value is positive and within financial liabilities at fair value through profit or loss when fair value is negative.

4. Significant accounting policies (continued)

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 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 *(Note 17)*. At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. Such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

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

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

Changes in accounting policies and disclosures

In preparing the Group's annual consolidated financial statements for the year ended 31 December 2012, the Group elected to early adopt a number of new standards including IFRS 10, IFRS 11, IFRS 12 and IFRS 13.

During 2013 the Group applied a number of amendments for the first time which do not have a material impact on the Group's financial statements. These standards are described below:

IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1. The amendments to IAS 1 introduce a grouping of items presented in OCI. Items that will be reclassified ('recycled') to profit or loss at a future point in time have to be presented separately from items that will not be reclassified. The amendments affect presentation only and have no impact on the Group's financial position or performance.

IAS 1 Clarification of the Requirement for Comparative Information (Amendment). These amendments clarify the difference between voluntary additional comparative information and the minimum required comparative information. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The amendments clarify that the opening statement of financial position, presented as a result of retrospective restatement or reclassification of items in financial statements does not have to be accompanied by comparative information in the related notes. The amendments do not impact the Group's financial statements.

4. Significant accounting policies (continued)

IAS 19 Employee Benefits (Revised 2011). This standard contains amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The amendments do not have a material impact on the Group's financial statements.

IFRS 7 Disclosures — Offsetting Financial Assets and Financial Liabilities (Amendments). The amendments to IFRS 7 require an entity to disclose information about rights of set-off and related arrangements (e.g., collateral agreements). The amendments do not have a material impact on the Group's financial statements.

Improvements to IFRSs (May 2012). In May 2012, as a result of Annual Improvements the IASB issued a number of amendments to IAS 1, *Presentation of Financial Statements*; IAS 16, *Property, Plant and Equipment*; IAS 32, *Financial Instruments: Presentation*; and IAS 34, *Interim Financial Reporting*. The amendments introduced relatively minor changes to clarify guidance in existing standards and do not have a material impact on the Group's financial statements.

5. Significant accounting judgments, estimates and assumptions

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

Accounting judgments

In the process of applying the Group's accounting policies, management has made the following judgments which have the most significant effect on the amounts recognised in the consolidated financial statements:

Acquisition of Scartel

In October 2013 the Group acquired a 100% interest in a group of subsidiaries (together "Scartel") from the Group's controlling shareholder Garsdale *(Note 9)*. The Group has evaluated various factors, such as

- the purpose of the transaction, which is developing the Group's leadership position in 4G services sector,
- the involvement of outside parties in the transaction, such as approval of the transaction by TeliaSonera, a non-controlling shareholder,
- the fact that the transaction was conducted at fair value,
- the existing complementary activities of the Group and Scartel,

and concluded that the acquisition transaction has substance from the prospective of the Group. Based on this, the Group made a significant judgment that the business combination of entities under common control could be accounted for using the acquisition method.

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

Consolidation of Lefbord

In December 2012 the Group acquired a 25% indirect interest in Euroset via its 50%-owned subsidiary Lefbord Investments Limited ("Lefbord") *(Note 10)*. The other 50% of Lefbord is owned by Garsdale, the Group's parent *(Note 29)*, which simultaneously acquired a further 25% indirect stake in Euroset. Pursuant to the transaction agreements, the Group was required to purchase on or before 6 December 2013 (with the possibility for this obligation to be deferred until 6 December 2015) Garsdale's interest in Lefbord for cash consideration or shares (at the discretion of the Group). Based on this, the Group made a significant judgment that, with respect to both Lefbord and Euroset, Garsdale is its *de facto* agent and that the Group obtained access to future economic benefits and effectively controls Lefbord from December 2012 and that, via Lefbord, it holds 50% of Euroset, rather than only 25%, from December 2012. Accordingly, the Group has consolidated Lefbord and classified the convertible debt instrument payable to Garsdale as a financial liability in the consolidated statement of financial position as of 31 December 2013.

Critical accounting estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below. The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Revenue recognition

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

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

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

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

Business combinations

The Group made acquisitions of other businesses in the past *(Note 9)*. The identification of assets acquired and liabilities assumed as a result of those acquisitions as well as the allocation of any

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

contingent consideration between the identified assets and liabilities based on their fair values and quantification of resulting goodwill required significant judgment and estimates. Those estimates were based on comparative market information, entity-specific future cash flow projections, discount rates, terminal growth rates and other assumptions.

Contingent consideration resulting from business combinations and equity investments or acquisitions is measured at fair value at the acquisition date *(Note 17)*. The determination of the fair value is based on discounted cash flows. The key assumptions take into account the probability of meeting each performance target and the discount factor. A change in any of these assumptions could significantly impact the financial statements.

Impairment of non-financial assets

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

Depreciation and amortisation

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

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

Deferred tax assets and uncertain tax positions

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

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

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

Fair value of financial instruments

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

Share-based payments

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

Decommissioning provision

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

6. Standards issued but not yet effective

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

Improvements to IFRSs (December 2013)

In December 2013, as a result of Annual Improvements to IFRSs 2010-2012 Cycle and Annual Improvements to IFRSs 2011-2013 Cycle, the IASB issued a number of amendments to

6. Standards issued but not yet effective (continued)

- IFRS 2, *Share-Based Payment* (definition of vesting condition),
- IFRS 3, *Business Combinations* (accounting for contingent consideration, scope exceptions for joint ventures),
- IFRS 8, *Operating Segments* (aggregation of operating segments, reconciliation of total assets),
- IFRS 13, *Fair Value Measurement* (short-term receivables and payables),
- IAS 16, *Property, Plant and Equipment* (revaluation method, proportionate restatement of accumulated depreciation),
- IAS 24, *Related Party Disclosures* (key management personnel),
- IAS 38, *Intangible Assets* (revaluation method, proportionate restatement of accumulated amortisation),
- IFRS 1, *First-Time Adoption* (meaning of 'effective IFRSs'),
- IAS 40, *Investment Property* (clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property).

The amendments introduced relatively minor changes to clarify guidance in existing standards. The amendments are effective for annual periods beginning on or after 1 July 2014 or for applicable transactions taking place on or after that date. The Group will adopt the amended standards from 1 July 2014. The Group does not expect these amendments to have a material impact on the Group's financial position or performance.

IFRS 9 Financial Instruments

In November 2013 the IASB added to IFRS 9, *Financial Instruments*, the requirements related to hedge accounting. IFRS 9, as issued, reflects the first and third phases of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities and hedge accounting as defined in IAS 39.

IFRS 9, as amended in November 2013, changed the mandatory effective date of this IFRS. The mandatory effective date is not specified in IFRS 9 but will be determined when the outstanding phases are finalised. However, earlier application of IFRS 9 is permitted.

In subsequent phases, the IASB will address impairment of financial assets. The Group will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive assessment.

IAS 36 Impairment of Assets

In May 2013 the IASB issued amendments to IAS 36, *Impairment of Assets,* which clarify that disclosures of information about recoverable amount are required for an impaired asset or group of assets instead of for each CGU to which a significant portion of goodwill was allocated. The amendments are effective retrospectively for annual periods beginning on or after 1 January 2014. Earlier application is permitted. The Group has adopted the amended standard starting from the accompanying financial statements and amended the respective disclosures.

6. Standards issued but not yet effective (continued)

IAS 32 Offsetting Financial Assets and Financial Liabilities (Amendments)

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These are effective for annual periods beginning on or after 1 January 2014. These amendments are not expected to be material to the Group.

7. Equity

Share capital

As of 31 December 2013 and 2012, the Company had 100,620,000,000 authorised ordinary shares with a par value of 0.1 Rubles, of which 620,000,000 were fully paid and issued shares, comprised of 46,940,089 treasury shares (31 December 2012: 54,690,089) and 573,059,911 (31 December 2012: 565,309,911) outstanding shares.

As of 1 January 2012, the Company had 100,620,000,200 authorised ordinary shares, of which 620,000,200 shares were fully paid, issued and outstanding. In July 2012 the Group retired 200 of its treasury shares held by MegaFon Investments (Cyprus) Limited ("MICL"), a wholly-owned subsidiary of the Company.

Annual dividend payment

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

Special dividend payment and the re-purchase of shares

On 24 April 2012 the Company paid a special dividend in the amount of 245 Rubles per ordinary share, which resulted in an aggregate distribution of 151,863 to the shareholders.

Also on 24 April 2012 the Group re-purchased (through MICL) from Allaction Limited, part of the Alfa Group *(Note 29)*, 89,279,700 or 14.4% of the Group's ordinary shares for 63,883, including transaction costs.

Initial public offering

On 28 November 2012 the Group completed an IPO in which it sold 26,839,411 treasury shares of the Company at a public offering price of $20 per ordinary share or 619 Rubles at the exchange rate as of 28 November 2012 (the "IPO price"). The Group received net cash proceeds of 16,384 after deducting underwriting discounts and commissions of 31 and other offering expenses of approximately 132.

7. Equity (continued)

Other capital reserves

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

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

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

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

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

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

	Foreign currency translation reserve	Cash flow hedge reserve	Share-based compen-sation reserve	Transac-tions with non-con-trolling interests	Reserve fund	**Total other capital reserves**
As of 1 January 2012	**(45)**	**—**	**—**	**(23)**	**15**	**(53)**
Foreign currency translation	66	—	—	—	—	**66**
Change in fair value of cash flow hedges *(Note 17)*	—	(261)	—	—	—	**(261)**
Sale of treasury shares upon exercise of stock options *(Note 25)*	—	—	(140)	—	—	**(140)**
Share-based compensation *(Note 25)*	—	—	315	—	—	**315**
As of 31 December 2012	**21**	**(261)**	**175**	**(23)**	**15**	**(73)**
Foreign currency translation	(144)	—	—	—	—	**(144)**
Change in fair value of cash flow hedges *(Note 17)*	—	136	—	—	—	**136**
Sale of treasury shares upon exercise of stock options *(Note 25)*	—	—	(554)	—	—	**(554)**
Share-based compensation *(Note 25)*	—	—	1,178	—	—	**1,178**
As of 31 December 2013	**(123)**	**(125)**	**799**	**(23)**	**15**	**543**

8. Group information

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

Name	Principal activities	Country of incorporation	% equity interest 2013	% equity interest 2012
OJSC MegaFon Retail	Retail	Russia	100.0	100.0
LLC NetByNet Holding	Broadband internet	Russia	100.0	100.0
CJSC MegaLabs	VAS	Russia	100.0	100.0
LLC VAS Media	VAS	Russia	100.0	100.0
LLC MegaFon Finance	Financing	Russia	100.0	100.0
MegaFon Investments (Cyprus) Limited *(Note 7)*	Transactions with treasury shares	Cyprus	100.0	100.0
LLC Scartel *(Note 9)*	Wireless services	Russia	100.0	—
LLC Yota *(Note 9)*	Wireless services	Russia	100.0	—

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

Investments in significant associates and joint ventures are as follows:

Name	Principal activities	Country of incorporation	% equity interest 2013	% equity interest 2012
LLC Euroset-Retail, joint venture *(Note 10)*	Retail	Russia	50.0	50.0
LLC News Tube, associate *(Note 9)*	Internet video services	Russia	37.6	37.6

9. Business combinations

Scartel

On 1 October 2013 MegaFon acquired 100% of the shares of Maxiten Co Limited, which holds a 100% interest in a group of subsidiaries (together “Scartel”) that provide 4G telecommunication services under the brand “Yota”, from the Group’s controlling shareholder Garsdale, for a consideration of 55,736 comprised of (1) $1,180 million deferred consideration (38,331 at the exchange rate as of 1 October 2013), of which 50% plus interest at 6% per annum is payable in one year from the date of acquisition and the other 50% plus interest at 6% per annum in two years after the acquisition; (2) settlement of Scartel’s indebtedness to Telecominvest Holdings Limited, an indirect subsidiary of Garsdale, in the amount of $477 million (15,483 at the exchange rate as of the payment date) and (3) an effective settlement of a pre-existing cash advance of 1,069 for future services and accounts receivable of 853 for lease of the Group’s telecommunications network due from Scartel as of the acquisition date *(Note 29)*.

The reasons for the acquisition were to gain a significant increase in network capacity and quality which will strengthen the Group’s leadership position in the fast growing mobile data market through enhanced overall service offering and customer experience; to enable the Group to carry out its 4G rollout with reduced capital and operating expenditures per unit of data

9. Business combinations (continued)

transmission capacity because of its enhanced spectrum position; and to realise considerable cash flow savings in network rollout and maintenance driven principally by elimination of significant current and future operating costs.

The acquisition of Scartel was accounted for using the acquisition method *(Note 5)*. The valuation of certain acquired assets and liabilities assumed has not been finalised as of the date these consolidated financial statements were authorised for issue; thus, the provisional measurements of certain intangible assets, deferred taxes and goodwill are subject to change.

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

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

Assets	
Property and equipment *(Note 14)*	13,833
Intangible assets *(Notes 5, 15)*	43,315
Inventories	52
Trade and other receivables	297
Current non-financial assets	2,237
Cash and cash equivalents	278
	60,012
Liabilities	
Loans and borrowings	(1,288)
Deferred tax liabilities	(5,886)
Non-current non-fiancial liabilities	(118)
Provisions	(232)
Trade and other payables	(3,590)
Current non-financial liabilities	(728)
	(11,842)
Total identifiable net assets at fair value	**48,170**
Goodwill arising on acquisition	7,566
Purchase consideration transferred	**55,736**

The goodwill recognised is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of Scartel. Management is still assessing the allocation of goodwill among cash generating units.

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

9. Business combinations (continued)

Acquisitions in 2012

VAS Media

On 11 September 2012, the Group acquired a 100% ownership interest in Felebior Holding Limited, which holds a 100% interest in a group of subsidiaries that supply multi-media content, ring tones, geo-positioning services, mobile payments and other VAS in Russia ("VAS Media") for a total consideration of 9,207, of which 528 was effectively a settlement of a pre-existing payable for VAS Media services. Before the acquisition VAS Media partnered with the Group on a variety of projects, such as provision of MegaFon-branded VAS to MegaFon customers *(Note 29)*.

The primary reason for the acquisition was to strengthen the Group's position in the VAS market and to accelerate the development, implementation and launch of new services by the Group.

The table below represents the allocation of the purchase price to the acquired net assets of VAS Media based on their estimated fair values as at the date of acquisition.

Assets	
Property and equipment	36
Intangible assets	6
Investments in associate	182
Other current assets	306
Cash and cash equivalents	240
	770
Liabilities	
Non-current liabilities	(2)
Current liabilities	(633)
	(635)
Total identifiable net assets at fair value	**135**
Goodwill arising on acquisition	8,544
Purchase consideration transferred	**8,679**

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

As a part of the transaction, the Group also acquired a 37.6% equity interest in LLC News Tube, an internet video services company *(Note 10)*.

10. Investments in associates and joint ventures

Investee	Share, %	31 December 2013	2012
Euroset, joint venture	50.0	35,278	35,480
News Tube, associate	37.6	182	182
Total		**35,460**	**35,662**

Euroset

On 6 December 2012 MegaFon entered into agreements with Garsdale, the Group's parent *(Note 29)*, and Lefbord *(Note 5)* pursuant to which the Group subscribed for ordinary and redeemable preference shares in Lefbord representing 50% of its share capital for $535 million cash consideration, or 16,491 at the exchange rate as of 6 December 2012 (the "MegaFon Contribution"). Concurrently, Garsdale contributed certain equity holdings valued at $140 million (4,315 at the exchange rate as of 6 December 2012) and promissory notes pursuant to which Garsdale promises to pay Lefbord (or its assignees) in aggregate $395 million or 12,175 at the exchange rate as of 6 December 2012 (together, the "Garsdale Contribution").

Following these contributions by MegaFon and Garsdale, Lefbord acquired a 50% stake in Euroset, the largest wireless equipment retailer in the Russian Federation, from Alpazo Limited for consideration in the form of the MegaFon Contribution and Garsdale Contribution. The remaining 50% of Euroset is indirectly owned by VimpelCom, a Russian telecommunications operator. Lefbord and VimpelCom exercise joint control over Euroset with each having substantive approval rights allowing them to effectively participate in all of the significant decisions of Euroset.

The sale and purchase agreement provided for the payment of additional consideration if Euroset met certain targets by 30 June 2013. On 25 September 2013 the Group paid a further $100 million (3,182 at the exchange rate as of the settlement date) cash consideration because the targets were met. This payment was partially financed by Garsdale in the amount of $50 million (1,591 at the exchange rate as of the settlement date). The final amount of contingent consideration paid corresponded to the estimates made at the time of the acquisition of Euroset.

Pursuant to the agreements with Garsdale, the Group is required to purchase on or before 6 December 2013 (with the possibility for this obligation to be deferred until 6 December 2015) Garsdale's interest in Lefbord for $535 million (16,491 at the exchange rate as of 6 December 2012), plus interest at a rate of 8% per annum, plus any earn-out related payments made by Garsdale to Lefbord, increased by any additional contributions made to Lefbord by Garsdale and reduced by any payments received by Garsdale from Lefbord. The Group has, at its discretion, the option to settle this obligation in cash or in its ordinary shares to be valued at the weighted-average market price for MegaFon GDRs for the six-month period prior to its purchase of Garsdale's remaining interest in Lefbord ("convertible debt instrument"). In December 2013 the Group and Garsdale agreed to defer settlement of the convertible debt instrument until December 2014.

As a result of the obligation to acquire Garsdale's 50% interest in Lefbord, the Group consolidated Lefbord and classified the convertible debt instrument payable to Garsdale as other

10. Investments in associates and joint ventures (continued)

current financial liability in the consolidated statement of financial position as of 31 December 2013 *(Notes 5, 17)*. The transactions referred to above result in the holding by the Group of a 50% interest in Euroset by the Group. The liability and purchased put option components of the convertible debt instrument that may be settled in cash upon conversion (at the discretion of the issuer) are accounted for separately.

The acquisition date fair values of each major class of consideration transferred are as follows:

Cash, net of allocation to purchased put option	15,694
Convertible debt instrument, principal *(Note 17)*	16,491
Contingent consideration *(Note 17)*	3,082
Total consideration transferred	**35,267**

The Group estimated the fair value of the contingent consideration using a probability-weighted cash flow model and the fair value of the purchased put option using Monte Carlo simulation. These fair value measurements are based on significant inputs not observable in the market and thus represent a Level 3 measurement.

The acquisition was recorded under the equity method of accounting, that is, the investment in joint venture was initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of net earnings and other comprehensive income of the joint venture.

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

10. Investments in associates and joint ventures (continued)

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

	31 December 2013	31 December 2012
Assets		
Non-current assets	42,717	45,907
Cash and cash equivalents	5,455	7,915
Other current assets	20,977	21,094
	69,149	**74,916**
Liabilities		
Non-current financial liabilities	—	(984)
Other non-current liabilities	(7,034)	(7,391)
Current financial liabilities	(10,021)	(9,025)
Other current liabilities	(21,567)	(26,584)
	(38,622)	**(43,984)**
Total identifiable net assets	**30,527**	**30,932**
The Group's share in the joint venture	50%	50%
The Group's share of identifiable net assets	15,264	15,466
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	**35,278**	**35,480**

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

	Year ended 31 December 2013	December 2012
Profit/(loss) before tax	**(367)**	**812**
Income tax expense	(37)	(386)
Profit/(loss) of the joint venture	**(404)**	**426**
The Group's share in the joint venture	50%	50%
The Group's share of the profit/(loss) of the joint venture	**(202)**	**213**

11. Segment information

The Group manages its business primarily based on eight geographical operating segments within Russia, which provide a broad range of voice, data and other telecommunication services, including wireless and wireline services to clients, interconnection services, data transmission services and VAS. The CODM evaluates the performance of the Group's operating segments based on revenue and operating income before depreciation and amortisation ("OIBDA"). However, total assets are not allocated to operating segments and not analysed by the CODM. Operating segments with similar economic characteristics have been aggregated into an

11. Segment information (continued)

integrated telecommunication services segment, which is the only reportable segment. The remaining operating segments, including less significant subsidiaries and retail business, do not meet the quantitative thresholds for reportable segments. Less than 2% 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.

12. Income taxes

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

	2013	2012
Current income tax:		
Current income tax charge	16,212	9,301
Adjustments recognised for current tax of prior periods	669	(835)
Deferred tax	(1,465)	3,000
Income tax expense	**15,416**	**11,466**

Income tax is calculated at 20% of taxable profit for the years ended 31 December 2013 and 2012, respectively. The reconciliation between the average effective income tax rate and the applicable Russian enacted statutory tax rate is as follows:

	2013	2012
Statutory income tax rate	**20.0%**	**20.0%**
Effect of intragroup transactions	1.6%	1.5%
Non-deductible expenses	1.5%	2.0%
Effect of income tax benefits and preferences	(0.2%)	(0.8%)
Non-taxable income	—	(2.3%)
Other differences	—	0.1%
Effective income tax rate	**22.9%**	**20.5%**

The effect of intragroup transactions, in the table above, represents taxable intragroup income. A decrease in non-deductible expenses during 2013 was mainly due to one-off social infrastructure expenses in 2012 *(Notes 28, 29)*. Non-taxable income in 2012 primarily relates to recognised gain on an IPO-related written put option *(Note 17)*.

12. Income taxes (continued)

Deferred tax relates to the following:

	Statement of financial position as of 31 December		Statement of comprehensive income for the years	
	2013	**2012**	**2013**	**2012**
Intangible assets	(8,645)	(1,128)	(698)	(209)
Property and equipment	(11,372)	(12,108)	(400)	3,297
Derivative financial instruments	(257)	(223)	65	201
Revenue recognition	733	1,109	376	(9)
Loss carry-forwards	2,706	956	(9)	(238)
Accrued employee benefits	1,184	914	(166)	221
Accrued expenses	781	852	198	(183)
Deferred and contingent consideration	747	176	(571)	(176)
Other movements and temporary differences	(48)	(308)	(260)	96
Deferred tax (benefit)/expense			**(1,465)**	**3,000**
Net deferred tax liabilities	**(14,171)**	**(9,760)**		

Reflected in the statement of financial position as follows:		
Deferred tax assets	**3,673**	**2,573**
Deferred tax liabilities	**(17,844)**	**(12,333)**
Net deferred tax liabilities	**(14,171)**	**(9,760)**

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

The Group recognised deferred tax asset in respect of tax losses of Scartel in the amount of 1,985 as at 31 December 2013. The Group expects to utilise some of the tax losses against a gain from the planned sale of network infrastructure from LLC Scartel to OJSC MegaFon, which should also reduce Scartel's future operating expenses. In order to utilise the remaining part of the tax losses the Group is able to implement other appropriate tax planning strategies depending on the results of Scartel in subsequent periods.

The tax planning strategies may include, among others, merging of the respective subsidiaries with OJSC MegaFon which is expected to have sufficient pretax income to utilise the accumulated tax losses of these subsidiaries.

Unrecognised deferred tax assets in the consolidated statement of financial position as of 31 December 2013 and 2012 amounted to 463 related to unused tax losses. Tax loss carry-forwards available for utilisation to the Group expire in 2017-2023.

12. Income taxes (continued)

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

	2013	2012
Balance at beginning of year	(9,760)	(6,755)
Tax benefit/(expense) during the year	1,465	(3,000)
Acquisition of subsidiary *(Note 9)*	(5,886)	—
Translation adjustment of foreign operations	10	(5)
Balance at end of year	**(14,171)**	**(9,760)**

Transfer pricing legislation

The new Russian transfer pricing legislation, which came into force on 1 January 2012, allows the Russian tax authorities to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all “controlled” transactions if the transaction price differs from the market level of prices. The list of “controlled” transactions includes transactions performed with related parties and certain types of cross-border transactions. For domestic transactions the transfer pricing rules apply only if the amount of all the transactions with each related party exceeds 2,000 in 2013 (3,000 in 2012). In cases where a domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could correspondingly adjust its profit tax liabilities based on a special notification issued by an authorised body in due course.

The current Russian transfer pricing rules have considerably increased the compliance burden for taxpayers compared to the transfer pricing rules which were in effect before 2012 due to, *inter alia*, shifting the burden of proof from the Russian tax authorities to the taxpayers. These rules are applicable not only to the transactions which took place in 2012 and 2013 but also to the prior transactions with related parties if related income and expenses were recognised in 2012 and 2013. Special transfer pricing rules apply to transactions with securities and derivatives.

Because of the lack of clarity in current Russian transfer pricing legislation and the absence of court precedent, the Russian tax authorities may challenge the level of prices applied by the Group under “controlled” transactions and accrue additional tax liabilities unless the Group is able to demonstrate the use of market prices with respect to the “controlled” transactions, and that there has been proper reporting to the Russian tax authorities, supported by appropriate available transfer pricing documentation.

Consolidated taxpayers’ group

Effective 1 January 2012 a new provision in Russian tax legislation was introduced that permits taxpayers to calculate income taxes on a consolidated basis. If certain requirements are met, corporate taxpayers are allowed to create a Consolidated Taxpayers’ Group (“CTG”). The CTG is able to reduce taxable profits by offsetting tax losses generated by the CTG participants against profits generated by the other CTG members. In April 2012 the Group created a CTG which included OJSC MegaFon and three of its subsidiaries. The Group’s management believes that the creation of the CGT will not result in significant changes in the taxes payable by the Group for the purpose of these consolidated financial statements.

13. Earnings per share

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

	2013	2012
Numerator:		
Net profit attributable to equity holders of the Company	51,608	44,393
Add back: interest expense on convertible debt instrument and gain on revaluation of purchased put option *(Note 10)*	1,120	72
Net profit attributable to equity holders of the Company, adjusted	**52,728**	**44,465**
Denominator:		
Weighted-average ordinary shares outstanding	570,151,007	561,293,092
Effect of dilutive securities:		
Employee stock options *(Note 25)*	5,532,897	67,204
Assumed debt conversion *(Note 10)*	18,454,992	1,619,097
Weighted-average diluted shares outstanding, adjusted	**594,138,896**	**562,979,393**
EPS – basic, Rubles	91	79
EPS – diluted, Rubles	89	79

14. Property and equipment

Property and equipment is as follows:

	Telecom-munications network	Buildings and structures	Vehicles, office and other equipment	Construction in-progress	**Total**
Cost as of					
1 January 2012	**268,327**	**55,409**	**20,229**	**42,971**	**386,936**
Additions	—	—	46	40,637	**40,683**
Acquisitions *(Note 9)*	—	—	36	—	**36**
Disposals	(7,446)	(246)	(1,701)	(995)	**(10,388)**
Transfer	43,413	10,599	4,436	(58,448)	**—**
Translation	(151)	(53)	16	(106)	**(294)**
31 December 2012	**304,143**	**65,709**	**23,062**	**24,059**	**416,973**
Additions	—	—	63	43,082	**43,145**
Acquisitions *(Note 9)*	9,146	176	290	4,221	**13,833**
Disposals	(10,480)	(3,154)	(1,460)	(1,265)	**(16,359)**
Reclassified to assets held for sale *(Note 22)*	—	(1,405)	—	(323)	**(1,728)**
Transfer	35,471	2,591	2,187	(40,249)	**—**
Translation	238	90	88	42	**458**
31 December 2013	**338,518**	**64,007**	**24,230**	**29,567**	**456,322**
Depreciation as of					
1 January 2012	**(138,295)**	**(11,605)**	**(14,073)**	**—**	**(163,973)**
Charge for the year	(36,898)	(4,156)	(4,454)	—	**(45,508)**
Disposals	6,619	122	1,413	—	**8,154**
Translation	(79)	14	(32)	—	**(97)**
31 December 2012	**(168,653)**	**(15,625)**	**(17,146)**	**—**	**(201,424)**
Charge for the year	(36,488)	(4,541)	(3,822)	—	**(44,851)**
Disposals	10,024	438	1,339	—	**11,801**
Reclassified to assets held for sale (*Note 22)*	—	212	—	—	**212**
Translation	(148)	(38)	(69)	—	**(255)**
31 December 2013	**(195,265)**	**(19,554)**	**(19,698)**	**—**	**(234,517)**
Net book value:					
31 December 2012	**135,490**	**50,084**	**5,916**	**24,059**	**215,549**
31 December 2013	**143,253**	**44,453**	**4,532**	**29,567**	**221,805**

Included in construction in-progress are advances to suppliers of network equipment of 2,673 and 3,299 as at 31 December 2013 and 2012, respectively.

Assets purchased under certain contracts with deferred payment terms in the amount of 950 (2012: nil) are pledged as security for the related liabilities.

Disposals of construction in-progress in 2013 include impairment allowance for advances to suppliers in the amount of 698. It is included in general and administrative expenses in the consolidated statement of comprehensive income *(Note 28)*.

15. Intangible assets

Intangible assets are as follows:

	4G operating licences	Other operating licences	Frequen-cies	Software	Marketing related intangible assets	Customer base	Other intangible assets	**Total**
Cost as of								
1 January 2012	—	**18,239**	**5,484**	**7,254**	**3,535**	**2,907**	**5,831**	**43,250**
Additions	—	421	458	2,232	—	—	1,433	**4,544**
Acquisitions *(Note 9)*	—	—	—	—	—	—	6	**6**
Disposals	—	(1)	(633)	—	—	—	(875)	**(1,509)**
Transfer	—	136	—	—	—	(18)	(118)	**—**
31 December 2012	—	**18,795**	**5,309**	**9,486**	**3,535**	**2,889**	**6,277**	**46,291**
Additions	—	28	1,323	2,063	—	—	585	**3,999**
Acquisitions *(Note 9)*	41,904	—	—	556	—	747	108	**43,315**
Disposals	—	(7)	(427)	(495)	—	(153)	(628)	**(1,710)**
Transfer	—	(2)	—	21	—	(28)	9	-
Translation	—	17	—	—	—	—	—	**17**
31 December 2013	**41,904**	**18,831**	**6,205**	**11,631**	**3,535**	**3,455**	**6,351**	**91,912**
Amortisation as of								
1 January 2012	—	**(14,059)**	**(1,500)**	**(3,639)**	**(1,514)**	**(726)**	**(3,325)**	**(24,763)**
Charge for the year	—	(897)	(864)	(2,242)	(670)	(225)	(1,148)	**(6,046)**
Disposals	—	1	633	—	—	—	875	**1,509**
31 December 2012	—	**(14,955)**	**(1,731)**	**(5,881)**	**(2,184)**	**(951)**	**(3,598)**	**(29,300)**
Charge for the year	(524)	(901)	(607)	(2,469)	(682)	(288)	(660)	**(6,131)**
Disposals	—	1	341	437	—	29	499	**1,307**
Translation	—	(12)	—	—	—	—	—	**(12)**
31 December 2013	**(524)**	**(15,867)**	**(1,997)**	**(7,913)**	**(2,866)**	**(1,210)**	**(3,759)**	**(34,136)**
Net book value:								
31 December 2012	—	**3,840**	**3,578**	**3,605**	**1,351**	**1,938**	**2,679**	**16,991**
31 December 2013	**41,380**	**2,964**	**4,208**	**3,718**	**669**	**2,245**	**2,592**	**57,776**
Weighted-average remaining amortisation period, years	**20**	**8**	**7**	**2**	**1**	**8**	**4**	**16**

The amount of fully amortised numbering capacity that is in use and included in other intangible assets in the table above as of 31 December 2013 is 1,831. The Group accelerated amortisation of numbering capacity in 2013 due to the introduction of mobile number portability in Russia. As of 31 December 2012 the gross book value and accumulated amortisation of numbering capacity were 1,839 and 1,622, respectively.

Operating licences and frequencies

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

15. Intangible assets (continued)

Operating licences primarily consist of

- several 2G licences (GSM 900/1800 standard),
- a nationwide 3G licence,
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (10x10 MHz band) awarded to OJSC MegaFon in 2012, and
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (30x30 MHz band) acquired in the Scartel business combination *(Note 9).*

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

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

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

Scartel, the Company's subsidiary since October 2013, was licensed to use the 2.5–2.7 GHz spectrum (30x30 MHz band), a frequency band three times broader than the Company's 4G frequency band licensed in 2012, and any of its competitors' licences in Russia. These 4G licences are amortised on a straight-line basis over their estimated useful lives of 20 years *(Note 5).*

Marketing related intangible assets

In April 2009 the Group and OJSC Rostelecom ("Rostelecom") entered into an agreement with the Organisational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi to acquire rights and licences to use the Olympic mascot, logos and other Olympic symbols and, in the case of the Group, to be referred to as the "General Mobile Partner of the 2014 XXII Olympic Winter Games". Under the agreement the Group is required to make a cash payment of $65 million (2,127 at the exchange rate as of 31 December 2013) in several installments from 2009 through 2014.

In addition, the Group and Rostelecom are jointly responsible to provide equal amounts of services in-kind of up to a combined total of $130 million (4,255 at the exchange rate as of 31 December 2013) from 2009 through 2014.

The Group estimated the cost of the rights and licences in 2009, based on an assumed liability with a net present value of future cash installments of 1,334 and deferred revenue with a fair value of 1,516 (Level 3).

15. Intangible assets (continued)

Goodwill

The changes in the carrying value of goodwill, net of accumulated impairment losses of nil, for the years ended 31 December 2013 and 2012 are as follows:

	2013	2012
Balance at beginning of year	23,950	15,393
Acquisitions *(Note 9)*	7,566	8,544
Measurement period adjustments	14	13
Balance at end of year	**31,530**	**23,950**

16. Impairment test

The Group performs its annual goodwill impairment test as of 1 October of each year using data that is appropriate at that time. 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 2013, 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 2013 or 2012.

Goodwill acquired through business combinations, except for Scartel in 2013 and VAS Media in 2012, has been allocated to related CGUs and groups of CGUs as follows:

	31 December	
	2013	2012
Integrated telecommunication services (group of CGUs)	17,327	8,769
Broadband internet CGU	6,419	6,419
Other	218	218
Total allocated goodwill	**23,964**	**15,406**
Unallocated:		
Scartel *(Note 9)*	7,566	—
VAS Media *(Note 9)*	—	8,544
Total goodwill	**31,530**	**23,950**

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)

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 4.5 times OIBDA, which represents a low 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.

16. Impairment test (continued)

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

Broadband internet CGU

The recoverable amount of the broadband internet CGU has been determined based on its value in use. The value in use was estimated using cash flow projections from financial budgets approved by senior management covering 2014 and further seven-year projections.

The calculation of value in use for the broadband internet unit is most sensitive to the following assumptions: subscribers' dynamics during the forecast period (average monthly revenue per user ("ARPU")), operating personnel growth, capital expenditures ("CAPEX") to revenues ratio, discount rates and growth rates used to extrapolate cash flows beyond the forecast period (terminal growth rate). The key assumptions used in the forecast are as follows:

Post-tax discount rate	11.0%
Terminal growth rate	2.8%
Reduction of ARPU for retail customers during the forecast period by	3.0%
Market share in Moscow	8.0%
CAPEX/Revenue ratio from 2018	10.0-10.5%

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

Terminal growth rate is based on long-term inflation forecast.

Revenue growth is projected based on market share, gross domestic product ("GDP"), traffic growth and other factors.

16. Impairment test (continued)

Sensitivity to changes in key assumptions

The estimated recoverable amount of the broadband internet unit exceeds its carrying value by 910. The following changes in the key assumptions made independently, with all other assumptions constant, would result in impairment for the broadband internet unit:

Post-tax discount rate increasing to	11.6%
Terminal growth rate reducing to	1.7%
Reduction of ARPU for retail customers during the forecast period by	6.0%
Market share in Moscow reducing to	5.0%
CAPEX/Revenue ratio from 2018 increasing to	12.75%

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

17. Financial assets and liabilities

Financial assets

	31 December	
	2013	**2012**
Trade and other receivables *(Note 20)*	10,732	13,542
Other financial assets:		
Financial assets at fair value through profit or loss:		
Euroset settlement put option *(Note 10)*	1,176	1,118
Cross-currency swap not designated as hedge	300	—
Total financial assets at fair value through profit or loss	**1,476**	**1,118**
Financial assets at fair value through OCI:		
Cross-currency swap designated as cash flow hedge	125	—
Loans and receivables:		
Short-term bank deposits in Rubles	3,855	5,189
Short-term bank deposits in US dollars	34,265	17,142
Total loans and receivables	**38,120**	**22,331**
Total other financial assets	**39,721**	**23,449**
Other current financial assets	**(39,296)**	**(23,449)**
Other non-current financial assets	**425**	**—**
Total financial assets	**50,453**	**36,991**
Total current financial assets	**(50,028)**	**(36,991)**
Total non-current financial assets	**425**	**—**

17. Financial assets and liabilities (continued)

Financial liabilities

	31 December 2013	31 December 2012
Trade and other payables *(Note 24)*	33,875	23,723
Financial liabilities at amortised cost:		
Loans and borrowings:		
Loans and borrowings, principal amounts		
Ruble bonds	30,000	10,000
Bank loans	75,542	95,461
Equipment financings	46,608	40,961
Total loans and borrowings, principal	152,150	146,422
Unamortised fees and discounts		
Bank loans	(382)	(511)
Equipment financings	(731)	(677)
Total unamortised fees and discounts	(1,113)	(1,188)
Interest accrued		
Ruble bonds	667	179
Bank loans	119	438
Equipment financings	186	181
Total interest accrued	972	798
Total loans and borrowings	**152,009**	**146,032**
Total current loans and borrowings	**(21,184)**	**(20,457)**
Total non-current loans and borrowings	**130,825**	**125,575**
Other financial liabilities at amortised cost:		
Deferred consideration for Scartel *(Note 9)*	39,198	—
Convertible debt instrument *(Note 10)*	20,678	16,812
Long-term accounts payable	950	—
Due to employees and related social charges, non-current	283	222
Liability for marketing related licences *(Note 15)*	177	682
Total financial liabilities at amortised cost	**213,295**	**163,748**
Other financial liabilities at fair value:		
Financial liabilities at fair value through profit or loss:		
Contingent consideration	—	5,806
Financial liabilities at fair value through OCI:		
Interest rate swaps designated as cash flow hedges	209	261
Cross-currency swaps designated as cash flow hedges	128	—
Total financial liabilities at fair value through OCI	**337**	**261**
Total financial liabilities	**247,507**	**193,538**
Total current financial liabilities	**(95,844)**	**(67,462)**
Total non-current financial liabilities	**151,663**	**126,076**

17. Financial assets and liabilities (continued)

Loans and borrowings

Principal amounts outstanding under loans and borrowings are as follows:

	Currency	Interest Rate	Maturity	31 December 2013	31 December 2012
Ruble bonds:					
Series 05	Ruble	8.05%	2022 with a put option in 2014	10,000	10,000
Series 06, 07	Ruble	8.00%	2023 with a put option in 2018	20,000	—
Ruble Bonds				**30,000**	**10,000**
Bank loans:					
Sberbank	Ruble	8.60%	2019-2020	37,693	46,693
Sberbank	Ruble	8.35%	2017-2018	29,512	29,512
Gazprombank	Ruble	8.75%	2018	6,300	6,300
Nordea Bank Moscow	US dollar	LIBOR+2.0%	2015	1,636	1,519
UniCredit Bank Moscow	US dollar	LIBOR+3.5%	2014	327	304
VTB Bank	Ruble	MosPrime+2.2%	2017	—	11,000
Other loans				74	133
Total bank loans				**75,542**	**95,461**
Equipment financings:					
China Development Bank and Bayerische Landesbank	US dollar	LIBOR+1.1% to +2.7%	2014-2018	32,502	26,848
BNP Paribas London branch and Nordea Bank Finland	US dollar	2.91% to 4.54%	2014-2016	4,200	5,776
Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	US dollar	1.92%	2014-2017	3,492	2,842
Nordic Investment Bank	Euro	EURIBOR+2.1%	2014-2019	3,044	3,218
Société Générale and Crédit Agricole Corporate and Investment Bank Helsinki Branch	US dollar	LIBOR+0.955%	2014-2021	2,249	—
Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft	Euro	3.74% and EURIBOR+ 0.35%	2014-2015	1,121	2,277
Total equipment financings				**46,608**	**40,961**
Total				**152,150**	**146,422**
Total current				**(20,483)**	**(19,881)**
Total non-current				**131,667**	**126,541**

17. Financial assets and liabilities (continued)

Ruble bonds

In March 2013 the Group issued two series of Ruble denominated bonds, in an aggregate principal amount of 20,000. The bonds are due for repayment in full in 2023, subject to a five-year put option. The coupon rate for both series was set at 8.0% per annum, paid semiannually, subject to revision in five years. The net proceeds of the bonds issue were applied to prepay in full the outstanding debt under the VTB Credit Facility in the amount of 11,000 and to partially prepay one of the Sberbank Credit Facilities in the amount of 9,000.

Sberbank

In December 2013 the Group signed amendments to the Sberbank Credit Facilities, which were fully drawn in 2012 and partially prepaid in the amount of 9,000 in March 2013 using the proceedes of Ruble bonds, extending terms of the facilities. The amendment was not a substantial modification in terms of IAS 39; accordingly, no debt extinguishment accounting was applied.

Covenant requirements

All financing facilities contain restrictive covenants, which, among other things, 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.

Currencies of loans and borrowings

The Group’s loans and borrowings are denominated in the following currencies at 31 December:

	2013		2012	
Original currency	**Borrowing currency**	**Millions of Rubles**	**Borrowing currency**	**Millions of Rubles**
Rubles	103,561	103,561	104,770	104,770
US dollars (in millions)	1,342	43,934	1,188	36,090
Euros (in millions)	104	4,655	138	5,562
Total loans and borrowings		**152,150**		**146,422**

Capitalised borrowing costs

Interest capitalised was 1,382 (out of the total interest expense of 13,566) and 1,885 (out of the total interest expense of 9,603) for the years ended 31 December 2013 and 2012, respectively. The rate used to determine the amount of borrowing costs eligible for capitalisation was 7.2% and 6.4% for the years ended 31 December 2013 and 2012, respectively. The interest capitalised has been paid in cash during the respective periods.

17. Financial assets and liabilities (continued)

Undrawn credit facilities

At 31 December 2013 the Group had available 85,635 (2012: 87,168) of undrawn credit facilities.

Deferred and contingent consideration

The following table presents changes to the liability for contingent consideration at fair value through profit or loss for the years ended 31 December:

	2013	**2012**
Balance at beginning of year	5,806	4,379
Investment in Euroset *(Note 10)*	—	3,082
Accrued interest	44	104
Payment for Euroset *(Note 10)*/NetByNet *(Note 29)*	(3,182)	(1,490)
Synterra final settlement	(2,696)	—
Measurement period adjustments	—	(99)
Change in estimates	(349)	14
Foreign currency exchange adjustment	377	(184)
Total	—	**5,806**
Total current	—	**5,806**
Total non-current	—	—

On 2 August 2013 the Group in a series of transactions with Synterra Cyprus Limited and Burnham Advisors Limited settled the contingent consideration which was due under the sale and purchase agreement dated 2 June 2010 for the acquisition of CJSC Synterra. In full settlement of the contingent consideration due, the Group transferred to the sellers its 60% interest in CJSC Synterra-Media (a provider of telecommunication services to TV broadcasters), its 100% interest in CJSC Absolut (the owner of the Group's head office building in Moscow) and a cash payment of $7 million (231 at the exchange rate as of 2 August 2013).

At the same time the Group signed an agreement with CJSC Absolut to lease the office building back from 2 August 2013 to 30 June 2016 for $12.6 million (415 at the exchange rate as of 2 August 2013).

A gain from settlement of contingent consideration of 263 has been recognised and included in the 'Gain on financial instruments, net' in the consolidated statement of comprehensive income.

17. Financial assets and liabilities (continued)

The following table presents changes to the liability for deferred consideration at amortised cost arising on Scartel acquistion *(Note 9)* for the year ended 31 December:

	2013
Balance at beginning of year	—
Acquisition *(Note 9)*	38,331
Accrued interest	575
Foreign currency exchange adjustment	292
Total	**39,198**
Total current	**(19,599)**
Total non-current	**19,599**

Hedging activities and derivatives

In the normal course of business, the Group is exposed to certain risks related to fluctuations in interest rates and foreign currency exchange rates. The Group uses derivative contracts, primarily interest rate swaps and foreign currency swaps, to manage those risks.

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.

Interest rate swaps are recorded on the statement of financial position at fair value. The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in other comprehensive income/(loss) and is subsequently reclassified into earnings in the period that the hedged forecast transaction affects earnings. There has been no ineffective portion in the reporting years. The fair values of the 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, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

17. Financial assets and liabilities (continued)

The Group had the following outstanding interest rate swaps stated at their notional amounts that were designated as cash flow hedges of interest rate risk:

	31 December 2013		31 December 2012	
Original currency	**Millions, original currency**	**Millions, Rubles**	**Millions, original currency**	**Millions, Rubles**
Euro	11	495	34	1,368
US Dollar	576	18,852	666	20,228

Cash flow hedge of foreign currency risk

In September 2013 the Company entered into a fixed-to-fixed rate cross-currency swap agreement with a notional amount of $107 million (3,502 at the exchange rate as of 31 December 2013) 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. The effective portion of changes in the fair value of the swap of 14 (gain) for the period ended 31 December 2013 has been recorded in other comprehensive income/(loss) and will subsequently be reclassified into earnings in the period in which the hedged forecast transaction affects earnings. There has been no ineffective portion in the reporting period.

Derrivatives not designated as hedging instruments

In May 2013 the Company entered into a cross-currency swap agreement with a notional amount of $293 million (9,590 at the exchange rate as of 31 December 2013) that limits the exposure from changes in US dollar exchange and interest rates on certain long-term debt.

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

17. Financial assets and liabilities (continued)

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

	2013	2012
Derivatives designated as cash flow hedges		
– interest rate swaps		
Amount of loss recognised in cash flow hedge reserve	(48)	(311)
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	139	50
Deferred tax on movements in OCI	34	—
	125	(261)
– cross-currency swap		
Amount of loss recognised in cash flow hedge reserve	(2)	—
Amount of gain reclassified from accumulated cash flow hedge reserve into foreign exchange gain/loss, net	(47)	—
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	63	—
Deferred tax on movements in OCI	(3)	—
	11	—
Total in OCI	**136**	**(261)**

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

	2013	2012
Gain from settlement of Synterra contingent consideration	263	—
Change in fair value of financial instruments measured through profit or loss:		
Euroset settlement put option	58	—
Cross-currency swap not designated as hedge	(52)	—
IPO-related written put option fair value change	—	6,348
Total gain on financial instruments, net	**269**	**6,348**

IPO-related written put option

In April 2012 the shareholders of the Group signed an agreement to the effect that, if an IPO of the Group had not been consummated by 31 December 2014, Sonera Holding B.V., a member of TeliaSonera Group, would have the right to sell to MICL (the "Put Option") and MICL would have the right to buy from Sonera Holding B.V. (the "Call Option") up to 10.6% of the Company's ordinary shares (the "Option Shares"). The price payable to exercise the Put and Call Options would have been based on the fair value of the Company's shares as determined at the date of exercise. Telecominvest Holdings Limited, a company indirectly controlled by USM Group *(Note 29)*, at its sole discretion could elect to purchase any or all of the Option Shares under the Put and Call Options.

17. Financial assets and liabilities (continued)

TeliaSonera's right, but not its obligation, to sell the Option Shares back to the Group at a certain date for a certain amount of cash consideration (written put option) created an obligation for the Group in the event that no IPO occured before 31 December 2014.

The written put option, along with the corresponding shares, was classified as a financial liability at fair value with an offset reflected in equity.

As the contract specified the number rather than the value of the shares to be redeemed, the financial liability was initially measured using an estimate of the share price the Group would have to pay. The best estimate of the share price at the time that the agreement was signed (24 April 2012) was the share price used in the equity transaction between MICL and Allaction Limited that also took place in April 2012, i.e. 715 Rubles per share. The financial liability was subsequently adjusted to reflect the IPO price of 619 Rubles per share. An amount of 6,348 was recognised as a fair value change of the liability during the year ended 31 December 2012. On 28 November 2012 the agreement with Sonera Holding B.V. and the Put and Call Options expired as a result of the Company's successful completion of its IPO. On that date the carrying amount of the liability was reclassified to equity.

Fair values

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

	Carrying amount		**Fair value**	
	31 December		**31 December**	
	2013	**2012**	**2013**	**2012**
Financial assets				
Financial assets at fair value through profit or loss:				
Euroset settlement put option	1,176	1,118	1,176	1,118
Cross-currency swap not designated as hedge	300	—	300	—
Cross-currency swap designated as cash flow hedge	125	—	125	—
Loans and receivables	38,120	22,331	38,120	22,331
Assets held for sale	1,516	—	1,851	—
Total financial assets	**41,237**	**23,449**	**41,572**	**23,449**

17. Financial assets and liabilities (continued)

	Carrying amount		Fair value	
	31 December		31 December	
	2013	2012	2013	2012
Financial liabilities				
Financial liabilities at amortised cost:				
Loans and borrowings	152,009	146,032	155,170	148,179
Convertible debt instrument	20,678	16,812	20,678	16,812
Liability for marketing related licences	177	682	177	682
Long-term accounts payable	950	—	950	—
Deferred consideration for Scartel	39,198	—	39,198	—
Financial liabilities at fair value through profit or loss:				
Contingent consideration	—	5,806	—	5,806
Financial liabilities at fair value through OCI:				
Interest-rate swaps designated as cash flow hedges	209	261	209	261
Cross-currency swaps designated as cash flow hedges	128	—	128	—
Total financial liabilities	**213,349**	**169,593**	**216,510**	**171,740**

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

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

Fair values of the Group’s loans and borrowings (Level 2), except for market quoted bonds (Level 1), 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 2013 was assessed to be insignificant.

The fair value of the Group’s assets held for sale (Level 3), which mainly consists of the office building in Saint Petersburg *(Note 22)*, is determined based on real estate transaction prices observed in the market.

17. Financial assets and liabilities (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 30)*.

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

	Euroset settlement put option	Cross-currency swaps	**Total financial assets**	Contingent considera-tion	Interest rate/cross-currency swaps	**Total financial liabilities**
31 December 2013						
Level 1	—	—	—	—	—	—
Level 2	—	425	**425**	—	(337)	**(337)**
Level 3	1,176	—	**1,176**	—	—	—
Total as of 31 December 2013	**1,176**	**425**	**1,601**	—	**(337)**	**(337)**
31 December 2012						
Level 1	—	—	—	—	—	—
Level 2	—	—	—	—	(261)	**(261)**
Level 3	1,118	—	**1,118**	(5,806)	—	**(5,806)**
Total as of 31 December 2012	**1,118**	**—**	**1,118**	**(5,806)**	**(261)**	**(6,067)**

During the years ended 31 December 2013 and 31 December 2012 there were no transfers between levels of the fair value hierarchy.

The table below presents a reconciliation of the beginning and ending balances of financial instruments having fair value measurements based on significant unobservable inputs (Level 3) for the year ended 31 December 2013:

	Beginning balance at 1 January 2013	Line items in profit or loss	Realised gains/(losses) recognised in profit or loss	Unrealised gains/(losses) recognised in profit or loss	Settlements	**Ending balance at 31 December 2013**
Euroset settlement put option	**1,118**	Gain on financial instruments	—	58	—	**1,176**
Contingent consideration	**(5,806)**	Gain on financial instruments	349	—	5,878	**—**
		Finance costs	—	(44)	—	**—**
		Foreign exchange loss	—	(377)	—	**—**
Total	**(4,688)**		**349**	**(363)**	**5,878**	**1,176**

17. Financial assets and liabilities (continued)

The significant unobservable inputs used for Euroset settlement put option valuation are: exercise date of the 5 December 2014, volatility of 25.3%, risk-free rate of 0.13%, and dividend yield of 7.5%. Volatility and risk-free rate are correlated with the option term: postponement of the exercise date increases the option term and, consequently, increases volatility and risk-free rate. If expected exercise date is moved to the 5 December 2015 the option asset increases by approximately 200.

18. Non-financial assets and liabilities

Current non-financial assets are as follows:

	31 December 2013	31 December 2012
VAT receivable	2,857	1,466
Prepayments for services	2,113	2,442
Deferred costs	478	241
Prepayments for inventory	281	631
Prepaid taxes, other than income tax	231	183
Total current non-financial assets	**5,960**	**4,963**

Non-current non-financial assets are as follows:

	31 December 2013	31 December 2012
Deferred costs, non-current	968	977
Long-term advances	332	979
Total non-current non-financial assets	**1,300**	**1,956**

Current non-financial liabilities are as follows:

	31 December 2013	31 December 2012
Advances from customers	10,035	8,424
VAT payable	4,581	6,603
Current portion of deferred revenue	3,064	3,202
Taxes payable, other than income tax	1,759	1,680
Other current liabilities	51	128
Total current non-financial liabilities	**19,490**	**20,037**

18. Non-financial assets and liabilities (continued)

Non-current non-financial liabilities are as follows:

	31 December 2013	31 December 2012
Deferred revenue	750	1,109
Advance received for sale of property and equipment	359	359
Other non-current liabilities	61	375
Total non-current non-financial liabilities	**1,170**	**1,843**

19. Inventory

Inventory is as follows:

	31 December 2013	31 December 2012
Handsets	5,396	2,981
Electronic devices and accessories	1,205	790
USB modems	1,013	718
Other	762	788
Total inventory	**8,376**	**5,277**

The amount of inventory write-down to net realisable value and other inventory losses recognised in 'Cost of equipment and accessories' line in the statement of comprehensive income for the year ended 31 December 2013 is 1,560 (2012: 525).

20. Trade and other receivables

Trade and other receivables are as follows:

	31 December 2013	31 December 2012
Local subscribers	5,245	4,633
Dealers	1,921	3,108
Interconnection charges	1,851	1,727
Rebates receivable	1,605	3,753
Roaming charges receivable	414	287
Other receivables	1,158	1,293
Impairment allowance	(1,462)	(1,259)
Total trade and other receivables	**10,732**	**13,542**

20. Trade and other receivables (continued)

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

	31 December 2013	2012
Neither past due nor impaired	9,286	12,185
Past due but not impaired:		
Less than 30 days	722	514
30 - 90 days	457	463
More than 90 days	267	380
Total trade and other receivables	**10,732**	**13,542**

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

	2013	2012
Balance at beginning of year	1,259	1,447
Change in the impairment allowance	1,163	1,319
Accounts receivable written off	(960)	(1,507)
Balance at end of year	**1,462**	**1,259**

21. Cash and cash equivalents

Cash and cash equivalents are as follows:

	31 December 2013	2012
Cash at bank and on hand in		
Rubles	1,984	1,640
US dollars	119	704
Euros	36	29
Short-term bank deposits in		
Rubles	1,549	14
US dollars	6,251	—
Total cash and cash equivalents	**9,939**	**2,387**

22. Assets held for sale

In December 2013 the Group decided to sell its office building in Saint Petersburg.

23. Provisions

Decommissioning provision

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

	2013	2012
Balance at beginning of year	5,724	5,032
Revisions in estimated cash flows	(1,445)	(194)
Acquisitions *(Note 9)*	232	—
Additions	256	363
Unwinding of discount	588	523
Balance at end of year	**5,355**	**5,724**

Revisions in estimated cash flows during the years ended 31 December 2013 and 2012 in the table above mainly relate to a decrease in expected decommissioning costs per item, which also reduced buildings and structures cost in property and equipment *(Note 14)*.

24. Trade and other payables

Trade and other payables are as follows:

	31 December	
	2013	**2012**
Equipment suppliers	10,989	6,488
Due to employees	5,916	5,033
Advertising	2,754	745
Payables for inventory	2,384	509
Interconnection charges	2,039	1,571
Rent and utilities	1,677	874
Social charges	1,366	1,190
Dealers	968	1,711
Content providers	934	793
Network repairs and maintenance	722	472
Channels rental	663	650
Roaming rebates given	368	802
Roaming charges payable	268	279
Social infrastructure payables *(Notes 29, 31)*	—	766
Other payables	2,827	1,840
Total trade and other payables	**33,875**	**23,723**

25. Share-based compensation

Long-term incentive programme 2013

In August 2013 the Company's Board of Directors approved a long-term motivation and retention program for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of the Company (equal to 7,000,000 phantom shares) at the base price of $24.25 per share. The plan has a three-year duration and the awarded share options vest in April-May 2015 and April-May 2016 and are settled in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted-average price of the Company's shares in the period between 15 January and 15 March of the relevant year of vesting. Vesting of the options is generally contingent upon the recipient's continuing employment with the Company. As of 31 December 2013 no options have been granted under the programme.

Long-term incentive programme 2012

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

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

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

25. Share-based compensation (continued)

The following table illustrates the major assumptions of the Monte Carlo model for the options for the year ended 31 December 2013:

Expected term, years	0.3 - 1.3
Expected volatility	24% - 26%
Expected dividend yield	7.5%
Risk free interest rate	0.21%

During the three months ended 31 December 2013, using its discretion under the plan, Group management permitted employees leaving the Group, who were considered deserving, to exercise a total of 60,000 options, notwithstanding the requirements of the plan set forth above.

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

	Number of options	**Share price at exercise date per option**	
		US Dollars	**Rubles**
Granted in February 2013	2,133,000		
Exercised	(60,000)	33.52	1,091
Forfeited	(88,000)		
Outstanding as of 31 December 2013	**1,985,000**		
Exercisable as of 31 December 2013	—	—	—

The fair value of options outstanding at 31 December 2013 is 458 Rubles per option. The carrying amount of the liability relating to these awards at 31 December 2013 is 493. The employee benefits expense recognised during the year ended 31 December 2013 in the consolidated statement of comprehensive income is 557, including related social charges.

CEO long-term incentive plan (see also Note 32 Events after the reporting date)

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

Pursuant to the plan, Mr. Tavrin was also given three options to buy up to a further 1.25% of the total issued shares on each of his employment anniversary dates in May 2013, May 2014 and May 2015 at the IPO price. The options could be exercised, in whole or in part, on those dates or subsequently. Any unexercised portion of the options will continue to be capable of being exercised in whole or in part until they lapse in May 2017. Their exercise is subject to Mr. Tavrin's continued employment with the Group and Mr. Tavrin's holding at least a 1.25% interest in the Company on the relevant exercise date.

The strike price of the options is subject to potential adjustment at the discretion of the Company's Board of Directors in case the Company declares a special dividend or a dividend

25. Share-based compensation (continued)

that materially exceeds the contemplated dividend policy. Mr. Tavrin agreed not to hold more than 5% of authorised share capital of the Company at any time prior to May 2017.

The awards are classified as equity. The fair value of the options has been estimated using the Black-Scholes model. The fair value of each grant is estimated on the date of grant. The Group used the following significant assumptions to estimate the fair value. Expected volatility was estimated based on the average historical volatility of publicly traded guideline companies over the period equal to the expected life of the option granted and other factors. The dividend yield was included into the model based on expected dividend payments. The risk free rate was determined on the basis of U.S. Treasury yield curve rates with a remaining term to maturity equal to the expected life of the options.

The expected term of the options was determined as an average of vesting term and original contractual term ("simplified method") since the Group has limited employee share option exercises and the available data does not demonstrate consistent exercise behavior.

The following table illustrates the major assumptions of the Black-Scholes model for the options for the year ended 31 December 2013:

Expected term, years	2.5 - 3.5
Expected volatility	32.9% - 39.5%
Expected dividend yield	7.5%
Risk free interest rate	0.12% - 0.38%
Share price	$20 (619 Rubles)

In May 2013 Mr. Ivan Tavrin exercised an option and acquired an additional 7,750,000 shares. None of the stock options were forfeited or expired during the year ended 31 December 2013.

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

	Number of options	Share price at grant/exercise date per option US Dollars	Rubles
Outstanding as of 1 January 2012	—		
Granted	31,000,000	20.00	619
Exercised	(7,750,000)	23.88	735
Outstanding as of 31 December 2012	**23,250,000**		
Exercisable as of 31 December 2012	—		
Exercised	(7,750,000)	31.05	975
Outstanding as of 31 December 2013	**15,500,000**		
Exercisable as of 31 December 2013	—		

The table below summarises the weighted-average grant date fair value of options:

Nonvested as of 1 January 2013	1,755
Vested (recognised employee benefits cost)	(1,177)
Nonvested as of 31 December 2013	**578**

26. Long-term incentive programme

In April 2008 the Group's Board of Directors approved a long-term motivation and retention programme. Under this programme certain key executive and senior level employees are eligible for cash benefits that depend on the increases in the Company's value which is based on formula driven calculation. These benefits vest every two years over a four-year period and are contingent upon the recipient's continuing employment with the Group and an increase in the value of the Group as calculated. These benefits are accounted for as other long-term employee benefits with accrued liabilities included in trade and other payables *(Note 24)* and non-current financial liabilities *(Note 17)* in the accompanying consolidated financial statements as of 31 December 2013 and 2012 in the amounts of 320 and 559, respectively. Current service costs and related social charges recognised as employee benefits cost under the programme for the years ended 31 December 2013 and 2012, included in general and administrative expenses *(Note 28)*, totaled 176 and 572, respectively.

27. Sales and marketing expenses

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

	2013	2012
Advertising	8,098	8,136
Dealer commissions for connection of new subscribers	5,805	7,098
Cash collection and other commissions	4,784	4,513
Total sales and marketing expenses	**18,687**	**19,747**

28. General and administrative expenses

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

	2013	2012
Employee benefits and related social charges	27,866	26,656
Rent	13,184	12,243
Operating taxes	7,106	6,684
Network repairs and maintenance	5,622	5,196
Utilities	4,372	3,850
Radio frequency fees	4,163	3,940
Change in the impairment allowance account for trade and other receivables and advances to suppliers	2,037	1,319
Office maintenance	1,882	1,839
Professional services	1,213	1,886
Vehicle costs	696	647
Materials and supplies	194	238
Insurance	81	88
Social infrastructure expenses *(Notes 29, 31)*	—	1,816
Other expenses	2,142	2,084
Total general and administrative expenses	**70,558**	**68,486**

29. Related parties

As of 31 December 2013 the Group is owned by USM Group, an indirect controlling shareholder, and TeliaSonera Group, another major shareholder with significant influence over the Group. Alfa Group held an equity interest in the Company until 24 April 2012.

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	
	2013	**2012**
Revenues from USM Group	764	101
Revenues from TeliaSonera Group	465	179
Revenues from Euroset	240	—
	1,469	**280**
Services from USM Group	1,233	2,975
Services from TeliaSonera Group	1,129	725
Services from Alfa Group	—	263
Services from Euroset	1,145	51
	3,507	**4,014**

	31 December	
	2013	**2012**
Due from USM Group	20	850
Due from TeliaSonera Group	72	154
Due from Euroset	184	82
	276	**1,086**
Due to USM Group	60,275	17,558
Due to TeliaSonera Group	149	53
Due to Euroset	293	57
	60,717	**17,668**

Terms and conditions of transactions with related parties

Outstanding balances at the years ended 31 December 2013 and 2012 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 31 December 2013 and 2012, 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.

29. Related parties (continued)

USM Group

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

The Group entered into an agreement with Telecominvest, a member of the USM Group, for provision of legal and personnel services effective in 2012 and 2013. In addition, the Group purchased billing system and related support services from PeterService, another member of the USM Group, in the amount of 1,880 and 1,970 during 2013 and 2012, respectively.

In February 2012 the Group prepaid Scartel an aggregate amount of $50 million (1,636 at the exchange rate as of 31 December 2013) for the provision of future interconnection services under a mobile virtual network operator ("MVNO") agreement. In July 2012 both MegaFon and Scartel became indirect subsidiaries of Garsdale. As a result, Scartel became a related party of MegaFon. Before that date, Scartel was not one of the Group's related parties. On 1 October 2013 MegaFon acquired Scartel *(Note 9)*.

Amounts due to USM Group mainly represent the convertible debt instrument related to its investment in Euroset made in 2012 *(Note 10)* and the deferred consideration for the Scartel acquisition (*Notes 9, 17*).

At the time of the acquisition of VAS Media *(Note 9)*, a member of the Company's Board of Directors and the spouse of a member of the Group's management beneficially owned an aggregate of approximately 13% of Felebior Holding Limited, the VAS Media holding company. In addition, other sellers of significant interests in Felebior Holding Limited have from time to time been associated with companies in the USM Group. The transaction was unanimously approved by the Board of Directors of the Group.

Cost of revenues for the eight months ended 31 August 2012 (before the acquisition) was 2,582, related to services the Group received from VAS Media. The amounts of revenue and net income of VAS Media included in the Group's consolidated statement of comprehensive income from 1 September to 31 December 2012 were 1,640 and 449, respectively. These amounts are shown before elimination of intragroup transactions, which were mainly revenues from services provided by VAS Media to the Group of 1,521.

The amount on deposit accounts with Round Bank as of 31 December 2013 and 2012 was nil and 450, respectively

In 2012 the Group became 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 contributed 766 and 1,050 to the Partnership during 2013 and 2012, respectively.

29. Related parties (continued)

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.

Alfa Group

The outstanding balances and transactions with Alfa Group relate to operations with Altimo, AlfaStrakhovanie and Alfa Bank, members of Alfa Group. Alfa Group held a 25.1% interest in the Group through its member subsidiary Allaction Limited until 24 April 2012, when Allaction Limited ceased to hold any shareholding in the Group and ceased to be a related party. Operating expenses from transactions with the Alfa Group mainly related to an agreement with Altimo for the provision of legal and personnel services and with AlfaStrakhovanie for the provision of employees' medical and health insurance in 2012.

Euroset

Beginning from December 2012, Euroset is the Group's joint venture with VimpelCom *(Note 10)*. In December 2012 the Group entered into a dealership agreement with Euroset which qualifies as a related party transaction.

NetByNet

In June 2012 the Group paid $44 million (1,490 at the exchange rates as of payment dates) in full and final settlement of all contingent consideration liability for the NetByNet acquisition. A portion of this liability has been paid to a company the beneficiary of which is the CEO of the Company, Mr. Tavrin. Mr. Tavrin was not a related party at the time of the NetByNet acquisition in June 2011.

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 a employee benefits expense to key management personnel of the Company for the years ended 31 December are as follows:

	2013	**2012**
Share-based compensation *(Note 25)*	1,491	315
Short-term employee benefits	632	665
Long-term incentive programme *(Note 26)*	63	315
Total	**2,186**	**1,295**

30. Financial risk management

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

The Group is exposed to market risk, credit risk and liquidity risk. The Group's senior management oversees the management of these risks. The Group's senior management is supported by the Finance and Strategy Committee 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 2013 and 2012. 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 2013 and 2012.

Interest rate risk

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

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

At 31 December 2013, after taking into account the effect of interest rate swaps, approximately 86% of the Group's borrowings are at a fixed rate of interest (2012: 85%).

30. 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 2013		
US Dollar	+3	(5)
US Dollar	-3	5
Ruble	+93	—
Ruble	-93	—
Year ended 31 December 2012		
US Dollar	+5	(6)
US Dollar	-5	6
Ruble	+109	(120)
Ruble	-109	120

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 costs, expenditures and liabilities is denominated in US dollars or Euro. If the Ruble were 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 devaluation, and also to match its foreign currency liabilities.

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

30. Financial risk management (continued)

During 2013, the Group entered into two 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 17)*.

Overall, the share of Ruble loans (including the effect of cross-currency swaps) increased to 76% as of 31 December 2013 (71% at 31 December 2012).

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

	Change in foreign exchange rates	Effect on profit before tax
Year ended 31 December 2013		
US Dollar	+10%	(5,078)
US Dollar	-10%	5,078
Euro	+10%	(462)
Euro	-10%	462
Year ended 31 December 2012		
US Dollar	+10%	(4,156)
US Dollar	-10%	4,156
Euro	+10%	(307)
Euro	-10%	307

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.

30. Financial risk management (continued)

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

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

The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in *Note 17*. The Group evaluates the concentration of risk with respect to trade receivables as low, as its customers are located in several jurisdictions and industries and operate in largely independent markets. Concentrations of credit risk with respect to trade receivables are limited given that the Group's customer base is large and unrelated. Due to this management believes there is no further credit risk provision required in excess of the normal provision for bad and doubtful 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 13% of the Group's loans and borrowings will mature in less than one year at 31 December 2013 (2012: 14%) based on the carrying value of borrowings reflected in the financial statements. The Group assessed the concentration of risk with respect to refinancing its debt and concluded it to be low.

As of 31 December 2013 and 2012, 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 *(Note 17)*. Additionally, the Group can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, Group management believes that cash flows from operating and financing activities will be sufficient for the Group to meet its obligations as they become due.

30. Financial risk management (continued)

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

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
31 December 2013					
Loans and borrowings	31,180	48,510	74,234	43,274	**197,198**
Convertible debt instrument	22,101	—	—	—	**22,101**
Deferred consideration	20,469	21,627	—	—	**42,096**
Long-term accounts payable	193	543	289	—	**1,025**
Liability for marketing related licences	177	—	—	—	**177**
Derivative financial liabilities	312	72	—	—	**384**
Trade and other payables	33,875	—	—	—	**33,875**
Total 31 December 2013	**108,307**	**70,752**	**74,523**	**43,274**	**296,856**
31 December 2012					
Loans and borrowings	29,377	99,863	42,202	752	**172,194**
Convertible debt instrument	17,810	—	—	—	**17,810**
Contingent consideration	5,848	—	—	—	**5,848**
Liability for marketing related licences	550	159	—	—	**709**
Derivative financial liabilities	135	91	46	3	**275**
Trade and other payables	23,723	—	—	—	**23,723**
Total 31 December 2012	**77,443**	**100,113**	**42,248**	**755**	**220,559**

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 2013 the Net Debt to OIBDA ratio was 0.77.

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

30. Financial risk management (continued)

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

	2013	2012
OIBDA	**132,592**	**117,149**
Depreciation	(44,851)	(45,508)
Amortisation	(6,131)	(6,046)
Loss on disposal of non-current assets	(1,200)	(1,713)
Finance costs	(12,184)	(7,718)
Finance income	1,888	1,193
Share of profit/(loss) of associates and joint ventures	(202)	213
Other non-operating income/(loss)	(81)	191
Gain on financial instruments, net	269	6,348
Foreign exchange loss, net	(2,914)	(8,196)
Profit before tax	**67,186**	**55,913**

Collateral

The Group did not pledge collateral as security for its financial liabilities at 31 December 2013 or 2012, except assets purchased under deferred payment terms *(Note 14)*.

31. Commitments, contingencies and uncertainties

Russian operating environment

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

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in uncertainty regarding further economic growth, availability of financing and cost of capital, 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.

3G licence capital commitments

In May 2007, MegaFon was awarded a licence that expires on 21 May 2017 for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G licence was granted subject to certain capital and other commitments. The three major conditions were that the Group builds a specified number of base stations that support 3G standards, starts commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also builds a certain number of base stations by

31. Commitments, contingencies and uncertainties (continued)

the end of the third, fourth and fifth years from the date of granting the licence. As of 4 March 2014, the Group believes it is in full compliance with the 3G licence conditions.

4G licence capital commitments

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

Under the terms and conditions of this licence, the Company is obligated to provide 4G 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 roll-out until the network is fully deployed, to clear frequencies currently allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401. In July 2012 the Company has fully paid the compensation due to the other operators. It is currently not able to reasonably estimate the amount of the cost of clearing military frequencies.

Social infrastructure expenses

The Group may be required 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 are conducted in collaboration with non-governmental charity organisations. These expenses are presented as part of the general and administrative expenses in the consolidated statements of comprehensive income.

Taxation

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

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 4 March 2014, the Group's management estimated the possible effect of additional operating taxes, before fines and interest, if any, on these consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 300.

31. Commitments, contingencies and uncertainties (continued)

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' liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Group.

32. Events after the reporting date

Apple agreement

In January 2014, the Group entered into an agreement with LLC Apple Rus ("Apple"), a Russian affiliate of Apple Computer Inc., to purchase at least 750,000 iPhone handsets over a three-year period ending on 31 December 2016 for further resale in Russia. According to the agreement, the Group is also required to spend on marketing, advertising and promotion of iPhone handsets an amount of approximately 1,000 over the same period.

Financing

In February 2014 the Group signed a new credit facility agreement with Société Générale and Nordea Bank Finland plc ("Finnvera VIII credit facility") for up to $150 million (4,909 at the exchange rate as of 31 December 2013). The Finnvera VIII credit facility shall be used to finance purchases of Nokia Solutions and Networks ("NSN") equipment and services. The facility carries interest at a rate of 2.2% per annum plus bank margin. The Finnvera VIII credit facility requires the Group to make semi-annual payments, plus accrued interest, during the period from 2014 to 2022. To date, no amount has been drawn under this Finnvera VIII credit facility.

CEO long-term incentive plan

On 4 March 2014 the Board of Directors of the Company agreed unanimously to amend the terms of the CEO long-term incentive plan *(Note 25)* and to accelerate the vesting of Mr. Tavrin's final option to acquire a 1.25% interest in the Company, so that all the remaining options may now be exercised at any time after 1 May 2014. In addition, the Board agreed to remove the restriction on Mr. Tavrin holding more than 5% of the authorised share capital of the Company at any time prior to May 2017.