MEGAFON

Interim condensed consolidated financial statements
(Unaudited)

For the nine months ended 30 September 2015

Contents

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Auditors' Report on Review of Interim condensed consolidated financial statements

To the Board of Directors and Shareholders

PJSC MegaFon

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of PJSC MegaFon (the "Company") and its subsidiaries (the "Group") as at 30 September 2015, and the related interim condensed consolidated statement of comprehensive income for the three- and nine-month periods ended 30 September 2015, the related interim condensed consolidated statements of changes in equity and cash flows for the nine-month period ended 30 September 2015, and notes to the interim condensed consolidated financial statements (the "interim condensed consolidated financial statements"). Management is responsible for the preparation and presentation of this interim condensed consolidated financial statements in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim condensed consolidated financial statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements as at 30 September 2015 and for the three- and nine-month periods ended 30 September 2015 are not prepared, in all material respects, in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*.

КПМГ
KPMG

Akylbek Y. A.

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

JSC "KPMG"

28 October 2015

Moscow, Russian Federation

Entity: PJSC MegaFon

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

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

30 Kadashevskaya Emb., Moscow 115035.

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

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

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

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

MegaFon

Interim condensed consolidated statement of comprehensive income

(In millions of Rubles)

	Note	Three months ended 30 September 2015	Three months ended 30 September 2014	Nine months ended 30 September 2015	Nine months ended 30 September 2014
		(Unaudited)		(Unaudited)	
Revenues		**81,279**	**81,066**	**231,403**	**232,608**
Operating expenses					
Cost of revenues		21,270	21,530	59,998	61,061
Sales and marketing expenses	11	4,628	4,209	12,492	11,952
General and administrative expenses	12	19,236	18,064	56,067	55,531
Depreciation		12,283	11,852	36,398	35,578
Amortisation		1,845	1,865	5,490	5,883
Loss on disposal of non-current assets	7	225	200	458	689
Total operating expenses		**59,487**	**57,720**	**170,903**	**170,694**
Operating profit		**21,792**	**23,346**	**60,500**	**61,914**
Finance costs		(3,480)	(3,222)	(11,027)	(10,667)
Finance income		279	330	1,773	791
Share of gain/(loss) of associates and joint ventures		144	3	(415)	(665)
Other non-operating (expenses)/income	14	(249)	42	(2,725)	(1,085)
Gain/(loss) on financial instruments, net		1,314	(1,016)	713	(55)
Foreign exchange loss, net		(2,385)	(3,412)	(4,750)	(6,708)
Profit before tax		**17,415**	**16,071**	**44,069**	**43,525**
Income tax expense	13	4,019	3,125	10,356	9,374
Profit for the period		**13,396**	**12,946**	**33,713**	**34,151**

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

Interim condensed consolidated statement of comprehensive income (continued)

(In millions of Rubles, except per share amounts)

	Three months ended 30 September 2015 (Unaudited)	Three months ended 30 September 2014 (Unaudited)	Nine months ended 30 September 2015 (Unaudited)	Nine months ended 30 September 2014 (Unaudited)
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	(781)	(356)	(660)	(374)
Net movement on cash flow hedges, net of tax	—	6	(30)	114
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods	**(781)**	**(350)**	**(690)**	**(260)**
Total comprehensive income for the period, net of tax	**12,615**	**12,596**	**33,023**	**33,891**
Profit for the period				
Attributable to equity holders of the Company	13,306	12,792	33,709	33,906
Attributable to non-controlling interest	90	154	4	245
Total comprehensive income/(loss) for the period				
Attributable to equity holders of the Company	12,711	12,530	33,193	33,753
Attributable to non-controlling interest	(96)	66	(170)	138
Earnings per share, Rubles				
Basic, profit for the period attributable to equity holders of the Company	22	22	56	58
Diluted, profit for the period attributable to equity holders of the Company	22	22	56	58

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

MegaFon

Interim condensed consolidated statement of financial position

(In millions of Rubles)

	Note	30 September 2015 (Unaudited)	31 December 2014 (Audited)
Assets			
Non-current assets			
Property and equipment	7	227,952	224,655
Intangible assets, other than goodwill	8	59,665	57,427
Goodwill		33,866	32,292
Investments in associates and joint ventures		34,529	34,944
Non-current financial assets	9	933	2,863
Non-current non-financial assets		2,342	2,053
Deferred tax assets		742	782
Total non-current assets		**360,029**	**355,016**
Current assets			
Inventory		6,301	6,484
Current non-financial assets		6,590	5,161
Prepaid income taxes		2,720	3,713
Trade and other receivables		17,416	16,260
Other current financial assets	9	7,518	48,887
Cash and cash equivalents		70,782	22,223
Total current assets		**111,327**	**102,728**
Total assets		**471,356**	**457,744**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company		181,273	157,689
Non-controlling interests		(100)	144
Total equity		**181,173**	**157,833**
Non-current liabilities			
Loans and borrowings	9	148,565	156,319
Other non-current financial liabilities	9	2,535	1,270
Non-current non-financial liabilities		1,839	1,712
Provisions		5,498	4,958
Deferred tax liabilities		18,560	19,572
Total non-current liabilities		**176,997**	**183,831**
Current liabilities			
Trade and other payables		34,246	36,549
Loans and borrowings	9	50,048	51,149
Other current financial liabilities	9	9,804	7,731
Current non-financial liabilities		18,775	20,493
Income taxes payable		313	158
Total current liabilities		**113,186**	**116,080**
Total equity and liabilities		**471,356**	**457,744**

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

Interim condensed consolidated statement of changes in equity

(In millions of Rubles)

For the nine months ended 30 September 2015 and 30 September 2014

	Attributable to equity holders of the Company									
	Ordinary shares		Treasury shares							
	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 2014	**620,000,000**	**526**	**46,940,089**	**(33,588)**	**12,567**	**157,986**	**543**	**138,034**	**271**	**138,305**
Net profit	—	—	—	—	—	33,906	—	33,906	245	34,151
Other comprehensive loss	—	—	—	—	—	—	(153)	(153)	(107)	(260)
Total comprehensive income/(loss)	—	—	—	—	—	**33,906**	**(153)**	**33,753**	**138**	**33,891**
Share-based compensation	—	—	—	—	—	—	689	689	—	689
Dividends	—	—	—	—	—	(38,428)	—	(38,428)	—	(38,428)
Settlement of convertible debt	—	—	(22,641,056)	16,201	—	5,138	—	21,339	—	21,339
Dividends to non-controlling interests	—	—	—	—	—	—	—	—	(49)	(49)
As of 30 September 2014 (unaudited)	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**158,602**	**1,079**	**155,387**	**360**	**155,747**
As of 1 January 2015	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**161,422**	**561**	**157,689**	**144**	**157,833**
Net profit	—	—	—	—	—	33,709	—	33,709	4	33,713
Other comprehensive loss	—	—	—	—	—	—	(516)	(516)	(174)	(690)
Total comprehensive income/(loss)	—	—	—	—	—	**33,709**	**(516)**	**33,193**	**(170)**	**33,023**
Dividends	—	—	—	—	—	(9,609)	—	(9,609)	—	(9,609)
Dividends to non-controlling interests	—	—	—	—	—	—	—	—	(74)	(74)
As of 30 September 2015 (unaudited)	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**185,522**	**45**	**181,273**	**(100)**	**181,173**

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

MegaFon

Interim condensed consolidated statement of cash flows

(In millions of Rubles)

	Nine months ended 30 September	
	2015	**2014**
	(Unaudited)	
Operating activities		
Profit before tax	44,069	43,525
Adjustments to reconcile profit before tax to net operating cash flows:		
Depreciation	36,398	35,578
Amortisation	5,490	5,883
Loss on disposal of non-current assets	458	689
(Gain)/loss on financial instruments, net	(713)	55
Net foreign exchange loss	4,750	6,708
Share of loss of associates and joint ventures	415	665
Change in impairment allowance for receivables and other non-financial assets	1,530	1,106
Finance costs	11,027	10,667
Finance income	(1,773)	(791)
Equity-settled share-based compensation	—	689
Working capital adjustments:		
Decrease in inventory	195	1,535
Increase in trade and other receivables	(2,239)	(5,810)
(Increase)/decrease in current non-financial assets	(1,113)	913
Decrease in trade and other payables	(3,333)	(2,540)
Decrease in current non-financial liabilities	(2,547)	(2,513)
Change in VAT, net	(67)	2,675
Income tax paid	(10,234)	(7,720)
Income tax refunded	178	172
Interest received	1,885	837
Interest paid, net of interest capitalised	(9,638)	(8,615)
Net cash flows received from operating activities	**74,738**	**83,708**
Investing activities		
Purchase of property, equipment and intangible assets	(45,764)	(40,901)
Proceeds from sale of property and equipment	262	570
Payment of contingent consideration	(104)	(36,330)
Net change in short-term demand deposits	45,853	31,226
Acquisition of subsidiaries, net of cash acquired	(1,467)	(146)
Escrow cash deposit	(690)	—
Net cash flows used in investing activities	**(1,910)**	**(45,581)**
Financing activities		
Proceeds from borrowings, net of fees paid	22,251	24,441
Repayment of borrowings	(43,532)	(8,434)
Dividends paid to equity holders of the Company	(9,609)	(38,428)
Dividends paid to non-controlling interests	(74)	(49)
Payment of liability for marketing related licences	—	(184)
Net cash flows used in financing activities	**(30,964)**	**(22,654)**
Net increase in cash and cash equivalents	41,864	15,473
Net foreign exchange difference	6,695	(2,054)
Cash and cash equivalents at beginning of period	22,223	9,939
Cash and cash equivalents at end of period	**70,782**	**23,358**

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

1. General

Public Joint Stock Company MegaFon ("MegaFon", the "Company" and together with its consolidated subsidiaries the "Group") is a leading universal telecommunications operator in Russia and provides a broad range of voice, data and other telecommunication services to retail customers, businesses, government clients and other telecommunication services providers.

In November 2012, MegaFon completed an initial public offering 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''.

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*, and should be read in conjunction with the annual audited consolidated financial statements of the Group for the year ended 31 December 2014.

These interim condensed consolidated financial statements are unaudited and do not include all the information and disclosures required in the annual International Financial Reporting Standards ("IFRS") financial statements. The Company omitted disclosures which would substantially duplicate the information contained in its 2014 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Company has provided disclosures where significant events have occurred subsequent to the issuance of its 2014 audited consolidated financial statements. Management believes that the disclosures in these interim condensed consolidated financial statements are adequate to make the presented information not misleading if these interim condensed consolidated financial statements are read in conjunction with the Group's 2014 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments necessary to present fairly the Group's financial position, financial performance and cash flows for the interim reporting periods in accordance with IAS 34, *Interim Financial Reporting*.

The interim condensed consolidated financial statements are presented in millions of Rubles, except for per share amounts which are in Rubles, unless otherwise indicated.

The interim condensed consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 28 October 2015.

3. Significant accounting policies

The accounting policies and methods of computation applied in the preparation of these interim condensed consolidated financial statements are consistent with those disclosed in the annual audited consolidated financial statements of the Group for the year ended 31 December 2014.

4. Business combinations

GARS

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

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

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

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

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

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

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

4. Business combinations (continued)

From the date of acquisition, GARS contributed 55 to revenue and 14 to profit before tax of the Group. If the combination had taken place at the beginning of the year, revenue of the Group for the nine months of 2015 would have been 232,301 and profit before tax would have been 44,205.

The Group recognised GARS acquisition-related costs as general and administrative expenses in the amount of 7 for the nine months ended 30 September 2015 in the interim condensed consolidated statement of comprehensive income.

5. Dividends

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

6. Segment information

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

Reconciliation of consolidated OIBDA to consolidated profit before tax for the three and nine months ended 30 September:

	Three months ended 30 September		Nine months ended 30 September	
	2015	**2014**	**2015**	**2014**
OIBDA	**36,145**	**37,263**	**102,846**	**104,064**
Depreciation	(12,283)	(11,852)	(36,398)	(35,578)
Amortisation	(1,845)	(1,865)	(5,490)	(5,883)
Loss on disposal of non-current assets	(225)	(200)	(458)	(689)
Finance costs	(3,480)	(3,222)	(11,027)	(10,667)
Finance income	279	330	1,773	791
Share of gain/(loss) of associates and joint ventures	144	3	(415)	(665)
Other non-operating (expenses)/income	(249)	42	(2,725)	(1,085)
Gain/(loss) on financial instruments, net	1,314	(1,016)	713	(55)
Foreign exchange loss, net	(2,385)	(3,412)	(4,750)	(6,708)
Profit before tax	**17,415**	**16,071**	**44,069**	**43,525**

6. Segment information (continued)

Seasonality of operations

The Company's services are impacted by seasonal trends throughout the year. Higher revenues and operating profits are usually expected in the second half of the year rather than in the first six months. Higher revenues during the period July to September are mainly attributed to the increased demand for telecommunication services during the peak holiday season. Higher revenues also occur in the month of December, due to increased demand for telecommunication services and equipment from private customers. Also the number of working days is significantly higher in the second half of a calendar year than in the first half of the year due to long public holidays in January and May in Russia, which further contributes to higher revenues in the second half of the year. This information is provided to allow for a better understanding of the Group's results; however, management has concluded that these impacts on the results are not "highly seasonal" as considered by IAS 34.

7. Property and equipment

During the nine months ended 30 September 2015, the Group acquired assets with a cost of 38,609 (30 September 2014: 36,017). Assets with a net book value of 892 were disposed of by the Group during the nine months ended 30 September 2015 (30 September 2014: 909), resulting in a net loss on disposal of 405 (30 September 2014: 689). Capitalised borrowing costs were 1,359 and 1,588 for the nine months ended 30 September 2015 and 2014, respectively.

8. Intangible assets

In August 2015 MegaFon acquired 900/1,800 MHz band spectrum in the Samara, Astrakhan, Yaroslavl regions and the Chuvash Republic through the purchase of 100% of the shares of JSC SMARTS-Samara, CJSC Astrakhan GSM, CJSC Yaroslavl GSM and CJSC SMARTS-Cheboksary (together "SMARTS"), the subsidiaries of Russian regional mobile operator JSC SMARTS.

The Group's management concluded that assets and activities of acquired companies are not capable of being conducted and managed as a business, accordingly acquisition of SMARTS was accounted for as an acquisition of assets.

The purchase price totaled 5,745 at the date of acquisition, consisting of cash consideration of 5,525 and a deferred payment with a fair value of 220 payable within six months from the date of the acquisition *(Note 9)*.

9. Financial assets and liabilities

Amended derivative financial instrument

In February 2015 the Group amended its cross-currency swap agreement with a remaining notional amount of $204 million (13,512 at the exchange rate as of 30 September 2015) by changing the swap rate for all the remaining swap payments. The change resulted in an additional charge to the ‘(Gain)/loss on financial instruments, net’ line in profit or loss for the nine months ended 30 September 2015.

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 profit or loss. Total loss recorded in profit or loss in respect of the derivative was 103 for the period ended 30 September 2015 (30 September 2014: 60 gain).

Loans and borrowings

In March 2015 the Group drew down approximately $93.5 million (6,193 at the exchange rate as of 30 September 2015) under the $150 million agreement for equipment financing signed in February 2014. As of 30 September 2015, this credit facility has been fully drawn.

In June 2015 the Company signed a new credit facility agreement for up to Euro 150 million (11,187 at the exchange rate as of 30 September 2015). The credit facility must be used to finance purchases of equipment and related services and requires the Group to make semi-annual payments, including accrued interest, over the period from 2016 to 2024. As of the date of authorisation of these interim condensed consolidated financial statements, no amount has been drawn under this credit facility.

Ruble bonds

In April 2015 the Group decided to repay its Series BO-04 Ruble bonds in full at the end of the second coupon period. The payment of the principal amount of 15,000 was made in May 2015.

9. Financial assets and liabilities (continued)

Fair values

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

		Carrying amount		Fair value	
		30 September 2015 (Unaudited)	31 December 2014	30 September 2015 (Unaudited)	31 December 2014
Financial assets					
Financial assets at fair value through profit or loss:					
Cross-currency swaps not designated as hedges	Level 2	2,202	1,533	2,202	1,533
Financial assets at fair value through OCI:					
Cross-currency swap designated as cash flow hedge	Level 2	1,639	2,082	1,639	2,082
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	3,917	47,534	3,917	47,534
Escrow account	Level 2	693	—	693	
Bank promissory note	Level 2	—	601	—	601
Total financial assets		**8,451**	**51,750**	**8,451**	**51,750**
Financial liabilities					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	176,709	170,104	173,287	161,981
Ruble bonds	Level 1	21,904	37,364	20,082	34,664
Deferred consideration	Level 3	9,314	7,407	9,314	7,407
Finance lease obligations	Level 3	1,085	144	1,085	144
Long-term accounts payable	Level 3	1,067	1,181	1,067	1,181
Financial liabilities at fair value through profit or loss:					
Contingent consideration	Level 3	534	—	534	—
Cross-currency swaps not designated as hedges	Level 2	176	16	176	16
Financial liabilities at fair value through OCI:					
Interest-rate swaps designated as cash flow hedges	Level 2	105	215	105	215
Cross-currency swap designated as cash flow hedge	Level 2	5	33	5	33
Due to employees and related social charges, non-current	Level 3	53	5	53	5
Total financial liabilities		**210,952**	**216,469**	**205,708**	**205,646**

9. Financial assets and liabilities (continued)

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

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

While management has used available market information in estimating the fair value of its financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

The GARS escrow account holds cash reserved for deferred and contingent consideration settlements under the sale and purchase agreement with the sellers of GARS *(Note 4)*. The fair value of the account approximates its carrying value.

Fair values of the Group's loans and borrowings and other liabilities carried at amortised cost, except for market quoted Ruble bonds, are determined by 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 30 September 2015 and 31 December 2014 was assessed to be insignificant.

During the nine months ended 30 September 2015 there were no transfers between levels of the fair value hierarchy.

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.

Valuation techniques and assumptions

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

The Group estimated the fair value of the GARS contingent consideration of 314 and the SMARTS deferred consideration of 220 using a probability-weighted cash flow model. These fair value measurements are based on significant inputs not observable in the market and thus represent a Level 3 measurement.

10. Long-term incentive programme

In July 2015 the Company's Board of Directors approved a long-term motivation and retention program. Under this programme certain key executive and senior level employees will be eligible for cash benefits that depend on the Group's meeting a three-year business plan for free cash flow and market share, which is based on a formula driven calculation. These benefits vest in April-May 2016 and April-May 2017 and are generally contingent upon the recipients' continuing employment with the Group and the Group's meeting the three-year targets.

These benefits are accounted for as other long-term employee benefits with accrued liabilities included in trade and other payables and non-current financial liabilities *(Note 9)* in the accompanying interim condensed consolidated financial statements as of 30 September 2015 in the amount of 134. Current service costs and related social charges recognised as employee benefits cost under the programme for the nine months ended 30 September 2015 and 2014, included in general and administrative expenses *(Note 12)*, totaled 134 and nil, respectively.

11. Sales and marketing expenses

Sales and marketing expenses for the three and nine months ended 30 September are as follows:

	Three months ended 30 September		**Nine months ended 30 September**	
	2015	**2014**	**2015**	**2014**
Dealer commissions for connection of new subscribers	2,034	1,504	5,636	4,292
Advertising	1,973	1,651	4,905	4,729
Cash collection and other commissions	621	1,054	1,951	2,931
Total sales and marketing expenses	**4,628**	**4,209**	**12,492**	**11,952**

12. General and administrative expenses

General and administrative expenses for the three and nine months ended 30 September are as follows:

	Three months ended 30 September		Nine months ended 30 September	
	2015	2014	2015	2014
Employee benefits and related social charges	6,329	6,194	19,621	20,491
Rent	4,176	4,029	12,458	11,599
Operating taxes	2,025	1,698	5,458	5,170
Utilities	1,543	1,305	4,267	3,728
Network repairs and maintenance	1,530	1,603	4,118	4,522
Radio frequency fees	1,280	1,405	3,793	3,964
Office maintenance	688	530	1,967	1,577
Change in allowance account for trade and other receivables and advances to suppliers	582	342	1,530	1,106
Professional services	251	208	691	614
Vehicle costs	193	193	550	602
Materials and supplies	52	36	170	138
Insurance	16	14	44	49
Other expenses	571	507	1,400	1,971
Total general and administrative expenses	**19,236**	**18,064**	**56,067**	**55,531**

13. Income tax

The Group calculates the period income tax expense using the tax rate that would be applicable to the expected total annual earnings.

The major components of income tax expense for the three and nine months ended 30 September in the interim condensed consolidated statement of comprehensive income are as follows:

	Three months ended 30 September		Nine months ended 30 September	
	2015	2014	2015	2014
Current income tax	3,679	2,719	11,362	8,226
Deferred income tax	340	406	(1,006)	1,148
Total income tax expense	**4,019**	**3,125**	**10,356**	**9,374**

14. Related parties

As of 30 September 2015 and 31 December 2014, the Group is primarily owned by USM Group, an indirect controlling shareholder, and TeliaSonera Group, another major shareholder with significant influence over the Group, a publicly owned Swedish company.

14. Related parties (continued)

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

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 periods:

	Three months ended 30 September		**Nine months ended 30 September**	
	2015	**2014**	**2015**	**2014**
Revenues from USM Group	5	—	16	11
Revenues from TeliaSonera Group	198	116	501	428
Revenues from Euroset	36	99	58	143
	239	**215**	**575**	**582**
Services from USM Group	238	148	690	522
Services from TeliaSonera Group	415	423	1,230	1,289
Services from Euroset	277	288	843	994
	930	**859**	**2,763**	**2,805**
Other non-operating expenses from USM Group	—	—	1,826	1,089

	30 September 2015	**31 December 2014**
Due from USM Group	1,806	13
Due from TeliaSonera Group	150	388
Due from Euroset	339	379
	2,295	**780**
Due to USM Group	9,690	7,476
Due to TeliaSonera Group	530	638
Due to Euroset	38	3
	10,258	**8,117**

Terms and conditions of transactions with related parties

Outstanding balances as of 30 September 2015 and 31 December 2014 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 30 September 2015 and 31 December 2014, the Group has not recorded any impairment of receivables relating to amounts owed by related parties.

14. Related parties (continued)

USM Group

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

Amounts due to USM Group mainly represent the deferred consideration for the Scartel acquisition (*Note 9*).

The Group purchased billing system and related support services from PeterService, a member of the USM Group, in the amount of 2,104 and 1,267 during the nine months ended 30 September 2015 and 2014, respectively. Amounts due from USM Group mainly represent advances for purchases of billing system from PeterService.

The Group is a member of the not-for-profit partnership "Development, Innovations, Technologies" (the "Partnership") which was established by companies in the USM Group. The Partnership may determine to incur education, science and other social costs as well as to maintain certain social infrastructure assets in Skolkovo Innovation Centre which are not owned by MegaFon and not recorded in the consolidated statement of financial position. The Group's accrued contributions to the Partnership of 1,826 during the nine months ended 30 September 2015 and 1,089 during the nine months ended 30 September 2014 are included into other non-operating expenses in the interim condensed consolidated statement of comprehensive income.

TeliaSonera Group

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

Euroset

Euroset is the Group's joint venture with PJSC VimpelCom. The Group has a dealership agreement with Euroset which qualifies as a related party transaction.

15. Commitments, contingencies and uncertainties

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.

15. Commitments, contingencies and uncertainties (continued)

During 2014 and the nine months ended 30 September 2015, the Russian economy was negatively impacted by a significant drop in crude oil prices and a devaluation of the Russian Ruble, as well as sanctions imposed on Russia by several countries. The Ruble interest rates have increased significantly and as of 30 September 2015 the key rate of the Central Bank of Russia was at 11.0%.

The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

4G/LTE licence capital commitments

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

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

Equipment purchases agreements

In April 2014 and December 2014 the Group entered into two separate 7-year agreements with two suppliers to purchase equipment and software for 2G/3G/4G network construction and modernisation. The software usage agreements contain various termination options, however the Group is specifically committed under the agreements to pay at least 3 years' worth of fees plus an amount equal to 50-60% of the fees for years four through seven of the agreements for each base station in use as at the date of termination while receiving a credit against these commitments for fees already paid. The amount of the commitments at 30 September 2015 is 11,671 (31 December 2014: 9,206).

Social infrastructure expenses

From time to time, the Group may determine to maintain certain social infrastructure assets which are not owned by the Group and not recorded in the consolidated financial statements as well as to incur education, science and other social costs. Such activities are conducted in collaboration with non-governmental charity organisations. These expenses are presented in other non-operating expenses in the interim condensed consolidated statement of comprehensive income *(Note 14)*.

15. Commitments, contingencies and uncertainties (continued)

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.

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

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 30 September 2015 the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these interim condensed consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of approximately 889 (31 December 2014: 925).

Litigation

The Group is not a party to any material litigation, although in the ordinary course of business, some of the Group's members 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 liabilities, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, financial performance or liquidity of the Group.

16. Subsequent events

Settlement of Scartel deffered consideration

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

Intangible assets

On 5 October 2015 the Company successfully bid for 1800 MHz band spectrum in the Republic of Dagestan and the Karachay-Cherkess Republic pursuant to a frequency distribution auction conducted by the Federal Service for Supervision of Communications, Information Technology, and Mass Media of the Russian Federation ("Roskomnadzor"). The total consideration for the spectrum is 1,260.

New corporate headquarters

On 12 October 2015 MegaFon acquired 49.999% of the shares of Glanbury Investments Ltd ("Glanbury"), which holds 100% of the shares of CJSC Sadovoe Koltso ("Garden Ring"), which owns and operates an office building in the center of Moscow.

Under the transaction, the Group will pay approximately $282 million for its stake in Glanbury and will enter into a joint venture agreement for the operation of the building with Sberbank Investments Limited, a subsidiary of PJSC Sberbank, which owns another 49.999% in Glanbury, and with Woodsworth Investments Limited, an independent real estate developer, which owns the remaining 0.002% in Glanbury.

Approximately $202 million (12,583 at the exchange rate as of the payment date) has been paid by MegaFon to the seller on 9 October 2015 while the remaining portion of the consideration is being deferred for up to one year.

This building will become new corporate headquarters of the Group, permitting the consolidation of the Group's operations in Moscow into a single location.

Ruble bonds

On 23 October 2015 the Group placed its Series BO-05 Ruble denominated exchange bonds, in an aggregate principal amount of 15,000. The bonds have a term of 10 years following placement, subject to a put option exercisable by the bondholders on the second anniversary of the placement date. The coupon rate was set at 11.4% per annum, paid semiannually, and will be revised in two years from the bonds' placement. Proceeds from the bonds will be used for general corporate purposes, including the refinancing of the Group's existing liabilities.