MegaFon

Consolidated financial statements

For the year ended 31 December 2017

Contents

KPMG

Independent Auditors' Report

To the Board of Directors and Shareholders of PJSC MegaFon

Opinion

We have audited the consolidated financial statements of PJSC MegaFon (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated income statement, and the related statement of other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the independence requirements that are relevant to our audit of the consolidated financial statements in the Russian Federation and with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the requirements in the Russian Federation and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revenue recognition - technical complexity	
Please refer to the Note 2.1 in the consolidated financial statements.	
The key audit matter	**How the matter was addressed in our audit**
Revenue is a material amount consisting of a high volume of individually low value transactions. There are a number of complex IT systems used to process revenue-related data and the Group relies on the output of these IT systems. The major risks of distortion of revenue arise from: – the capture, processing and transfer of data on the parameters of services between the switching equipment, billing system and accounting system; and – the correct application of the tariffs, as these continuously change during the year.	Our audit procedures included an assessment of the Group's policies and controls in place over the IT system environment to determine their effectiveness in preventing and/or detecting revenue-related data distortion or loss. We performed the following key audit procedures: — we tested how often back-ups were taken and inspected the server rooms to ensure appropriate physical safeguards were in place; — we tested that only authorised access can be made to the systems by inspecting approved access requests for compliance with the internal policy; — we tested that only authorised system program changes can be made, and that these authorised changes were appropriately made, by inspecting documentation relating to the testing of these changes before implementation; — for new tariffs introduced in the year we inspected documentation relating to the application of the new tariffs in 'test' mode before going 'live' in the commercial operation; — we inspected the data processing on parameters of services from initial capture of data by the switching equipment and further transfer of data to the billing system by tracing a number of connection entries. Further, we inspected the Group's end-to-end revenue reconciliations between the data in the billing system and the accounting system; — we tested that valid metrology certificates were issued by appropriately specialized organizations for the switching equipment and billing system; — we recalculated the amounts billed to subscribers on a sample basis by multiplying the parameters of services rendered and the appropriate tariffs; — we reconciled the data on subscribers' payments taken from the payment agents' confirmations with the relevant amounts in the billing system. In all of the procedures listed above we involved our own IT specialists. We also performed other analytical procedures to check that the trends in revenue by type of service were in line with our understanding of the Group's business and the wider industry.

Goodwill impairment testing - cash generating unit "Broadband internet"	
Please refer to the Note 3.2.3 in the consolidated financial statements.	
The key audit matter	**How the matter was addressed in our audit**
Part of the Group's goodwill is allocated to the "Broadband internet" cash generating unit (CGU). In addition to an annual goodwill impairment test required by International Financial Reporting Standards, the Group identified impairment indications in respect of the "Broadband internet" CGU at 31 December 2017. The Group uses a number of methods to determine the recoverable amount of the CGU. Impairment testing is complex and based on highly judgmental assumptions.	We tested two of the methods applied by the Group to determine the CGU's recoverable amount: value in use based on discounted cash flow projections and fair value based on market quotes for peer companies' shares. We tested the recoverable amount under the market approach based on our own procedures – using recent actual deals over similar companies in the industry. We tested the appropriateness of the Group's methodology and key assumptions applied to determine the recoverable amount of the CGU based on the discounted cash flow model. We evaluated the key assumptions used by the Group in the model as follows: — we assessed the historical forecasting accuracy for average revenue per user (ARPU), market share, and operating and capital expenditures (capex); — we compared forecasted ARPU, and capex to revenue and OIBDA margin ratios to external market data and consensus forecasts; we assessed the appropriateness of the market share forecast based on analysts' expectations of the subscribers' growth rate; — we compared the first forecast year in the model to the Group's approved budget for 2018. We performed our own sensitivity analysis and assessed the impact of changes in key assumptions which we consider reasonably possible based on our industry knowledge. In all of the procedures listed above we involved KPMG valuation specialists. We assessed whether the related disclosures in the consolidated financial statements are appropriate.

Impairment testing of investment in joint venture Euroset	
Please refer to the Note 3.3 in the consolidated financial statements.	
The key audit matter	**How the matter was addressed in our audit**
During 2017, the Group separated Euroset from CGUs "Integrated telecommunications	We involved KPMG valuation specialists to assist us in testing the appropriateness of the Group's

services" as a result of forthcoming disposal of this investment and has determined that there is objective evidence that the investment in Euroset is impaired due to overall margin decrease in the Russian mobile retail market, which has adversely impacted the profitability of Euroset. Thus, separate impairment testing of investment was performed by management. Impairment testing is complex and based on highly judgmental assumptions.	methodology and key assumptions applied to determine the recoverable amount of the investment in Euroset. We evaluated the key assumptions used by the Group in its discounted cash flow model as follows: — we compared the historical information used in the calculations with the financial statements of Euroset for the previous reporting periods; — we compared the forecast data on the rate of revenue growth with the average annual historical sales level and the growth rate of the population in the forecast period, obtained from external sources; — we estimated the reasonableness of the market rate of the commission for connection by comparing the rate used in the model with average rates on the market, based on the Group's contracts with independent dealers. We performed our own sensitivity analysis and assessed the impact of changes in key assumptions which we consider reasonably possible based on our industry knowledge. We assessed whether the related disclosures in the consolidated financial statements are appropriate.

Business combination- purchase price allocation

Please refer to the Note 5.3 in the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit
On 9 February 2017 the Group completed the acquisition of the shares in Mail.ru Group Limited. The transaction had a material impact on consolidated financial statements. The Group accounted for the acquisition in accordance with IFRS 3 Business Combinations and performed a purchase price allocation. Determining the fair value of certain assets involves significant inherent uncertainties and thus requires significant degree of management judgment. The goodwill arising from the	Our audit procedures included the following: We assessed professional competence of the qualified independent appraiser, which was engaged by the Group. We inspected the purchase agreement and compared the consideration due and payment terms to the management's calculations. We involved KPMG valuation specialists to assist us in testing the appropriateness of the Group's methodology and key assumptions applied to determine the fair value of assets: — we assessed reasonableness of approaches used by independent appraiser for calculation of fair values of assets acquired based on our understanding of generally accepted valuation methods used for similar assets on the market;

acquisition is also highly dependent on the fair value of the identifiable assets acquired. Therefore, testing of fair value of assets, particularly, brands, user bases and MMO games, is a key area that we concentrated on.	— we compared royalty rate for brands and useful lives and churn rates for brands and user bases applied in models to external market data; — we compared advertising industry growth rate forecast used in the model to consensus forecasts; — we compared market shares and operating expenses used in models to historical financial data and market growth rates to external sources; — we assessed the reasonableness of revenue forecasts for unique MMO games through corroborative discussions with management and specialists of the Group and through evaluation of projected life-cycles of MMO games for consistency; — we performed our own sensitivity analysis and assessed the impact of changes in key assumptions which we consider reasonably possible based on our industry knowledge. We assessed whether the related disclosures in the consolidated financial statements are appropriate.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report other than the consolidated financial statements and our auditors' report thereon.

The Annual Report is expected to be made available to us after the date of this auditors' report. Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

— Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

— Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

— Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

— Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is:

Yerkozha Akylbek

JSC "KPMG"

Moscow, Russia

14 March 2018

Consolidated income statement

(In millions of Rubles, except per share amounts)

	Note	Years ended 31 December 2017	2016
Revenue	2.1	**373,297**	**316,275**
Operating expenses			
Cost of revenue		109,196	95,157
Sales and marketing expenses	2.2	28,561	19,254
General and administrative expenses	2.3	100,298	80,725
Depreciation	3.1,3.8	57,341	51,925
Amortisation	3.2.1	17,642	7,881
Goodwill impairment	3.2.3	—	3,400
Loss on disposal of non-current assets		491	849
Total operating expenses		**313,529**	**259,191**
Operating profit		**59,768**	**57,084**
Finance costs		(24,321)	(19,094)
Finance income		2,235	1,810
Share of loss of associates and joint ventures	3.3	(2,205)	(2,651)
Impairment loss from Euroset	3.3	(15,917)	—
Other non-operating expenses	5.2	(1,639)	(2,906)
Loss on financial instruments, net	3.4.4	(30)	(235)
Foreign exchange (loss)/gain, net		(3,722)	1,822
Profit before tax		**14,169**	**35,830**
Income tax expense	2.4	8,844	10,241
Profit for the year		**5,325**	**25,589**
Profit for the year			
Attributable to equity holders of the Company		4,551	25,496
Attributable to non-controlling interest		774	93
		5,325	**25,589**
Earnings per share, Rubles			
Basic and diluted, profit for the year attributable to equity holders of the Company	2.5	8	43

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

MegaFon

Consolidated statement of other comprehensive income

(In millions of Rubles)

	Note	Years ended 31 December 2017	2016
Profit for the year		**5,325**	**25,589**
Other comprehensive income/(loss) items that may be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax		(121)	875
Net movement on cash flow hedges, net of tax	3.4.4	152	(1,889)
Net other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods		**31**	**(1,014)**
Total comprehensive income for the year, net of tax		**5,356**	**24,575**
Total comprehensive income for the year			
Attributable to equity holders of the Company		4,818	24,299
Attributable to non-controlling interest		538	276
		5,356	**24,575**

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

Consolidated statement of financial position

(In millions of Rubles)

	Note	As of 31 December 2017	2016
Assets			
Non-current assets			
Property and equipment	3.1	220,705	237,155
Intangible assets, other than goodwill	3.2.1	128,140	61,295
Goodwill	3.2.2	73,218	30,549
Investments in associates and joint ventures	3.3	28,567	45,234
Non-current financial assets	3.4	3,585	4,799
Non-current non-financial assets	3.7	4,558	3,039
Deferred tax assets	2.4	3,829	1,199
Total non-current assets		**462,602**	**383,270**
Current assets			
Inventory	3.6	10,045	9,354
Current non-financial assets	3.7	7,446	5,051
Prepaid income taxes	2.4	2,586	1,992
Trade and other receivables	3.5	26,520	19,352
Other current financial assets	3.4	16,097	10,842
Cash and cash equivalents	3.4.1	36,147	31,922
Assets held for sale	3.1	284	—
Total current assets		**99,125**	**78,513**
Total assets		**561,727**	**461,783**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	4	109,773	124,166
Non-controlling interests	5.7	55,536	(43)
Total equity		**165,309**	**124,123**
Non-current liabilities			
Loans and borrowings	3.4	212,097	195,724
Other non-current financial liabilities	3.4	4,540	6,653
Non-current non-financial liabilities	3.7	10,181	2,605
Provisions	3.8	4,378	3,888
Deferred tax liabilities	2.4	28,792	20,812
Total non-current liabilities		**259,988**	**229,682**
Current liabilities			
Trade and other payables	3.4	50,535	43,581
Loans and borrowings	3.4	52,013	39,389
Dividends payable	4	—	2,839
Other current financial liabilities	3.4	3,853	3,538
Current non-financial liabilities	3.7	29,186	18,186
Income taxes payable	2.4	843	445
Total current liabilities		**136,430**	**107,978**
Total equity and liabilities		**561,727**	**461,783**

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

Consolidated statement of changes in equity

(In millions of Rubles)

		Attributable to equity holders of the Company									
		Ordinary shares		Treasury shares							
	Note	**Number of shares**	**Amount**	**Number of shares**	**Amount**	**Capital surplus**	**Retained earnings**	**Other capital reserves** *(Note 4)*	**Total**	**Non-controlling interests**	**Total equity**
As of 1 January 2016		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**152,425**	**(233)**	**147,898**	**(147)**	**147,751**
Profit for the year		—	—	—	—	—	25,496	—	25,496	93	**25,589**
Other comprehensive loss		—	—	—	—	—	—	(1,197)	(1,197)	183	**(1,014)**
Total comprehensive income/(loss)		—	—	—	—	—	**25,496**	**(1,197)**	**24,299**	**276**	**24,575**
Dividends		—	—	—	—	—	(48,031)	—	(48,031)	—	**(48,031)**
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(172)	**(172)**
As of 31 December 2016		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**129,890**	**(1,430)**	**124,166**	**(43)**	**124,123**
Profit for the year		—	—	—	—	—	4,551	—	4,551	774	**5,325**
Other comprehensive income/(loss)		—	—	—	—	—	—	267	267	(236)	**31**
Total comprehensive income		—	—	—	—	—	**4,551**	**267**	**4,818**	**538**	**5,356**
Dividends	4	—	—	—	—	—	(19,211)	—	(19,211)	—	**(19,211)**
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(172)	**(172)**
Equity-settled share-based compensation	5.7	—	—	—	—	—	—	—	—	1,743	**1,743**
Acquisition of MGL	5.3	—	—	—	—	—	—	—	—	54,900	**54,900**
Acquisition of MGL treasury shares	5.7	—	—	—	—	—	—	—	—	(1,430)	**(1,430)**
As of 31 December 2017		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**115,230**	**(1,163)**	**109,773**	**55,536**	**165,309**

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 2017	2016
Operating activities			
Profit before tax		14,169	35,830
Adjustments to reconcile profit before tax to net cash flows:			
Depreciation	3.1,3.8	57,341	51,925
Amortisation	3.2.1	17,642	7,881
Goodwill impairment	3.2.3	—	3,400
Loss on disposal of non-current assets		491	849
Loss on financial instruments, net	3.4.4	30	235
Foreign exchange loss/(gain), net		3,722	(1,822)
Share of loss of associates and joint ventures	3.3	2,205	2,651
Impairment loss from Euroset	3.3	15,917	—
Change in impairment allowance for receivables and other non-financial assets		2,680	2,528
Finance costs		24,321	19,094
Finance income		(2,235)	(1,810)
Equity-settled share-based compensation	5.1	1,743	—
Other non-cash items		58	—
Working capital adjustments:			
Increase in inventory		(665)	(669)
Increase in trade and other receivables		(4,687)	(2,288)
Decrease in current non-financial assets		186	2,055
Increase/(decrease) in trade and other payables		4,774	(6,315)
Increase/(decrease) in current non-financial liabilities		6,617	(812)
Change in VAT, net		880	(1,002)
Income tax refunded		26	19
Income tax paid		(11,353)	(8,791)
Net cash flows from operating activities		**133,862**	**102,958**
Investing activities			
Purchase of property, equipment and intangible assets		(61,748)	(57,892)
Proceeds from sale of property and equipment		465	709
Acquisition of subsidiaries, net of cash acquired	5.3	(40,136)	(62)
Proceeds from disposal of subsidiaries, net of cash disposed		(43)	—
Payment of deferred and contingent consideration		(1,444)	(2,421)
Purchase of interests in associates		(823)	—
Net change in short-term deposits		(2,743)	12,461
Net change in other deposits		247	401
Loans granted		(56)	(3,388)
Repayments of loans granted		890	—
Interest received		2,152	1,152
Dividends received from associates		18	—
Net cash flows used in investing activities		**(103,221)**	**(49,040)**
Financing activities			
Proceeds from borrowings, net of fees paid		127,626	125,581
Repayment of borrowings		(104,134)	(97,077)
Interest paid, net of interest capitalised		(24,588)	(19,219)
Dividends paid to equity holders of the Company	4	(22,050)	(45,192)
Dividends paid to non-controlling interests		(172)	(172)
Acquisition of MGL treasury shares		(1,430)	—
Finance lease payments		(33)	(27)
Net cash flows used in financing activities		**(24,781)**	**(36,106)**
Net increase in cash and cash equivalents		5,860	17,812
Net foreign exchange difference		(1,635)	(3,339)
Cash and cash equivalents at beginning of year		31,922	17,449
Cash and cash equivalents at end of year	3.4.1	**36,147**	**31,922**

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

1. GENERAL

1.1. About the Company

Public Joint Stock Company MegaFon ("MegaFon", the "Company" and, together with its consolidated subsidiaries, the "Group") is a company incorporated under the laws of the Russian Federation ("Russia") and registered in the Unified State Register of Legal Entities under number 1027809169585. Its registered office is at 41 Oruzheyniy lane, Moscow, 127006, Russian Federation.

MegaFon is a leading provider of integrated digital communications in Russia and offers a broad range of voice, data and other telecommunication services to retail customers, businesses, government clients and other telecommunication services providers.

MegaFon lists its ordinary shares on the Moscow Exchange and its ordinary shares represented by Global Depositary Receipts, or GDRs, on the London Stock Exchange, in each case under the symbol ‘‘MFON’’.

On 9 February 2017 MegaFon completed the acquisition of 15.2% of the shares, representing 63.8% of the voting rights, of Mail.Ru Group Limited ("MGL"), which is a leading company in the Russian-speaking internet market. The Group consolidated MGL starting from the beginning of 2017 *(Note 5.3)*.

As of 31 December 2017, the Group is primarily owned by USM group, which is an indirect controlling shareholder. In October and November 2017 Telia Company, a publicly owned Swedish company, disposed of its entire stake in the Company by selling an approximately 19% interest in the Company to JSC Gazprombank, which is a major banking institution in the Russian Federation, and an approximately 6% interest to various institutional investors.

1.2. Basis of preparation

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

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

The consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 14 March 2018.

Foreign currency translation

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

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

1.2. Basis of preparation (continued)

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

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

1.3. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of 31 December 2017.

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

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

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

1.4. Significant accounting judgments, estimates and assumptions

The preparation of these consolidated financial statements required management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated statement of financial position, the consolidated income statement, the consolidated statement of other comprehensive income and the accompanying disclosures. Subsequent revisions or corrections made to these assumptions and estimates hereafter could result in outcomes that require a material adjustment to the carrying amount of affected assets or liabilities in future periods.

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

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

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

1.5. Significant accounting policies

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

Changes in accounting policies and disclosures

During 2017 the Group applied the following amendments to accounting standards for the first time:

Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12

The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments did not impact the Group's consolidated financial statements.

Disclosure Initiative – Amendments to IAS 7

The amendments help investors to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. The amendments affected presentation and disclosure only and did not impact the Group's financial position or performance.

1.6. Standards issued but not yet effective

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

IFRS 15 Revenue from Contracts with Customers

In May 2014 the IASB issued IFRS 15, *Revenue from Contracts with Customers*, a comprehensive revenue recognition guidance that replaces the following previous revenue recognition standards: International Accounting Standards ("IAS") 18, *Revenue*, IAS 11, *Construction Contracts*, International Financial Reporting Interpretations Committee ("IFRIC") Interpretation 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue – Barter Transactions Involving Advertising Services*.

1.6. Standards issued but not yet effective (continued)

The core principle of the Standard is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Group will adopt IFRS 15 from 1 January 2018, its effective date. The Group will apply the Standard using the modified retrospective method which will have the cumulative effect of initially applying the Standard to contracts that are not completed at the date of initial application (1 January 2018) and will be recognized as an adjustment to the opening balance of retained earnings at 1 January 2018.

Based on the Group's preliminary evaluation the key impact of the transitioning to IFRS 15 will be an increase in customer acquisition costs assets and a corresponding increase in the opening retained earnings at 1 January 2018 of 1 to 3 billion Rubles. With regards to internet segment the Group does not expect a significant effect on profit or equity, but as a result of changes to principal versus agent evaluation in terms of IFRS 15, the Group expects a decrease in revenue from online advertising, community IVAS and agent/partner fees and a corresponding decrease in costs of revenue.

IFRS 9 Financial Instruments

In July 2014 the IASB completed its process to replace IAS 39, *Financial Instruments: Recognition and Measurement*, with the issuance of the final amendments to IFRS 9. IFRS 9 (July 2014) is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted. IFRS 9 is to be applied retrospectively in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. IFRS 9 is not to be applied to items that have been derecognised at the date of initial application.

The Group will adopt IFRS 9 from 1 January 2018. The Group does not expect a significant impact on its consolidated financial statements from implementation of the Standard.

During 2017 the IASB issued an amendment to IFRS 9, *Prepayment Features with Negative Compensation*. The amendment introduces some narrow-scope changes to measurement of particular prepayable financial assets with so-called negative compensation. It is effective from 1 January 2019, with early application permitted. The amendments do not impact the Group's consolidated financial statements.

IFRS 16 Leases

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

1.6. Standards issued but not yet effective (continued)

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

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

The Group will adopt IFRS 16 from 1 January 2019. The Group is evaluating the possible effect of the Standard on its consolidated financial statements. It is planning to use the modified retrospective transition method with the cumulative effect recognised at the initial application.

Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2

In June 2016 the IASB issued, *Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2*, which clarifies how to account for certain types of share-based payment transactions.
The amendments are effective for annual periods beginning on or after 1 January 2018. The Group will adopt them from that date. The amendments are not expected to have any impact on the Group's consolidated financial statements.

Transfers of Investment Property – Amendments to IAS 40

In December 2016 the IASB issued, *Transfers of Investment Property – Amendments to IAS 40*, which clarifies that an entity shall transfer a property to, or from, investment property when, and only when, there is an observable evidence of the change in use. The amendments give examples of the relevant evidence. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments are effective for annual periods beginning on or after 1 January 2018. The Group will adopt them from that date. The amendments are not expected to have any impact on the Group's consolidated financial statements.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

In December 2016 the IASB issued IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration*, which clarifies IAS 21, *The Effects of Changes in Foreign Exchange Rates*, specifying that on payment or receipt of advance consideration, the respective asset, expense or income to which this consideration relates should subsequently be recorded using the exchange rate as of the date the advance consideration was paid or received. The Interpretation is effective for annual periods beginning on or after 1 January 2018. The Interpretation has no impact on the Group's financial position or performance as it does not change the way the Group has been accounting for advance consideration paid or received in foreign currencies.

1.6. Standards issued but not yet effective (continued)

IFRIC 23 Uncertainty over Income Tax Treatments

In June 2017 the IASB issued IFRIC 23, *Uncertainty over Income Tax Treatments*, which clarifies requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes. The Interpretation is effective for annual periods beginning on or after 1 January 2019. The Group does not expect the Interpretation to have a material impact on the Group's consolidated financial statements.

Improvements to IFRSs (December 2016)

The amendments issued as a result of the Annual Improvements to IFRSs 2014-2016 Cycle introduced relatively minor changes to clarify guidance in existing standards. The amendments are effective for annual periods beginning on or after 1 January 2018. The Group does not expect these amendments to have a material impact on the Group's consolidated financial statements.

Long-Term Interests in Associates and Joint Ventures - Amendments to IAS 28

In October 2017 the IASB issued Amendments to IAS 28 clarifying that companies should account for long-term interests in an associate or joint venture to which the equity method is not applied, using IFRS 9. The Amendments will be effective for annual periods beginning on or after 1 January 2019. The Group does not expect these amendments to have a material impact on the Group's consolidated financial statements.

Improvements to IFRSs (December 2017)-Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23

The amendments issued as a result of the Annual Improvements to IFRSs 2015-2017 Cycle introduced relatively minor changes to clarify guidance in existing standards. The amendments are effective for annual periods beginning on or after 1 January 2019. The Group does not expect these amendments to have a material impact on the Group's consolidated financial statements.

2. INCOME STATEMENT

2.1. Revenue

Accounting policies

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

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

Service revenue

Service revenue is generally recognised when the services are rendered.

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

Wireless revenue

The Group earns wireless revenues for usage of its cellular system, which include airtime charges from contract and prepaid subscribers, monthly contract fees, interconnect fees from other wireless and wireline operators, roaming charges, data transfer charges, and charges for value added services ("VAS"). Interconnect revenue includes revenues from wireless and wireline operators that was earned from terminating traffic from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers using the network of the Group. VAS include SMS, provision of content and media and commissions for mobile payments.

(a) Loyalty programme

The Group operates a loyalty programme which allows customers to accumulate awards for usage of the Group's cellular network. The awards can then be redeemed for free services, subject to a minimum number of awards being obtained. The portion of consideration received is allocated to the awards based on their fair value and deferred until the award credits are redeemed or expire. The Group estimates the fair value of awards to a customer by applying a statistical analysis. Inputs to the models include making assumptions about expected redemption rates, the mix of services that will be available for redemption in the future and customer preferences.

2.1. Revenue (continued)

(b) Multiple element arrangements

The Group enters into multiple element arrangements in which a customer may purchase a combination of equipment (e.g. handsets) and telecommunication services (e.g. airtime, data, and other services). The Group allocates consideration received from subscribers to the separate units of accounting based on their relative fair values but not exceeding the contractual consideration. Revenues allocated to the delivered equipment and related costs are recognised in the accompanying consolidated income statement at the time of sale provided that other conditions for revenue recognition are met. Amounts allocated to telecommunication services are deferred and recognised as revenue over the period of rendering the services. Allocation of each separable component of a bundled offer based on the individual components' relative fair values involves estimates and management's judgment.

(c) Roaming rebates

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

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

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

Wireline revenue

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

2.1. Revenue (continued)

Construction contracts revenue

The Group has contracts with customers for installation of network equipment for a fixed fee, which cannot exceed the costs incurred plus a certain margin. Revenue under the contracts is recognised by reference to the stage of completion as defined in the contract and accepted by the customer.

If the outcome of the contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. Contract costs are recognised as incurred unless they create an asset related to future contract activity. An expected loss on a contract is recognised immediately in profit or loss.

Revenue recognised under construction contracts for the year ended 31 December 2017 is 2,143 (2016: 370). For contracts in progress at 31 December 2017 the aggregate amount of costs incurred and recognised profits to date is 2,606 (2016: 370); the amount of advances received as at 31 December 2017 is 3,987 (2016: 2,350).

Revenue from context advertising

The Internet segment *(Note 5.6)* earns revenue for search context advertising through partnerships with third parties. Context advertising revenue is recognised as the services are provided (i.e. when a user clicks on an advertiser's listing) on a net basis.

The revenue from advertising in applications, on the web pages of communities and via networks is recognised on a gross basis with costs and commissions paid to third party owners and administrators of websites, applications, platforms and communities recognised in sales and marketing expenses.

Revenue from MMO games

The Internet segment *(Note 5.6)* earns online games revenue from in-game virtual items purchased by players. Under the item-based revenue model, the revenue is recognised over the life of the in-game virtual items as they are purchased and consumed. Deferred revenue is reduced as revenues are recognised. The estimated life span of in-game items is determined based on historical player usage patterns and playing behaviour.

Revenue earned from licensing games to overseas parties consists of a non-refundable initial payment for the licence and usage-based royalty fees. The upfront fee is recognised as revenue immediately once the games are launched into commercial use by the licensees. Ongoing usage-based royalties are recognised as earned, provided the collection is probable.

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.

2.2. Sales and marketing expenses

Accounting policies

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

Advertising costs are expensed as incurred.

2.3. General and administrative expenses

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

	2017	**2016**
Employee benefits and related social charges	43,332	27,556
Operating lease expense	19,706	18,291

State pension funds

The Group contributes to local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended 31 December 2017 and 2016 were 6,996 and 5,564, respectively.

2.4. Income taxes

Accounting policies

Current income tax

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

The current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries in which the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which the applicable tax regulation is subject to interpretation. If the applicable tax regulation is subject to interpretation, the Company establishes a provision where appropriate on the basis of amounts expected to be paid to the tax authorities.

2.4. Income tax (continued)

Deferred income tax

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

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

Significant estimates

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

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 due or likelihood of a position being sustained may change during the settlement process.

Disclosures

The operations of the telecom segment are subject to taxation in the Russian Federation and Tajikistan. The operations of the internet segment are subject to taxation in multiple jurisdictions, including the Russian Federation, Cyprus, British Virgin Islands, the United Kingdom, the United States of America, Estonia, the Netherlands.

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

	2017	**2016**
Current income tax:		
Current income tax charge	10,892	9,026
Adjustments recognised for current tax of prior periods	(225)	581
Deferred tax	(1,823)	634
Income tax expense	**8,844**	**10,241**

2.4. Income tax (continued)

The reconciliation between the average effective income tax rate and tax expense calculated at domestic statutory rates applicable to individual Group entities is as follows:

	2017	2016
Statutory income tax rate	**18.0%**	**20.0%**
Non-deductible expenses	12.1%	6.6%
Effect of intra-group transactions	1.6%	0.9%
Deferred tax assets write-off	3.1%	0.1%
Effect of income tax preferences	(2.7%)	(1.3%)
Goodwill impairment *(Note 3.2.3)*	—	1.9%
Euroset impairment *(Note 3.3)*	22.5%	—
Effect of changes in tax rates	5.8%	—
Other	2.0%	0.4%
Effective income tax rate	**62.4%**	**28.6%**

The effect of intragroup transactions, in the table above, represents taxable intra-group income.

Deferred tax relates to the following:

	Statement of financial position as of 31 December		Income statement for the years	
	2017	**2016**	**2017**	**2016**
Property and equipment	(16,050)	(16,844)	(721)	1,832
Intangible assets	(18,964)	(9,316)	2,439	325
Derivative financial instruments	770	993	186	(1,180)
Investments in joint ventures and subsidiaries	(146)	(153)	(7)	59
Tax loss carry-forwards	4,009	3,627	(382)	(848)
Revenue recognition	2,793	519	(2,274)	122
Accrued employee benefits	1,279	193	(1,086)	268
Accrued expenses	1,504	1,011	(493)	(190)
Other movements and temporary differences	(158)	357	515	246
Deferred tax expense			**(1,823)**	**634**
Net deferred tax liabilities	**(24,963)**	**(19,613)**		
Reflected in the consolidated statement of financial position as follows:				
Deferred tax assets	**3,829**	**1,199**		
Deferred tax liabilities	**(28,792)**	**(20,812)**		

The Group recognises deferred tax assets in respect of tax loss carry-forwards to the extent that realisation of tax losses against future taxable profit is probable. Deferred tax assets related to tax losses of the Group's subsidiaries are recognised based on the tax planning opportunities that would be implemented, if necessary, to prevent tax losses from not being used.

2.4. Income tax (continued)

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

	2017	2016
Scartel	1,837	2,583
MegaFon Retail	1,375	1,021
Other	797	23
Balance at end of year	**4,009**	**3,627**

In order to utilise tax losses the Group is able to implement appropriate tax planning strategies depending on the results of these subsidiaries in subsequent periods. The tax planning strategies may include, among others, merging of the respective subsidiaries with 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 amounted to 3,859 as of 31 December 2017 (2016: 2,757). Unrecognised deferred tax assets arose on the acquisition of subsidiaries and joint ventures due to the difference between the accounting and tax bases of the subsidiaries and joint ventures acquired and are not expected to be realised due to lack of appropriate taxable profits.

The temporary differences associated with investments in subsidiaries for which a deferred tax liability has not been recognised amounted to 75,984 as of 31 December 2017 (2016: nil).

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

	2017	2016
Balance at beginning of year	19,613	19,526
Tax (benefit)/expense during the year	(1,823)	634
Translation adjustment of foreign operations	(73)	(75)
Acquisition of subsidiaries *(Note 5.3)*	7,209	—
Deferred tax on cash flow hedges in OCI *(Note 3.4.4)*	37	(472)
Balance at end of year	**24,963**	**19,613**

2.5. Earnings per share

Accounting policies

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

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

2.5 Earning per share (continued)

Disclosures

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

	2017	2016
Numerator:		
Profit attributable to equity holders of the Company	4,551	25,496
Denominator:		
Weighted-average ordinary shares outstanding	595,700,967	595,700,967
EPS – basic and diluted, Rubles	**8**	**43**

There were no potentially dilutive securities outstanding at 31 December 2017 or 2016.

3. ASSETS AND LIABILITIES

3.1. Property and equipment

Accounting policies

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

Depreciation expenses are based on management's estimates of residual value, the depreciation method used and the useful lives of property and equipment. Estimates may change due to technological developments, competition, changes in market conditions and other factors, and may result in changes in estimated useful lives and depreciation charges. The actual economic lives of long-lived assets may be different from the estimated useful lives. A change in estimated useful lives is accounted for prospectively as a change in accounting estimate.

The estimated useful lives are as follows:

Telecommunications network	3 to 20 years
Buildings and structures	7 to 50 years
Vehicles, office and other equipment	3 to 7 years

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

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

3.1. Property and equipment (continued)

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

The present value of the expected cost for the decommissioning of an asset after its use is included in the cost of the respective asset. Please refer to *Note 3.8* for further information about the provision for decommissioning liabilities.

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

The Group, jointly with other operators, plans, develops and uses telecommunication networks. The activities are accounted for as joint operations. Accordingly, the Group records its share of the jointly held assets and its share of the jointly incurred expenses.

Finance leases

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

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

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

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

3.1. Property and equipment (continued)

Capitalised borrowing costs

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

Impairment

The Group tests long-lived assets, other than goodwill, for impairment when circumstances indicate there may be a potential impairment.

An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) an asset’s fair value less costs to sell and (2) value in use. The recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

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

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

Estimating recoverable amounts of assets is based on management’s evaluations, including estimates of applicable market rates, if the market approach is used, or future cash flows, discount rates, terminal growth rates, and assumptions about future market conditions, if the income approach is used.

Non-current assets held for sale

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

3.1. Property and equipment (continued)

Disclosures

Property and equipment is as follows:

	Telecom-munications network	Buildings and structures	Vehicles, office and other equipment	Construction in-progress	Total
Cost as of					
1 January 2016	**425,162**	**74,866**	**28,509**	**22,539**	**551,076**
Additions	—	—	—	58,104	**58,104**
Acquisitions *(Note 5.3)*	3	—	—	—	**3**
Disposals	(16,649)	(205)	(1,702)	(643)	**(19,199)**
Put into use	56,980	2,215	2,059	(61,254)	**—**
Translation	(1,783)	(542)	(687)	(106)	**(3,118)**
31 December 2016	**463,713**	**76,334**	**28,179**	**18,640**	**586,866**
Additions	—	—	—	52,414	**52,414**
Acquisitions *(Note 5.3)*	2,451	636	215	538	**3,840**
Disposals	(24,932)	(318)	(3,034)	(398)	**(28,682)**
Put into use	44,308	3,469	2,198	(49,975)	**—**
Reclassified to AHFS	—	(634)	—	—	**(634)**
Reclassified to intangible assets *(Note 3.2.1)*	(33,349)	—	(809)	(1,384)	**(35,542)**
Translation	(393)	(135)	(131)	(104)	**(763)**
31 December 2017	**451,798**	**79,352**	**26,618**	**19,731**	**577,499**
Depreciation as of					
1 January 2016	**(263,278)**	**(29,923)**	**(23,458)**	**—**	**(316,659)**
Charge for the year	(44,941)	(4,958)	(2,984)	—	**(52,883)**
Disposals	16,122	178	1,656	—	**17,956**
Translation	1,152	245	478	—	**1,875**
31 December 2016	**(290,945)**	**(34,458)**	**(24,308)**	**—**	**(349,711)**
Charge for the year	(49,980)	(4,774)	(2,587)	—	**(57,341)**
Disposals	24,668	231	2,964	—	**27,863**
Reclassified to AHFS	—	350	—	—	**350**
Reclassified to intangible assets *(Note 3.2.1)*	20,908	—	705	—	**21,613**
Translation	277	63	92	—	**432**
31 December 2017	**(295,072)**	**(38,588)**	**(23,134)**	**—**	**(356,794)**
Net book value:					
31 December 2016	**172,768**	**41,876**	**3,871**	**18,640**	**237,155**
31 December 2017	**156,726**	**40,764**	**3,484**	**19,731**	**220,705**

During the year ended 31 December 2017 the Group has reclassified its billing system and similar software from property and equipment to intangible assets as a result of the technological changes in the system and software *(Note 3.2.1)*.

Included in construction in-progress are advances to suppliers of network equipment of 857 and 1,659 as at 31 December 2017 and 2016, respectively.

3.1. Property and equipment (continued)

Assets purchased under certain contracts with deferred payment terms in the amount of 332 (2016: 736) are pledged as security for the related liabilities.

Finance leases

The carrying value of buildings and structures held under finance leases at 31 December 2017 was 3,432 (2016: 3,701). Leased assets are pledged as security for the related finance lease liabilities.

Capitalised borrowing costs

Capitalised borrowing costs were 1,752 and 1,875 for the years ended 31 December 2017 and 2016, respectively. The rate used to determine the amount of borrowing costs eligible for capitalisation was 9.5% and 8.8% for the years ended 31 December 2017 and 2016, respectively.

3.2. Intangible assets

3.2.1. Intangible assets, other than goodwill

Accounting policies

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

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the statement of comprehensive income when incurred.

Software development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset.

Research and development costs recognised as an expense in the consolidated income statement during 2017 amounted to 393 (2016: nil).

3.2. Intangible assets (continued)

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

Operating licences and frequincies	10 to 20 years
Customer base	3 to 19 years
Trademarks and patents	7 to 20 years
Games	3 to 9 years
Other software	1 to 5 years
Other intangible assets	1 to 10 years

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

Impairment

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. See *Note 3.1* for further description of the accounting policies for impairment testing of nonfinancial assets.

3.2. Intangible assets (continued)

Disclosures

Intangible assets, other than goodwill, are as follows:

	Operating licences and frequencies	Customer base	Trademarks and patents	Games	Other software	Other intangible assets	Total
Cost as of							
1 January 2016	**76,904**	**4,192**	**726**	—	**14,322**	**7,823**	**103,967**
Additions	3,417	2	6	—	3,234	814	**7,473**
Disposals	(550)	—	(13)	—	(1,759)	(1,333)	**(3,655)**
Translation	(78)	—	—	—	—	—	**(78)**
31 December 2016	**79,693**	**4,194**	**719**	—	**15,797**	**7,304**	**107,707**
Additions	1,808	105	50	1,016	3,239	1,223	**7,441**
Acquisitions *(Note 5.3)*	—	22,295	22,493	12,151	4,586	1,456	**62,981**
Disposals	(539)	(105)	(54)	—	(2,481)	(534)	**(3,713)**
Reclassified from property and equipment *(Note 3.1)*	—	—	—	—	34,158	1,384	**35,542**
Translation	(19)	—	—	340	—	27	**348**
31 December 2017	**80,943**	**26,489**	**23,208**	**13,507**	**55,299**	**10,860**	**210,306**
Amortisation as of							
1 January 2016	**(25,158)**	**(2,341)**	**(547)**	—	**(10,396)**	(3,725)	**(42,167)**
Charge for the year	(4,226)	(474)	(63)	—	(2,395)	(723)	**(7,881)**
Disposals	496	—	13	—	1,726	1,324	**3,559**
Translation	77	—	—	—	—	—	**77**
31 December 2016	**(28,811)**	**(2,815)**	**(597)**	—	**(11,065)**	**(3,124)**	**(46,412)**
Charge for the year	(4,392)	(3,757)	(2,300)	(2,197)	(3,807)	(1,189)	**(17,642)**
Disposals	510	105	54	—	2,472	485	**3,626**
Reclassified from property and equipment *(Note 3.1)*	—	—	—	—	(21,613)	—	**(21,613)**
Translation	19	—	—	(124)	—	(20)	**(125)**
31 December 2017	**(32,674)**	**(6,467)**	**(2,843)**	**(2,321)**	**(34,013)**	**(3,848)**	**(82,166)**
Net book value:							
31 December 2016	**50,882**	**1,379**	**122**	—	**4,732**	**4,180**	**61,295**
31 December 2017	**48,269**	**20,022**	**20,365**	**11,186**	**21,286**	**7,012**	**128,140**
Weighted-average remaining amortisation period, years	11	5	9	5	6	6	7

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

Operating licences primarily consist of
- several 2G licences,
- a nationwide 3G licence,
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (10x10 MHz band), and
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (30x30 MHz band).

3.2. Intangible assets (continued)

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

Nationwide 3G and 4G (10x10 MHz band) licences were obtained by MegaFon at nominal cost in 2007 and 2012, respectively, but require the Company to meet certain conditions, including capital commitments and coverage requirements *(Note 5.8)*.

3.2.2. Goodwill

Accounting policies

Goodwill represents the excess of the consideration transferred plus the fair value of any non-controlling interest in the acquired company at the acquisition date over the fair values of the identifiable net assets acquired. Goodwill is not amortised, but tested for impairment at least annually *(Note 3.2.3)*.

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

Disclosures

The changes in the carrying value of goodwill, net of accumulated impairment losses of 3,400, for the years ended 31 December 2017 and 2016 are as follows:

	2017	**2016**
Balance at beginning of year	30,549	33,909
Acquisitions *(Note 5.3)*	42,669	40
Goodwill impairment *(Note 3.2.3)*	—	(3,400)
Balance at end of year	**73,218**	**30,549**

3.2.3. Goodwill impairment

Accounting policies

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

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 are expected to benefit from the synergies of the combination. The Group has allocated goodwill to the following CGUs: 1) integrated telecommunication services group of CGUs, 2) broadband internet CGU and 3) GARS Holding Limited ("GARS") CGU.

3.2. Intangible assets (continued)

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

Estimating recoverable amounts of assets and CGUs is based on management’s evaluations, including determining the appropriate CGUs and estimates of applicable multiples, if the market approach is used, or future cash flows, discount rates, terminal growth rates, and assumptions about future market conditions, if the income approach is used. Allocation of the carrying value of the assets being tested between individual CGUs also requires management’s judgment.

Goodwill impairment test

The Group considers the relationship between market capitalisation and its book value, among other factors, when reviewing for indicators of impairment. As of 31 December 2017, the market capitalisation of the Group was not below the book value of its equity.

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

	31 December	
	2017	**2016**
Integrated telecommunication services (group of CGUs)	25,384	25,384
Broadband internet CGU	3,567	3,567
GARS CGU	1,598	1,598
Total allocated goodwill	**30,549**	**30,549**
Unallocated:		
MGL *(Note 5.3)*	42,669	—
Total goodwill	**73,218**	**30,549**

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

As a result of the annual test, no impairment of goodwill was identified in 2017; a 3,400 impairment loss was recognised in 2016 in respect of goodwill allocated to Broadband internet CGU.

Unallocated goodwill, resulting from the acquisition of MGL, together with assets acquired, does not exceed its market capitalisation as at 31 December 2017.

3.2. Intangible assets (continued)

Integrated telecommunication services (group of CGUs)

The net assets of the Company's own retail network have been allocated to the integrated telecommunication services group of CGUs. Management has determined that the cash flows of the Company's own retail network should not be considered to be independent of those from the integrated telecommunication services group of CGUs, because of the level of the Company's control over those assets and the extent of their integration with the Company's other operations.

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 at 4 times operating income before depreciation and amortisation ("OIBDA"), a multiple which is at the lower end of the range of OIBDA multiples observed in the market for acquisitions of similar businesses. The fair value was then reduced by 5% as an estimate of costs to sell the business.

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

Broadband internet CGU

The recoverable amount of the broadband internet CGU, 10,900 as at 31 December 2017, has been determined by taking the mid-point between the lowest and highest estimates for value arrived at using the different valuation methods, such as recent transactions, discounted cash flows ("DCF") and quotes for peer companies' shares.

The adjustment upwards of the DCF valuation is intended to reflect implementation of the Group's strategies in respect of the broadband business and its further integration with the telecommunication services group of CGUs which are not reflected in the DCF projections.

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

	31 December	
	2017	**2016**
Range of decrease of ARPU for retail customers during the forecast period by	(4.0%)	(1.0%)-0%
Pre-tax discount rate	10.7%	12.8%
Market share in Moscow (in terms of retail customer base)	4.9-5.1%	6.4%-6.7%
Annual salary growth rate during the forecast period	2.5-2.7%	4.8%-5.6%
CAPEX/Revenue ratio target in the long-term	10.0%	10.5%

3.2. Intangible assets (continued)

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

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

Annual salary growth is projected based on inflation estimates and management's forecasted employment strategies.

Recent transactions were based on mergers and acquisitions of broadband companies in Russia which closed during 2015-2017.

Sensitivity to changes in key assumptions

The estimated recoverable amount of the broadband internet unit exceeds its carrying value by 452. The following changes in the key assumptions made independently, with all other assumptions constant, would result in impairment for the broadband internet unit:

Decrease of ARPU for retail customers in each region during the forecast period increasing to	(7.7%)
Pre-tax discount rate increasing to	12.0%
Market share in Moscow reducing to	0.8%
Annual salary growth rate during the forecast period increasing to	4.2%
CAPEX/Revenue ratio from 2020 increasing to	12.6%

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

3.3. Investments in associates and joint ventures

Accounting policies

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

3.3. Investments in associates and joint ventures (continued)

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

Impairment

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

Disclosures

Investments in associates and joint ventures are as follows:

Investee	**% equity interest**	**31 December 2017**	**2016**
LLC Euroset-Retail ("Euroset"), joint venture	50.000	14,041	31,705
JSC Sadovoe Koltso ("Garden Ring"), joint venture	49.999	13,320	13,520
Other investments - associates		1,206	9
Total		**28,567**	**45,234**

Garden Ring

Garden Ring, which owns and operates an office building in the center of Moscow, is the Group's joint venture with Sberbank. The Group has a ten-year lease agreement with Garden Ring for a part of the building. This building has become the new corporate headquarters of the Group, permitting the consolidation of the Group's operations in Moscow into a single location. See *Note 5.8* for the applicable lease commitments. The remaining part of the building is mostly leased by Sberbank.

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

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

3.3. Investments in associates and joint ventures (continued)

	31 December 2017	2016
Assets		
Non-current assets	48,269	49,231
Cash and cash equivalents	1,003	1,227
Other current assets	280	98
	49,552	**50,556**
Liabilities		
Non-current financial liabilities	(21,572)	(24,761)
Other non-current liabilities	(5,712)	(5,882)
Current financial liabilities	(3,492)	(737)
	(30,776)	**(31,380)**
Total identifiable net assets	**18,776**	**19,176**
The Group's share in the joint venture	49.999%	49.999%
The Group's share of identifiable net assets	9,388	9,588
Excess of the consideration transferred over the Group's share in the fair value of identifiable net assets	3,932	3,932
Carrying amount of the Group's interest	**13,320**	**13,520**

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 2017	2016
Profit and total comprehensive income of Garden Ring	275	353
Amortisation of the Group's purchase price allocation adjustments and application of the Group's accounting policies	(675)	(372)
Loss and total comprehensive loss of the joint venture	**(400)**	**(19)**
The Group's share in the joint venture	49.999%	49.999%
The Group's share of the loss and total comprehensive loss of Garden Ring	**(200)**	**(9)**

Euroset

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

Euroset is the Group's joint venture with PJSC VimpelCom ("VimpelCom").

In July 2017 MegaFon and VEON Ltd, the parent company of VimpelCom, agreed to terminate the Euroset joint venture. This transaction closed in February 2018 *(Note 5.9)*.

3.3. Investments in associates and joint ventures (continued)

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

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

	31 December 2017	31 December 2016
Assets		
Non-current assets	26,692	30,874
Cash and cash equivalents	12,739	10,999
Other current assets	19,841	16,818
	59,272	**58,691**
Liabilities		
Non-current financial liabilities	(3,930)	(5,470)
Other non-current liabilities	(3,902)	(4,549)
Current financial liabilities	(5,487)	(3,951)
Other current liabilities	(26,065)	(21,340)
	(39,384)	**(35,310)**
Total identifiable net assets	**19,888**	**23,381**
The Group’s share in the joint venture	50%	50%
The Group’s share of identifiable net assets	9,944	11,691
Excess of the consideration transferred over the Group’s share in the fair value of identifiable net assets	4,097	20,014
Carrying amount of the Group’s interest	**14,041**	**31,705**

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

	Year ended 31 December 2017	Year ended 31 December 2016
Loss of Euroset	(917)	(1,663)
Amortisation of the Group’s purchase price allocation adjustments and application of the Group’s accounting policies	(2,571)	(3,272)
Loss of the joint venture	**(3,488)**	**(4,935)**
Other comprehensive loss of Euroset	(6)	(3)
Total comprehensive loss of the joint venture	**(3,494)**	**(4,938)**
The Group’s share in the joint venture	50%	50%
The Group’s share of the loss and total comprehensive loss of Euroset	**(1,747)**	**(2,469)**

3.3. Investments in associates and joint ventures (continued)

Total summarised profit and loss information of Garden Ring and Euroset is as follows:

	Year ended 31 December 2017	2016
Revenue	68,029	63,060
Depreciation and amortisation	(5,216)	(5,953)
Interest income	194	387
Interest expense	(3,685)	(3,311)
Income tax	716	822

Euroset investment impairment

During the year the Group determined that there is objective evidence that the investment in Euroset is impaired due to the recent developments in the Russian mobile retail market, which have adversely impacted the profitability of Euroset. In anticipation of the termination of its Euroset joint venture, the Group reconsidered the composition of its CGUs for the purposes of asset impairment testing and removed the investment in Euroset from the integrated telecommunication services group of CGUs. The Group has calculated the amount of impairment as the difference between the recoverable amount of the Group's investment and its carrying value and recognised an impairment loss in profit or loss in the amount of 15,917.

The estimated recoverable amount of investment is based on its value in use and includes savings to the Group from lower than market Euroset commission costs alongside the standalone Euroset results.

The value in use was estimated using the cash flow projections for a six-year period. The calculation of the recoverable amount of the investment is particularly sensitive to the following assumptions:

	30 June 2017
Pre-tax discount rate	13.8%
Average annual revenue growth rate during the forecast period	7.0%
Terminal growth rate	2.6%
OIBDA margin during the forecast period	0.8%

There was no change in estimation of the value in use as of 31 December 2017.

The changes in the carrying value of the investment in Euroset for the year ended 31 December 2017 are as follows:

At 1 January 2017	**31,705**
Impairment loss from Euroset	(15,917)
Share of loss of associates and joint ventures	(1,747)
At 31 December 2017 (Level 3)	**14,041**

3.4. Financial assets and liabilities

Accounting policies

Initial recognition and measurement

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

Subsequent measurement of financial assets and liabilities

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

- *Fair value through profit or loss.* Derivatives, including separated embedded derivatives, are classified as held for trading and accounted for at fair value through profit or loss unless they are designated as effective hedging instruments.

  Financial assets and liabilities accounted for at fair value through profit or loss are carried in the consolidated statement of financial position at fair value with changes in fair value being recognised in profit or loss, in the ‘foreign exchange gain/(loss)’, ‘finance costs’ or ‘gain/(loss) on financial instruments’ lines, depending on the nature of the changes.

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

De-recognition of financial assets

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

3.4. Financial assets and liabilities (continued)

Impairment of financial assets

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

De-recognition of financial liabilities

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

3.4. Financial assets and liabilities (continued)

Disclosures

Financial assets are as follows:

	31 December 2017	2016
Trade and other receivables *(Note 3.5)*	26,520	19,352
Other financial assets:		
Financial assets at fair value through profit or loss:		
Financial investments in associates	264	—
Financial derivatives under lease and hosting contracts	150	—
Derivative financial assets over the equity of investee	122	—
Total financial assets at fair value through profit or loss	**536**	—
Financial assets at fair value through OCI:		
Cross-currency swap designated as cash flow hedge	—	435
Total financial assets at fair value through OCI	—	**435**
Loans and receivables at amortised cost:		
Short-term bank deposits in Rubles	560	—
Short-term bank deposits in US dollars	7,096	5,095
Loans receivable from Garden Ring and Strafor	6,357	7,340
Other deposits	4,976	2,771
Other	157	—
Total loans and receivables at amortised cost	**19,146**	**15,206**
Total other financial assets	**19,682**	**15,641**
Other current financial assets	**(16,097)**	**(10,842)**
Other non-current financial assets	**3,585**	**4,799**
Total financial assets	**46,202**	**34,993**
Total current financial assets	**(42,617)**	**(30,194)**
Total non-current financial assets	**3,585**	**4,799**

Loan receivable

In February 2016 the Group granted Strafor Commercial Ltd ("Strafor") a loan in the amount of \$43.8 million (2,523 at the exchange rate as of 31 December 2017). The loan is repayable in February 2018 with interest at 7% paid annually. The loan was granted after performance of all necessary credit checks and satisfactory assessment of refinancing risks. The loan is secured by a pledge of 50% of the shares of Strafor and 50% of the shares of North Financial Overseas Corp., both companies being related to the Svyaznoy group, a telecommunications retailer in Russia, and was granted in the context of the Group's long term relations with the retailer. In February 2017 Strafor made an early repayment of \$15 million (890 at the exchange rate as of the payment date) out of the loan due in February 2018, together with interest. In February 2018 the loan was modified (*Note 5.9*).

3.4. Financial assets and liabilities (continued)

Other deposits

Other deposits consist of cash advances received under certain contracts with customers and held in Company bank accounts.

Financial liabilities are as follows:

	31 December 2017	2016
Trade and other payables	50,535	43,581
Financial liabilities at amortised cost:		
Loans and borrowings:		
Bank loans and borrowings	208,143	179,115
Ruble bonds	55,967	55,998
Total loans and borrowings	**264,110**	**235,113**
Total current loans and borrowings	**(52,013)**	**(39,389)**
Total non-current loans and borrowings	**212,097**	**195,724**
Other financial liabilities at amortised cost:		
Finance lease obligations *(Notes 3.1, 5.8)*	4,222	4,173
Deferred and contingent consideration	—	284
Other liabilities	329	335
Total financial liabilities at amortised cost	**268,661**	**239,905**
Financial liabilities at fair value through OCI:		
Foreign currency forwards and cross-currency swap designated as cash flow hedges	3,842	5,399
Total financial liabilities at fair value through OCI	**3,842**	**5,399**
Total other financial liabilities	**8,393**	**10,191**
Other current financial liabilities	**(3,853)**	**(3,538)**
Other non-current financial liabilities	**4,540**	**6,653**
Total financial liabilities	**323,038**	**288,885**
Total current financial liabilities	**(106,401)**	**(86,508)**
Total non-current financial liabilities	**216,637**	**202,377**

GARS earn-out settlement

In September 2017 MegaFon paid $4.3 million (247 at the exchange rate as of payment date) in full settlement of the deferred consideration for GARS.

3.4. Financial assets and liabilities (continued)

3.4.1. Cash and cash equivalents

Accounting policies

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

Disclosures

Cash and cash equivalents are as follows:

	31 December 2017	2016
Cash at bank and on hand in		
Rubles	7,023	1,948
US dollars	865	247
Euros	1,384	74
Other	50	1
Short-term bank deposits in		
Rubles	7,878	860
US dollars	18,947	28,792
Total cash and cash equivalents	**36,147**	**31,922**

3.4.2. Loans and borrowings

Principal amounts outstanding under loans and borrowings are as follows:

	Interest Rate	Maturity	31 December 2017	2016
Bank loans and borrowings:				
Ruble loans – fixed rates	7.36%-11.82%	2018-2024	161,928	127,203
US dollar loans – floating rates	LIBOR+0.955%-LIBOR+2.9%	2018-2022	34,153	38,661
US dollar loans – fixed rates	2.29%	2018-2024	5,082	7,347
Euro loans – floating rates	EURIBOR+0.56%-EURIBOR+2.05%	2019-2024	9,171	8,103
Total bank loans and borrowings			**210,334**	**181,314**
Ruble bonds	7.85%-9.95%	2019-2026 with a put option in 2018	**55,000**	**55,000**
Total			**265,334**	**236,314**
Total current			**(52,013)**	**(39,385)**
Total non-current			**213,321**	**196,929**

3.4. Financial assets and liabilities (continued)

Bank loans

In February 2017 the Group signed a new credit facility agreement for the total amount of up to 35,000 maturing in 2024, which has subsequently been fully drawn.

Ruble bonds

In April 2017 the Group redeemed in full Series 05 Ruble denominated bonds at their nominal value of 1,000 Rubles. Early redemption is permitted under the terms of the bonds issue documentation. The Group initially issued 10,000,000 Series 05 bonds in October 2012 with a maturity of 10 years at a coupon rate of 8.05% per annum with embedded mandatory put options following coupon rate resets. In 2014 and 2016 the Group purchased a total of 99,999,933 bonds under mandatory put options. Totally, 67 Series 05 bonds was remained outstanding by April 2017.

On 9 October 2017 the Group placed its Series BO-001P-03 Ruble denominated exchange bonds in an aggregate principal amount of 15,000 at a coupon rate of 7.85% per annum paid semiannually. The new bonds have a term of 5 years with no embedded put options.

On 20 October 2017 the Group redeemed its Series BO-05 Ruble denominated bonds in an aggregate principal amount of 15,000. Early redemption is permitted under the terms of the bonds issue documentation. The Group initially issued its Series BO-05 Ruble bonds in October 2015 with a maturity of 10 years at a coupon rate of 11.4% per annum.

Covenant requirements

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

3.4. Financial assets and liabilities (continued)

3.4.3. Reconciliation of movements of liabilities to cash used in financing activities

	Liabilities				Equity			
	Loans and borrowings	**Derivatives**	**Lease liabilities**	**Dividends payable**	**Dividends**	**Dividends to NCI**	**Acquisition of MGL treasury shares**	**Total**
Balance as of 1 January 2017	**235,113**	**4,964**	**4,173**	**2,839**	—	—	—	**247,089**
Proceeds from borrowings, net of fees paid	127,626	—	—	—	—	—	—	**127,626**
Repayment of borrowings	(99,416)	(4,718)	—	—	—	—	—	**(104,134)**
Interest paid, net of interest capitalised	(24,142)	(9)	(437)	—	—	—	—	**(24,588)**
Dividends paid to equity holders of the Company	—	—	—	(2,839)	(19,211)	—	—	**(22,050)**
Dividends paid to non-controlling interests	—	—	—	—	—	(172)	—	**(172)**
Acquisition of MGL treasury shares	—	—	—	—	—	—	(1,430)	**(1,430)**
Finance lease payments	—	—	(33)	—	—	—	—	**(33)**
Total cash flows used in financing activities	**4,068**	**(4,727)**	**(470)**	**(2,839)**	**(19,211)**	**(172)**	**(1,430)**	**(24,781)**
Finance costs	24,625	—	519	—	—	—	—	**25,144**
Foreign exchange (gain)/loss, net	(1,411)	3,794	—	—	—	—	—	**2,383**
Changes through OCI	—	(189)	—	—	—	—	—	**(189)**
Acquisition of subsidiaries	268	—	—	—	—	—	—	**268**
Other	1,447	—		—	—	—	—	**1,447**
Balance as of 31 December 2017	**264,110**	**3,842**	**4,222**	—	**(19,211)**	**(172)**	**(1,430)**	**251,361**

3.4. Financial assets and liabilities (continued)

3.4.4. Derivative financial instruments and hedging activities

Accounting policies

Derivative financial instruments, which include foreign currency forwards, cross-currency swaps 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 DCF models as appropriate. Derivatives are included within financial assets at fair value through profit or loss when fair value is positive and within financial liabilities at fair value through profit or loss when fair value is negative. Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic risks and characteristics are not closely related to those of the host contract and the combined instrument is not measured at fair value, with changes in fair value being recognised in profit or loss.

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

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

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

Disclosures

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

		31 December 2017		**31 December 2016**	
	Original currency	**Millions, original currency**	**Millions, Rubles**	**Millions, original currency**	**Millions, Rubles**
Foreign currency forwards:					
designated as cash flow hedges	US Dollar	208	11,981	466	28,266
Total foreign currency forwards			**11,981**		**28,266**
Cross-currency swaps:					
designated as cash flow hedge	US Dollar	—	—	15	910
Total cross-currency swaps			**—**		**910**

3.4. Financial assets and liabilities (continued)

Foreign currency forwards designated as cash flow hedges

During the year ended 31 December 2016 the Group entered into a number of US dollar forward purchase agreements that limit the exposure from changes in US dollar exchange rates on certain long-term debts. The forwards have been designated and qualified as cash flow hedges of foreign currency risk. There has been no ineffective portion in the reporting period. Forwards were partly settled in 2017 and affected consolidated income statement and will affect it within the next six months from 31 December 2017.

Cross-currency swap designated as a cash flow hedge

At 31 December 2016 the Group had a fixed-to-fixed rate cross-currency swap agreement in place that limited the exposure from changes in US dollar exchange rates on certain long-term debt. The swap was designated and qualified as a cash flow hedge of foreign currency risk. There has been no ineffective portion in the reporting period. The hedge was settled and affected consolidated income statement in February 2017.

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

	2017	**2016**
Foreign currency forwards:		
Amount of loss recognised in cash flow hedge reserve	(3,560)	(5,887)
Amount of loss reclassified from accumulated cash flow hedge reserve into foreign exchange loss, net	3,752	3,736
Deferred tax on movements in OCI	(38)	430
	154	**(1,721)**
Cross-currency swap:		
Amount of loss recognised in cash flow hedge reserve	(47)	(316)
Amount of loss reclassified from accumulated cash flow hedge reserve into foreign exchange loss, net	44	245
Amount of loss reclassified from accumulated cash flow hedge reserve into finance costs	—	28
Deferred tax on movements in OCI	1	9
	(2)	**(34)**
Interest rate swaps:		
Amount of gain recognised in cash flow hedge reserve	—	3
Amount of gain reclassified from accumulated cash flow hedge reserve into finance costs	—	(170)
Deferred tax on movements in OCI	—	33
	—	**(134)**
Total in OCI	**152**	**(1,889)**

3.4. Financial assets and liabilities (continued)

Derivatives not designated as hedging instruments

During 2017 the Group's internet segment had some derivative financial instruments not designated as hedges. During the year ended 31 December 2016 the Group settled two cross-currency swaps as well as entered into and settled a number of foreign currency forwards that had not been designated as hedging instruments.

Gain/(loss) on financial instruments

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

	2017	2016
Change in fair value of financial instruments measured through profit or loss:		
Cross-currency swaps not designated as hedges	—	(159)
Foreign-currency forwards not designated as hedges	—	(76)
Derivative financial instruments over the equity of investee	44	—
Financial derivatives under lease and hosting contracts	(14)	—
Derivative financial assets over other agreements	(60)	—
Total loss on financial instruments, net	**(30)**	**(235)**

3.4.5. Fair values

Accounting policies

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

The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

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

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

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

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

3.4. Financial assets and liabilities (continued)

Disclosures

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 consolidated financial statements:

		Carrying amount		Fair value	
		31 December		31 December	
		2017	2016	2017	2016
Financial assets:					
Financial assets at fair value through profit or loss:					
Financial investments in associates	Level 3	264	—	264	—
Financial derivatives under lease and hosting contracts	Level 3	150	—	150	—
Derivative financial assets over the equity of investee	Level 3	122	—	122	—
Financial assets at fair value through OCI:					
Cross-currency swap designated as cash flow hedge	Level 2	—	435	—	435
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	7,656	5,095	7,656	5,095
Loans receivable from Garden Ring and Strafor	Level 2	6,357	7,340	6,436	7,340
Other deposits	Level 2	4,976	2,771	4,706	2,534
Other	Level 3	157	—	157	—
Total financial assets		**19,682**	**15,641**	**19,491**	**15,404**
Financial liabilities:					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	208,143	179,115	234,969	186,775
Ruble bonds	Level 1	55,967	55,998	56,299	55,411
Deferred and contingent consideration	Level 3	—	284	—	284
Finance lease obligations	Level 3	4,222	4,173	4,222	4,173
Other liabilities	Level 3	329	335	343	384
Financial liabilities at fair value through OCI:					
Foreign currency forwards and cross-currency swap designated as cash flow hedges	Level 2	3,842	5,399	3,842	5,399
Total financial liabilities		**272,503**	**245,304**	**299,675**	**252,426**

3.4. Financial assets and liabilities (continued)

Valuation techniques and assumptions

Management has determined that cash, short-term deposits, other loans, 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.

The fair value of loans receivable from Garden Ring and Strafor approximates their carrying value.

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

The fair values of the Group's loans and borrowings and other liabilities carried at amortised cost, except for market quoted bonds, are determined by using a DCF 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 2017 and 2016 was assessed to be insignificant.

The Group, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Group manages these risks and monitors their exposure on a regular basis *(Note 5.4)*.

The fair values of foreign currency forwards 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 foreign exchange spot and forward rates, current interest rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

3.4. Financial assets and liabilities (continued)

Disclosures

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

	Cross-currency swaps	Financial invest-ments in associates	Derivatives under leases and over the equity of investee	**Total financial assets**	Foreign currency forwards	Cross-currency swaps	**Total financial liabilities**
31 December 2017							
Level 1	—	—	—	—	—	—	—
Level 2	—	—	—	—	(3,842)	—	**(3,842)**
Level 3	—	264	272	**536**	—	—	—
Total as of 31 December 2017	—	**264**	**272**	**536**	**(3,842)**	—	**(3,842)**
31 December 2016							—
Level 1	—	—	—	—	—	—	—
Level 2	435	—	—	**435**	(5,393)	(6)	**(5,399)**
Level 3	—	—	—	—	—	—	—
Total as of 31 December 2016	**435**	—	—	**435**	**(5,393)**	**(6)**	**(5,399)**

During the years ended 31 December 2017 and 31 December 2016 there were no transfers between levels of the fair value hierarchy.

3.5. Trade and other receivables

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

	31 December 2017	**2016**
Neither past due nor impaired	20,114	16,539
Past due but not impaired:		
Less than 30 days	2,152	1,093
30 - 90 days	3,382	1,217
More than 90 days	872	503
Total trade and other receivables	**26,520**	**19,352**

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

	2017	**2016**
Balance at beginning of year	2,778	2,217
Acquisitions *(Note 5.3)*	398	—
Change in the impairment allowance	2,681	2,038
Accounts receivable written off	(2,666)	(1,477)
Balance at end of year	**3,191**	**2,778**

3.6. Inventory

Accounting policies

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

Disclosures

The amount of inventory write-down to net realisable value and other inventory losses recognised in 'Cost of revenue' line in the consolidated income statement for the year ended 31 December 2017 is 550 (2016: 1,652).

3.7. Non-financial assets and liabilities

Accounting policies

Value-added tax

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

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

Disclosures

Current non-financial assets are as follows:

	31 December	
	2017	**2016**
Prepayments for services	4,605	2,373
VAT receivable	1,160	1,252
Deferred costs	1,176	1,033
Prepaid taxes, other than income tax	289	172
Prepayments for inventory	216	221
Total current non-financial assets	**7,446**	**5,051**

3.7. Non-financial assets and liabilities (continued)

Non-current non-financial assets are as follows:

	31 December 2017	2016
Deferred costs, non-current	2,744	2,560
Long-term advances	1,814	479
Total non-current non-financial assets	**4,558**	**3,039**

Current non-financial liabilities are as follows:

	31 December 2017	2016
Advances from customers	15,044	12,044
VAT payable	4,987	3,206
Current portion of deferred revenue	7,579	1,425
Taxes payable, other than income tax	1,544	1,475
Other current liabilities	32	36
Total current non-financial liabilities	**29,186**	**18,186**

Non-current non-financial liabilities are as follows:

	31 December 2017	2016
Deferred revenue	9,672	2,514
Other non-current liabilities	509	91
Total non-current non-financial liabilities	**10,181**	**2,605**

3.8. Provisions

Accounting policies

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

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

3.8. Provisions (continued)

Decommissioning provision

The Group has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located upon their being decommissioned. Decommissioning costs are determined by calculating the present value of the expected costs to settle the obligation using estimated cash flows, and are recognised as part of the cost of the particular asset. The cash flows are discounted at the current pre-tax rate that reflects the risks specific to the decommissioning liability. The unwinding of the discount is expensed in profit or loss as finance costs. The estimated future costs of decommissioning are reviewed annually and adjusted as appropriate. Changes in estimated liability resulting from revisions of the estimated future costs or in the discount rate applied are added to or deducted from the cost of the asset, except where a reduction in the provision is greater than the unamortised capitalised cost, in which case the capitalised cost is reduced to nil and the remaining adjustment is recognised in the consolidated income statement.

In determining the best estimate of the provision, assumptions and estimates are made in relation to discount rates, the expected cost to dismantle and remove the asset from the site, including long-term inflation forecasts, and the expected timing of those costs.

Disclosures

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

	2017	**2016**
Balance at beginning of year	3,888	4,603
Revisions in estimated cash flows	64	(1,288)
Net additions	51	90
Unwinding of discount	375	483
Balance at end of year	**4,378**	**3,888**

4. EQUITY

Accounting policies

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

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

Disclosures

Share capital

As of 31 December 2017 and 2016, the Company had 100,000,000,000 authorised ordinary shares with a par value of 0.1 Rubles, of which 595,700,967 were issued and outstanding and 24,299,033 were classified as treasury shares (held through its wholly owned subsidiary, MegaFon Investments (Cyprus) Limited).

Annual dividend payment

On 30 June 2017 the Annual General Meeting of Shareholders of the Company approved the payment of a final dividend for the 2016 financial year in the amount of 19,211, or 32.25 Rubles per ordinary share (or GDR). Such dividends were paid in full in August 2017. Together with the interim dividend approved and paid in 2016, total dividends for 2016 amounted to 38,423, or 64.50 Rubles per ordinary share (or GDR).

Other capital reserves

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

	Foreign currency translation reserve	Cash flow hedge reserve	Share-based compen-sation reserve	Transac-tions with non-con-trolling interests	Reserve fund	**Total other capital reserves**
As of 1 January 2016	**(1,883)**	**170**	**1,488**	**(23)**	**15**	**(233)**
Foreign currency translation	692	—	—	—	—	**692**
Change in fair value of cash flow hedges *(Note 3.4.4)*	—	(1,889)	—	—	—	**(1,889)**
As of 31 December 2016	**(1,191)**	**(1,719)**	**1,488**	**(23)**	**15**	**(1,430)**
Foreign currency translation	115	—	—	—	—	**115**
Change in fair value of cash flow hedges *(Note 3.4.4)*	—	152	—	—	—	**152**
As of 31 December 2017	**(1,045)**	**(1,567)**	**1,488**	**(23)**	**15**	**(1,163)**

4. EQUITY (continued)

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

The cash flow hedge reserve is used to record the accumulated impact of derivatives designated as cash flow hedges *(Note 3.4.4)*.

The share-based compensation reserve is used to recognise the value of equity-settled share-based payment transactions provided to employees, including key management personnel, as part of their remuneration *(Note 5.1)*.

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

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

5. ADDITIONAL NOTES

5.1. Share-based compensation

Accounting policies

Equity-settled transactions

Employees (including senior executives) of the Group and its associates, may receive remuneration in the form of share-based payment transactions, whereby share-based payment recipients render services as consideration for equity instruments ("equity-settled transactions") or a cash equivalent thereof ("cash-settled share-based payments").

If the Group has a choice to settle share-based payments in cash or in equity, the entire transaction is treated either as cash-settled or as equity-settled, depending on whether or not the Group has a present obligation to settle in cash.

The cost of equity-settled transactions is determined by the fair value at the date when the grant is made using an appropriate valuation model. That cost is recognised over the period in which the service conditions are fulfilled in employee benefits and related social charges expense *(Note 2.3)*. For MegaFon equity-settled transactions the corresponding amount is recorded as an increase in other reserves in equity, while for MGL awards non-controlling interest ('NCI') is increased *(Note 5.7)*.

5.1 Share-based compensation (continued)

Cash-settled transactions

The cost of cash-settled transactions is measured initially at fair value at the grant date using an appropriate valuation model. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is re-measured to fair value at each reporting date up to, and including the settlement date, with changes in fair value recognised in employee benefits and related social charges expense *(Note 2.3).*

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 or share-based transaction, volatility and dividend yield and making assumptions about them.

Disclosures

Former CEO long-term incentive plan

During his time as the CEO of the Company, Mr. Ivan Tavrin, among other options, was granted options to buy up to 5% of the total issued shares of the Company at the December 2012 IPO price ($20 per share). In December 2014 Mr. Tavrin exchanged the interest in the Company which he had acquired to that date and all remaining unexercised options for an interest in USM Holdings Limited ("USMHL") *(Note 5.2).* The unexercised options expired in May 2017.

MGL share-based payment arrangements

During 2017 and 2016, the Company had the following outstanding option plans:

	2010 Option Plan	**2015 RSU Plan**	**2017 RSU Plan**
Adoption date	November 2010	February 2015	November 2017
Type of shares	Ordinary shares	Ordinary shares	Ordinary shares
Number of options or RSU reserved	10,706,403	5,795,500	5,182,471
Exercise price	Granted prior to 31 December 2011 - $19.60 Granted since 31 December 2011 - $17.50	nil	nil
Exercise basis	Prior to November 2011 – net share basis only Since November 2011 – net share basis or cash at the Group's discretion	Shares or cash at the Group's discretion	Shares or cash at the Group's discretion
Expiration date	December 2022	December 2022	December 2022
Vesting period	Generally 4 years	Generally 4 years	Generally 4 years

The 2017 RSU Plan vesting terms include performance conditions. Under all the plans the options are not transferrable.

5.1 Share-based compensation (continued)

The following table summarises the weighted-average exercise prices and number of share options and RSUs:

		Weighted-average exercise prices per option	
	Number of options	US Dollars	Equivalent in Rubles at exchange rate as of 31 December 2017
Outstanding as of 1 January 2017	**10,563,127**	**10.08**	**581**
Exercisable as of 1 January 2017	7,730,377	13.60	783
Available for grant as of 1 January 2017	6,384,864	2.12	122
Granted	4,029,000	0.56	32
Exercised	7,350,613	10.79	622
Cancelled	—	n/a	n/a
Forfeited	38,000	5.93	342
Outstanding as of 31 December 2017	**7,203,514**	**4.05**	**233**
Exercisable as of 31 December 2017	2,464,597	10.50	605
Available for grant as of 31 December 2017	2,393,864	4.79	276

The weighted-average share price was $27.30 for options and RSUs exercised in 2017.

The valuations of all equity-settled options and RSUs granted during 2017 are summarised in the table below:

Option plan	Number of options	Dividend yield, %	Volatility, %	Risk-free interest rate, %	Share price (USD)	Fair value, total	Fair value per option (RUR)
2010 Option Plan	130,000	0%	49.4%	1.98%	26.35	106	812
2015 RSU Plan	464,000	0%	40.9-52.3%	1.81-2.28%	21.24-33.00	684	1,474
2017 RSU Plan	3,435,000	0%	41.1%	2.17%	29.30	5,907	1,720

The valuations of all cash-settled options as of 31 December 2017 are summarised in the table below:

Number of options	Dividend yield, %	Volatility, %	Risk-free interest rate, %	Share price (USD)	Fair value, total	Fair value per option (RUR)
590,064	0%	41%	2.22%	28.90	482	816

All valuations are made using Binominal valuation models. The forfeiture rate used in all valuation models in 2017 is 0.5-3.3%. It is based on historical data and current expectations and is not necessarily indicative of forfeiture patterns that may occur.

The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options/RSUs is indicative of future trends, which may not necessarily be the actual outcome.

5.2. Related parties

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

	For the years ended 31 December 2017	2016
Revenues from USM group	1	16
Revenues from Telia group	350	557
Revenues from Euroset	3,450	401
Revenue from MGL's equity accounted associates	121	—
	3,922	**974**
Services from USM group	968	1,144
Services from Telia group	710	983
Services from Euroset	1,646	1,226
Services from Garden Ring	1,771	1,567
Services from MGL's equity accounted associates	15	—
	5,110	**4,920**
Other non-operating expenses from USM group	—	**1,293**

	31 December 2017	2016
Due from USM group	1	4
Due from Telia group	—	253
Due from Euroset	1,473	333
Due from Garden Ring	4,777	4,509
Due from MGL's equity accounted associates	77	—
	6,328	**5,099**
Due to USM group	1,271	1,468
Due to Telia group	—	322
Due to Euroset	92	27
Due to Garden Ring	142	—
Due to MGL's equity accounted associates	2	—
	1,507	**1,817**

Terms and conditions of transactions with related parties

Outstanding balances at the years ended 31 December 2017 and 2016 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 31 December 2017 and 2016, 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.

5.2. Related parties (continued)

USM group

The outstanding balances and transactions with USM group relate to operations with USM Holdings Limited and its consolidated subsidiaries

The Group purchased billing system and related support services from PeterService, another member of the USM group, in the amount of 6,019 and 7,254 during 2017 and 2016, respectively.

In February 2017 MegaFon acquired MGL *(Note 5.3)*. Before that date, MGL was a related party of the Group as both MegaFon and MGL were indirect subsidiaries of USM group.

The Group is a member of the Not-for-profit Partnership “Development, Innovations, Technologies” (the “Partnership”) which was established by companies in the USM group. The Partnership is required to incur education, science and other social costs as well as to maintain certain social infrastructure assets in Skolkovo Innovation Centre which are not owned by MegaFon and not recorded in the consolidated statement of financial position. The Group’s accrued contributions to the Partnership of nil during the year ended 31 December 2017 (2016: 1,293) are included into other non-operating expenses in the consolidated income statement.

Telia group

The outstanding balances and transactions with Telia 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 Telia group located outside Russia and a wireline interconnection agreement with Telia Carrier Russia.

In October and November 2017 Telia Company sold its entire interest in MegaFon *(Note 1.1)*. Consequently, Telia group ceased to be a related party.

Euroset

Euroset is the Group’s joint venture with VimpelCom *(Note 3.3)*. The Group has a dealership and equipment sales agreement with Euroset which qualifies as a related party transaction.

Garden Ring

Garden Ring is the Group’s joint venture with Sberbank *(Note 3.3)*. The Group has a lease agreement with Garden Ring which qualifies as a related party transaction. The Group also has a loan receivable from Garden Ring. The balance due from Garden Ring at 31 December 2016 and 2017 mainly consists of the loan receivable.

5.2. Related parties (continued)

Compensation to key management personnel

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

	2017	**2016**
Short-term employee benefits	580	505
Share-based compensation *(Note 5.1)*	—	81
Long-term incentive programme	89	158
Total	**669**	**744**

5.3. Business combinations

Accounting policies

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

The identification of assets acquired and liabilities assumed as a result of those acquisitions, determining the fair value of assets acquired and liabilities assumed as well as any contingent consideration and quantification of resulting goodwill requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, terminal growth rates, licence and other asset useful lives and market multiples, among other items.

Results of subsidiaries acquired and accounted for by the acquisition method have been included in operations from the relevant date of acquisition.

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

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

5.3. Business combinations (continued)

2017 acquisition

Mail.Ru

On 9 February 2017 the Group completed the acquisition of 15.2% of the shares, representing 63.8% of the voting rights of MGL, from three entities owned by USM group for a total consideration of $740 million (44,040 at the exchange rate as of the date of acquisition), consisting of cash consideration of $640 million (38,088 at the exchange rate as of the date of acquisition) and deferred consideration of $100 million (5,952 at the exchange rate as of the date of acquisition) plus interest payable on or prior to the first anniversary of the acquisition date. The deferred consideration of $100 million (5,773 at the exchange rate as of the payment date) was paid in December 2017.

The primary reason for the acquisition was to achieve significant synergies for both companies, including enhancement of MegaFon's digital offerings and their distribution, launch of a special VKmobile offering for users of the VK social network, and other potential initiatives.

Based on the current set-up of the Board of Directors of MGL, the Company concluded that it has the ability to direct relevant activities of MGL and therefore has control over that company.

Accordingly, the Group has consolidated MGL from the beginning of 2017.

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

Cash	38,088
Deferred consideration	5,952
Total consideration transferred	**44,040**

The acquisition of MGL was accounted for using the acquisition method. The Group has elected to measure the NCI in the acquiree at its proportionate interest in the identifiable net assets of the acquiree.

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

Assets	
Property and equipment	3,840
Intangible assets	62,568
Investments in associates and joint ventures	649
Other financial assets	539
Other non-financial assets	4,550
Deferred tax assets	2,600
Trade and other receivables	5,135
Cash and cash equivalents	5,513
	85,394

5.3. Business combinations (continued)

Liabilities	
Loans and borrowings	123
Other financial liabilities	943
Other non-financial liabilities	9,844
Deferred tax liabilities	9,945
Trade and other payables	7,049
Income taxes payable	389
	28,293
Total identifiable net assets at fair value	**57,101**
Goodwill arising on acquisition	41,839
Non-controlling interest	(54,900)
Purchase consideration transferred	**44,040**

NCI includes the value of the outstanding equity-settled share-based awards of MGL measured at market as of the date of acquisition.

From the date of the acquisition, MGL has contributed 51,744 of revenue and 2,811 to the profit before tax of the Group *(Note 5.7).*

The goodwill recognised is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of MGL. It is not expected to be deductible for income tax purposes. Management is still assessing the allocation of goodwill among cash generating units ('CGUs').

The Group recognised MGL acquisition-related costs as general and administrative expenses in the amount of 251 for the year ended 31 December 2017 in the consolidated income statement.

ZakaZaka

In May 2017, MGL, and thereby the Group, acquired the remaining 90.09% of ZakaZaka, a food delivery company, for cash consideration of 1,042. The main purpose of the acquisition was to further expand the MGL's food delivery business. The provisional fair values of total identified assets and liabilities at the date of acquisition were insignificant. Goodwill in the amount of 780 is mainly attributable to expected synergies and cost savings with the MGL's food delivery business.

Am.ru

In May 2017, MGL, and thereby the Group, acquired exclusive rights for Am.ru, one of the largest Russian auto classifieds websites, for cash consideration of 542. The primary purpose of the acquisition was to establish the Group's solid presence in the auto classifieds.

5.3. Business combinations (continued)

2016 acquisition

In 2016 the Group acquired a 100% interest in LLC Atlant Telecom, an alternative wireline and broadband internet service provider in Moscow and Moscow region, for cash consideration of 62. The resulting goodwill is 40.

5.4. Financial risk management

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

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

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

Market risk

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

The sensitivity analyses in the following sections relate to the position as of 31 December 2017 and 2016. 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 2017 and 2016.

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.

5.4. Financial risk management (continued)

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, when necessary, enters into interest rate swaps, under which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount. These swaps are designated to hedge underlying debt obligations.

At 31 December 2017 approximately 84% of the Group's borrowings are at a fixed rate of interest (2016: 80%).

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 2017		
US Dollar	+17	(58)
US Dollar	-17	58
Year ended 31 December 2016		
US Dollar	+20	(79)
US Dollar	-20	79

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

Foreign currency risk

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

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

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

5.4. Financial risk management (continued)

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

Before 2015 the Group entered into a long-term cross-currency swap and in 2016 it entered into a number of foreign currency forward purchase agreements. These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain of the Group's long-term debts denominated in foreign currencies *(Note 3.4.4)*.

Overall, the share of Ruble loans (including the effect of foreign currency forwards and cross-currency swaps) amounted to 87% as of 31 December 2017 (89% at 31 December 2016).

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) 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 2017		
US Dollar	+20%	(1,886)
US Dollar	-20%	1,886
Euro	+20%	302
Euro	-20%	(302)
Year ended 31 December 2016		
US Dollar	+20%	3,935
US Dollar	-20%	(3,935)
Euro	+20%	(1,606)
Euro	-20%	1,606

The movement in the pre-tax effect is a result of monetary assets and liabilities denominated in currencies other than the functional currency of the Company.

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

5.4. Financial risk management (continued)

operating activities (primarily for trade receivables) and from its financing activities, including deposits with banks and financial institutions and other financial instruments.

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

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

The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in *Note 3.4*. The Group considers the concentration of risk with respect to trade receivables to be low, as its customers are located in several jurisdictions and industries and operate in largely independent markets. Concentrations of credit risk with respect to trade receivables are limited given that the Group’s customer base is large and unrelated. Due to this management believes there is no further credit risk provision required in excess of the normal impairment allowance for trade and other receivables.

The Group monitors its credit risk with regards to loans extended to Garden Ring and Strafor *(Note 3.4)*. This assessment is undertaken each financial year by examining the financial position of the debtor and the market in which the debtor operates. As at 31 December 2017 and 2016, no impairment losses were identified.

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 20% of the Group’s loans and borrowings will mature in less than one year at 31 December 2017 (2016: 17%) based on the carrying value of borrowings reflected in the consolidated financial statements. The Group assessed the concentration of risk with respect to refinancing its debt and concluded it to be low.

As of 31 December 2017 and 2016, the Group has net current liability position. The Group believes it will continue to be able to generate significant operating cash flows and that adequate access to sources of funding and significant amount of available credit lines are sufficient to meet the Group’s requirements. Additionally, the Group can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, Group management believes that cash flows from operating and financing activities will be sufficient for the Group to meet its obligations as they become due.

5.4. Financial risk management (continued)

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

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
31 December 2017					
Loans and borrowings	74,557	72,935	119,367	100,658	**367,517**
Trade and other payables	50,535	—	—	—	**50,535**
Finance lease obligations	485	1,125	1,125	6,158	**8,893**
Derivative financial liabilities	3,842	—	—	—	**3,842**
Long-term accounts payable	—	96	—	—	**96**
Total 31 December 2017	**129,419**	**74,156**	**120,492**	**106,816**	**430,883**
31 December 2016					
Loans and borrowings	61,614	105,147	70,427	83,730	**320,918**
Trade and other payables	43,581	—	—	—	**43,581**
Finance lease obligations	464	827	827	7,214	**9,332**
Derivative financial liabilities	3,248	2,151	—	—	**5,399**
Long-term accounts payable	—	335	—	—	**335**
Deferred consideration	284	—	—	—	**284**
Total 31 December 2016	**109,191**	**108,460**	**71,254**	**90,944**	**379,849**

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 2017 the Net Debt to OIBDA ratio was 1.62 (2016: 1.62).

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

Collateral

The Group did not pledge collateral as security for its financial liabilities at 31 December 2017 or 2016, except certain assets purchased under finance leases or on deferred payment terms *(Notes 3.1 and 3.4).*

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

5.5. Group information

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

Legal entity		Principal activities	Country of incorporation	% equity interest 2017	% equity interest 2016
Mail.Ru Group Limited	subsidiary	Internet services	BVI	15.2	—
JSC MegaFon Retail	subsidiary	Retail	Russia	100	100
LLC NetByNet Holding	subsidiary	Broadband internet	Russia	100	100
LLC Scartel	subsidiary	Wireless services	Russia	100	100
LLC MegaFon Finance	subsidiary	Financing	Russia	100	100
MegaFon Investments (Cyprus) Limited	subsidiary	Transactions with treasury shares	Cyprus	100	100
JSC MegaLabs	subsidiary	New telecom services development	Russia	100	100
CJSC TT mobile	subsidiary	Integrated telecom	Tajikistan	75	75
LLC Euroset-Retail *(Note 3.3)*	joint venture	Retail	Russia	50	50
JSC Sadovoe Koltso *(Note 3.3)*	joint venture	Corporate office	Russia	49.999	49.999

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

5.6. Segment information

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

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

Operating segments with similar economic characteristics, such as forecasted OIBDA, have been aggregated into a telecom segment, which was the only reportable segment before MGL was acquired.

With the acquisition of MGL *(Note 5.3)* the Group acquired a whole new business which it did not have before. Accordingly, a new internet operating and reportable segment has been added to the Group structure. Currently the Group's CODM does not review the operating results of MGL on any level lower than the level of the consolidated financial statements of MGL, accordingly, no further operating segments have been identified following this acquisition.

The financial results of MGL are included in the segment disclosure starting from the date of acquisition.

5.6. Segment information (continued)

Around 1.4% of the Group's telecom revenue and results are generated by segments outside of Russia. The information about the breakdown of revenue from customers of the internet segment by the customers' country of residence is not available to the management of the Group, and it considers that the cost to develop such information would be excessive.

No single customer represents 10% or more of the consolidated revenue.

The income statement items for each segment, as presented to the CODM, are presented below:

Year ended 31 December 2017	**Telecom (MegaFon)**	**Internet (MGL)**	**Eliminations**	**Group**
Revenue				
External customers	321,797	51,500	—	**373,297**
Inter-segment	13	244	(257)	**—**
Total revenue	**321,810**	**51,744**	**(257)**	**373,297**
OIBDA				
External customers	121,906	13,336	—	**135,242**
Inter-segment	(56)	231	(175)	**—**
Total OIBDA	**121,850**	**13,567**	**(175)**	**135,242**

Management has presented the performance measure OIBDA because it believes that this measure is relevant to an understanding of the Group's financial performance.

OIBDA is not a defined performance measure in IFRS. The Group's definition of OIBDA may not be comparable with similarly titled performance measures and disclosures by other entities.

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

	2017	**2016**
OIBDA	**135,242**	**121,139**
Depreciation	(57,341)	(51,925)
Amortisation	(17,642)	(7,881)
Goodwill impairment	—	(3,400)
Loss on disposal of non-current assets	(491)	(849)
Finance costs	(24,321)	(19,094)
Finance income	2,235	1,810
Share of loss of associates and joint ventures	(2,205)	(2,651)
Impairment loss from Euroset	(15,917)	—
Other non-operating loss	(1,639)	(2,906)
Loss on financial instruments, net	(30)	(235)
Foreign exchange (loss)/gain, net	(3,722)	1,822
Profit before tax	**14,169**	**35,830**

5.7. Non-controlling interest

One subsidiary of the Group that has a material NCI is MGL, based in Cyprus and acquired in the beginning of 2017, with a NCI of 84.8% *(Note 5.3)*. The balance of the NCI of MGL at 31 December 2017 is 55,484. The amounts allocated to the NCI for the year ended 31 December 2017 include profit of 550, other comprehensive loss of 279, equity-settled share-based compensation of 1,743, and acquisition of treasury shares of 1,430.

The summarised financial information of MGL is provided below.

Summarised income statement for the year ended 31 December 2017:

	MGL
Revenue	51,744
Operating expenses	(38,177)
Amortisation and depreciation	(11,637)
Finance costs	(15)
Finance income	511
Share of loss of associates and joint ventures	(258)
Foreign exchange gain	729
Loss on financial instruments, net	(30)
Other non-operating loss	(56)
Profit before tax	**2,811**
Income tax	(2,138)
Profit for the year	**673**
OCI	(327)
Total comprehensive income	**346**

Profit for the year ended 31 December 2017 includes amounts relating to the acquisition-date fair value adjustments.

Summarised statement of financial position as at 31 December 2017:

	MGL
Non-current assets	65,555
Current assets	23,789
Non-current liabilities	(15,621)
Current liabilities	(15,960)
Total equity	**57,763**
Attributable to:	
Equity holders of the Company	2,279
NCI	55,484

Summarised cash flow information for the year ended 31 December 2017:

	MGL
Operating activities	18,815
Investing activities	(7,351)
Financing activities	(1,565)
Net increase in cash and cash equivalents	**9,899**

5.8. Commitments, contingencies and uncertainties

Russian operating environment

During 2016 and 2017, the Russian economy was negatively impacted by significant declines in crude oil prices and the value of the Russian Ruble, as well as sanctions imposed on Russia by several countries. Ruble interest rates continued to fluctuate and as at 31 December 2017 the key rate of the Central Bank of Russia was at 7.75%. The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

4G/LTE licence capital commitments

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted MegaFon a licence and allocated frequencies to provide services under the 4G/LTE standard in Russia. Under the terms and conditions of this licence, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Company is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed.

Under the 4G/LTE licences acquired at frequency distribution auctions and from other operators via acquisition of other entities the Company is obligated to provide 4G/LTE services in each population center with over 10,000 inhabitants in Russia by the end of the seven-year period starting from the date of obtaining the licence, i.e. by 2023.

As of the date these consolidated financial statements were authorised for issue the Group was fully compliant with these capital expenditure commitments.

Equipment purchases agreements

In 2014 the Group entered into two separate 7-year agreements with two suppliers to purchase equipment and software for 2G/3G/4G network construction and modernisation. The software usage agreements contain various termination options, however the Group is specifically committed under the agreements to pay at least an amount equal to 50% of the fees due for years four through seven of the agreements for each base station in use as at the date of termination while receiving a credit against these commitments for fees already paid. The amount of the commitments at 31 December 2017 is 8,675 (31 December 2016: 7,459).

Social infrastructure expenses

From time to time, the Group may determine to maintain certain social infrastructure assets which are not owned by the Group and not recorded in the consolidated financial statements as well as to incur education, science and other social costs. Such activities may be conducted in collaboration with non-governmental organisations. These expenses are presented in other non-operating loss in the consolidated income statement *(Note 5.2)*.

5.8. Commitments, contingencies and uncertainties (continued)

Taxation

Russian and Tajik tax, currency and customs legislation, including transfer pricing legislation, are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Group may be challenged by the relevant regional and federal authorities. Recent events within Russia and Tajikistan suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

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

As of 31 December 2017 the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these consolidated financial statements, if the authorities were successful in enforcing different interpretations being taken by them, to be in the amount of approximately 856.

Finance lease commitments

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

	2017		2016	
	Minimum payments	**Present value of payments**	**Minimum payments**	**Present value of payments**
Within one year	485	456	464	428
After one year but not more than five years	2,250	1,581	1,654	1,157
More than five years	6,158	2,185	7,214	2,588
Total minimum lease payments	8,893	4,222	9,332	4,173
Less amounts representing finance charges	(4,671)	—	(5,159)	—
Present value of minimum lease payments	**4,222**	**4,222**	**4,173**	**4,173**

5.8. Commitments, contingencies and uncertainties (continued)

Operating lease commitments

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

The Group normally enters into operating leases with a term not exceeding one year. Accordingly, the Group's operating lease commitments at 31 December 2017 and 2016 approximate the annual lease expense (*Note 2.3*).

MegaFon has a ten-year lease agreement with Garden Ring for a part of the building *(Note 3.3)*. Future minimum rentals payable under this non-cancellable operating lease as at 31 December are, as follows:

	2017	**2016**
Within one year	1,538	1,508
After one year but not more than five years	6,465	6,338
More than five years	5,196	6,861
	13,199	**14,707**

Litigation

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

Anti-terror laws

On 7 July 2016 the President of the Russian Federation signed a package of anti-terror laws. The package requires telecommunications operators to store all data, including that from phone calls, messages, and data transmitted by customers for certain time periods, effective from 1 July 2018. This would require the Group to establish additional data centers and invest in data-processing technologies. The potentially significant capital expenditures required to do this would negatively impact the Group's cash flow generation, diverting resources from investment in growth, which could potentially impact future revenues and OIBDA.

Based on the current understanding of the law's requirements, the Group expects that the implementation of the changes may cost it approximately 35,000-40,000 over the next five years. The details of the package are being finalised currently and may undergo changes. The Group will update its estimate of the potential effect of the laws on its capital commitments when more information about the final form of the anti-terror package is received.

5.9. Events after the reporting date

Ruble bonds

On 19 February 2018 the Group placed its Series BO-001P-04 Ruble denominated exchange bonds, in an aggregate principal amount of 20,000. The bonds have a term of 3 years following placement. The coupon rate was set at 7.2% per annum, payable semiannually.

On 7 March 2018 the Group redeemed in full at par its Series 06 and 07 Ruble denominated bonds in an aggregate principal amount of 20,000. The Group initially issued these bonds in March 2013 with a maturity of 10 years at a coupon rate of 8% per annum. The coupon rate was to be re-set after five years and the Group had the right to redeem the bonds on the last day of the coupon period for which the coupon rate was defined. The redemption of the bonds was effected pursuant to the Group's exercise of this right.

Euroset

In February 2018 MegaFon acquired a 50% interest from VEON, resulting in MegaFon's owning 100% of Euroset which will remain an operating company. In addition, VEON made a cash payment of approximately 1,200 in respect of its share of Euroset's liabilities and obligations. Also, by the date of acquisition, VEON had acquired the rights to Euroset's lease agreements for approximately 1,700 outlets.

Strafor loan

In February 2018 the loan due from Strafor *(Note 3.4)* was extended to April 2018 and was converted into Rubles so that the amount due including interest as of the conversion date was 1,724. The Strafor loan was also assigned to and assumed by Lonestar Enterprises Ltd, another company related to the Svyaznoy group.

ESForce Holding Limited

In January 2018 MGL, and thereby the Group, signed an agreement for acquisition of a 100% interest in ESForce Holding Limited, one of the world's largest esports organisations, for a cash consideration of \$100 million (5,760 at the exchange rate as of 31 December 2017) less any outstanding debt, and contingent consideration based on performance indicators, at the end of 2018. The contingent consideration is expected in the amount of \$20 million (1,152 at the exchange rate as of 31 December 2017).