Interim condensed consolidated financial statements
(Unaudited)

For the nine months ended 30 September 2016

Contents

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Auditors' Report on Review of Interim Condensed Consolidated Financial Statements

To the Board of Directors and Shareholders
PJSC MegaFon

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of PJSC MegaFon (the "Company") and its subsidiaries (the "Group") as at 30 September 2016, and the related interim condensed consolidated income statement and statement of other comprehensive income for the three- and nine-month periods ended 30 September 2016, the related interim condensed consolidated statements of changes in equity and cash flows for the nine-month period ended 30 September 2016, and notes to the interim condensed consolidated financial statements (the "interim condensed consolidated financial statements"). Management is responsible for the preparation and presentation of this interim condensed consolidated financial statements in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim condensed consolidated financial statements based on our review.

Scope of Review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements as at 30 September 2016 and for the three- and nine-month periods ended 30 September 2016 are not prepared, in all material respects, in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*.

КПМГ
KPMG
МОСКВА

Akylbek Y. A.
Director, power of attorney dated 16 March 2015 No. 77/15
JSC "KPMG"

8 November 2016
Moscow, Russian Federation

Audited entity: PJSC MegaFon

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

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

30 Kadashevskaya Emb., Moscow 115035.

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

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

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

Member of the Self-regulated organization of auditors "Russian Union of auditors" (Association). The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No. 11603053203.

MegaFon

Interim condensed consolidated income statement

(In millions of Rubles, except per share amounts)

	Note	Three months ended 30 September 2016 (Unaudited)	Three months ended 30 September 2015 (Unaudited)	Nine months ended 30 September 2016 (Unaudited)	Nine months ended 30 September 2015 (Unaudited)
Revenues		**81,115**	**81,279**	**234,988**	**231,403**
Operating expenses					
Cost of revenues		24,745	21,270	69,511	59,998
Sales and marketing expenses		4,917	4,628	13,927	12,492
General and administrative expenses		19,168	19,236	59,464	56,067
Depreciation		13,370	12,283	39,196	36,398
Amortisation		1,981	1,845	5,861	5,490
Loss on disposal of non-current assets	6	248	225	584	458
Total operating expenses		**64,429**	**59,487**	**188,543**	**170,903**
Operating profit		**16,686**	**21,792**	**46,445**	**60,500**
Finance costs		(5,365)	(3,480)	(13,673)	(11,027)
Finance income		568	279	1,316	1,773
Share of (loss)/gain of associates and joint ventures		(1,337)	144	(3,124)	(415)
Other non-operating expenses		(484)	(249)	(2,351)	(2,725)
(Loss)/gain on financial instruments, net		(190)	1,314	(349)	713
Foreign exchange gain/(loss), net		(413)	(2,385)	2,223	(4,750)
Profit before tax		**9,465**	**17,415**	**30,487**	**44,069**
Income tax expense	8	2,920	4,019	8,049	10,356
Profit for the period		**6,545**	**13,396**	**22,438**	**33,713**

Profit for the period				
Attributable to equity holders of the Company	6,346	13,306	22,417	33,709
Attributable to non-controlling interest	199	90	21	4
	6,545	**13,396**	**22,438**	**33,713**
Earnings per share, Rubles				
Basic, profit for the period attributable to equity holders of the Company	**11**	**22**	**38**	**56**
Diluted, profit for the period attributable to equity holders of the Company	**11**	**22**	**38**	**56**

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

Interim condensed consolidated statement of other comprehensive income

(In millions of Rubles)

	Three months ended 30 September 2016	Three months ended 30 September 2015	Nine months ended 30 September 2016	Nine months ended 30 September 2015
	(Unaudited)		(Unaudited)	
Profit for the period	**6,545**	**13,396**	**22,438**	**33,713**
Other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods:				
Foreign currency translation difference, net of tax	43	(781)	708	(660)
Net movement on cash flow hedges, net of tax	(699)	—	(1,323)	(30)
Net other comprehensive loss that may be reclassified to profit or loss in subsequent periods	**(656)**	**(781)**	**(615)**	**(690)**
Total comprehensive income for the period, net of tax	**5,889**	**12,615**	**21,823**	**33,023**
Total comprehensive income/(loss) for the period				
Attributable to equity holders of the Company	5,675	12,711	21,654	33,193
Attributable to non-controlling interest	214	(96)	169	(170)
	5,889	**12,615**	**21,823**	**33,023**

MegaFon

Interim condensed consolidated statement of financial position

(In millions of Rubles)

	Note	30 September 2016 (Unaudited)	31 December 2015 (Audited)
Assets			
Non-current assets			
Property and equipment	6	227,297	234,417
Intangible assets, other than goodwill		60,853	61,800
Goodwill		33,949	33,909
Investments in associates and joint ventures		44,761	47,885
Non-current financial assets	7	5,818	4,102
Non-current non-financial assets		3,042	2,894
Deferred tax assets		892	832
Total non-current assets		**376,612**	**385,839**
Current assets			
Inventory		11,414	8,684
Current non-financial assets		5,892	6,649
Prepaid income taxes		865	2,641
Trade and other receivables		19,492	21,156
Other current financial assets	7	25,430	26,973
Cash and cash equivalents		25,703	17,449
Total current assets		**88,796**	**83,552**
Total assets		**465,408**	**469,391**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company		135,931	147,898
Non-controlling interests		(37)	(147)
Total equity		**135,894**	**147,751**
Non-current liabilities			
Loans and borrowings	7	227,550	172,643
Other non-current financial liabilities	7	7,082	5,033
Non-current non-financial liabilities		2,625	2,435
Provisions		5,012	4,603
Deferred tax liabilities		18,047	20,358
Total non-current liabilities		**260,316**	**205,072**
Current liabilities			
Trade and other payables		33,245	45,961
Loans and borrowings	7	10,843	47,037
Other current financial liabilities	7	2,925	2,900
Current non-financial liabilities		21,106	20,567
Income taxes payable	8	1,079	103
Total current liabilities		**69,198**	**116,568**
Total equity and liabilities		**465,408**	**469,391**

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

Interim condensed consolidated statement of changes in equity

(In millions of Rubles)

For the nine months ended 30 September 2016 and 30 September 2015

	Attributable to equity holders of the Company									
	Ordinary shares		Treasury shares							
	Number of shares	Amount	Number of shares	Amount	Capital surplus	Retained earnings	Other capital reserves	Total	Non-controlling interests	Total equity
As of 1 January 2015	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**161,422**	**561**	**157,689**	**144**	**157,833**
Profit for the period	—	—	—	—	—	33,709	—	33,709	4	33,713
Other comprehensive loss	—	—	—	—	—	—	(516)	(516)	(174)	(690)
Total comprehensive income/(loss)	—	—	—	—	—	**33,709**	**(516)**	**33,193**	**(170)**	**33,023**
Dividends	—	—	—	—	—	(9,609)	—	(9,609)	—	(9,609)
Dividends to non-controlling interests	—	—	—	—	—	—	—	—	(74)	(74)
As of 30 September 2015 (unaudited)	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**185,522**	**45**	**181,273**	**(100)**	**181,173**
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 period	—	—	—	—	—	22,417	—	22,417	21	22,438
Other comprehensive income/(loss)	—	—	—	—	—	—	(763)	(763)	148	(615)
Total comprehensive income/(loss)	—	—	—	—	—	**22,417**	**(763)**	**21,654**	**169**	**21,823**
Dividends *(Note 4)*	—	—	—	—	—	(33,621)	—	(33,621)	—	(33,621)
Dividends to non-controlling interests	—	—	—	—	—	—	—	—	(59)	(59)
As of 30 September 2016 (unaudited)	**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**141,221**	**(996)**	**135,931**	**(37)**	**135,894**

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

MegaFon

Interim condensed consolidated statement of cash flows

(In millions of Rubles)

	Nine months ended 30 September 2016	2015
	(Unaudited)	
Operating activities		
Profit before tax	30,487	44,069
Adjustments to reconcile profit before tax to net operating cash flows:		
Depreciation	39,196	36,398
Amortisation	5,861	5,490
Loss on disposal of non-current assets	584	458
Loss/(gain) on financial instruments, net	349	(713)
Net foreign exchange (gain)/loss	(2,223)	4,750
Share of loss of associates and joint ventures	3,124	415
Change in impairment allowance for receivables and other non-financial assets	1,919	1,530
Finance costs	13,673	11,027
Finance income	(1,316)	(1,773)
Working capital adjustments:		
(Increase)/decrease in inventory	(2,729)	195
Increase in trade and other receivables	(1,859)	(2,239)
Decrease/(increase) in current non-financial assets	2,244	(1,113)
Decrease in trade and other payables	(8,109)	(3,333)
Decrease in current non-financial liabilities	(1,785)	(2,547)
Change in VAT, net	1,573	(67)
Income tax refunded	18	178
Income tax paid	(7,091)	(10,234)
Net cash flows received from operating activities	**73,916**	**82,491**
Investing activities		
Purchase of property, equipment and intangible assets	(42,562)	(44,677)
Proceeds from sale of property and equipment	659	262
Payment of contingent consideration	(492)	(104)
Net change in short-term bank deposits	(2,906)	45,853
Interest received	793	1,885
Net change in other deposits	401	(690)
Loans granted	(3,388)	—
Acquisition of subsidiaries, net of cash acquired	(62)	(1,467)
Net cash flows (used in)/received from investing activities	**(47,557)**	**1,062**
Financing activities		
Proceeds from borrowings, net of fees paid	101,561	22,251
Repayment of borrowings	(72,098)	(43,532)
Interest paid	(11,826)	(10,725)
Dividends paid to equity holders of the Company	(33,621)	(9,609)
Dividends paid to non-controlling interests	(59)	(74)
Finance lease payments	(25)	—
Net cash flows used in financing activities	**(16,068)**	**(41,689)**
Net increase in cash and cash equivalents	10,291	41,864
Net foreign exchange difference	(2,037)	6,695
Cash and cash equivalents at beginning of period	17,449	22,223
Cash and cash equivalents at end of period	**25,703**	**70,782**

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

1. General

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

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

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*, and should be read in conjunction with the audited consolidated financial statements of the Group for the year ended 31 December 2015.

These interim condensed consolidated financial statements are unaudited and do not include all the information and disclosures required in the annual International Financial Reporting Standards ("IFRS") financial statements. The Company omitted disclosures which would substantially duplicate the information contained in its 2015 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Company has provided disclosures where significant events have occurred subsequent to the issuance of its 2015 audited consolidated financial statements. Management believes that the disclosures in these interim condensed consolidated financial statements are adequate to make the presented information not misleading if these interim condensed consolidated financial statements are read in conjunction with the Group's 2015 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments necessary to present fairly the Group's financial position, financial performance and cash flows for the interim reporting periods in accordance with IAS 34, *Interim Financial Reporting*.

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

The Company changed the presentation of interest paid and interest received in its interim condensed consolidated statement of cash flows to better represent the essence of the cash flows. Interest paid has been moved from operating activities to financing activities in the amount of 10,524 (2015: 9,638), from investing activities to financing activities in the amount of 1,302 (2015: 1,087) in respect of capitalised interest; and interest received has been moved from operating activities to investing activities in the amount of 793 (2015: 1,885).

The interim condensed consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 8 November 2016.

3. Significant accounting policies

The accounting policies and methods of computation applied in the preparation of these interim condensed consolidated financial statements are consistent with those disclosed in the audited consolidated financial statements of the Group for the year ended 31 December 2015, except for the change in cash flow presentation described in p. 2, *Basis of preparation.*

4. Dividends

On 30 June 2016 the Annual General Meeting of Shareholders of the Company approved the payment of a final dividend for the 2015 financial year in the amount of 28,820, or 48.38 Rubles per ordinary share (or GDR), and an interim dividend for the first quarter of 2016 in the amount of 4,801, or 8.06 Rubles per ordinary share (or GDR). Such dividends were paid in full in August 2016. Together with the interim dividend paid in December 2015 total dividends for 2015 amounted to 67,248, or 112.89 Rubles per ordinary share (or GDR).

5. Segment information

The Group manages its business primarily based on eight geographical operating segments within Russia, which provide a broad range of voice, data and other telecommunication services, including wireless and wireline services to clients, interconnection services, data transmission services and value added services. The Chief Operating Decision Maker ("CODM") evaluates the performance of the Group's operating segments based on revenue and operating income before depreciation and amortisation ("OIBDA"). Total assets and liabilities are not allocated to operating segments and not analysed by the CODM. Operating segments with similar economic characteristics have been aggregated into an integrated telecommunication services segment, which is the only reportable segment. Less than 2% of the Group's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

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

	Three months ended 30 September		**Nine months ended 30 September**	
	2016	**2015**	**2016**	**2015**
OIBDA	**32,285**	**36,145**	**92,086**	**102,846**
Depreciation	(13,370)	(12,283)	(39,196)	(36,398)
Amortisation	(1,981)	(1,845)	(5,861)	(5,490)
Loss on disposal of non-current assets	(248)	(225)	(584)	(458)
Finance costs	(5,365)	(3,480)	(13,673)	(11,027)
Finance income	568	279	1,316	1,773
Share of (loss)/gain of associates and joint ventures	(1,337)	144	(3,124)	(415)
Other non-operating expenses, net	(484)	(249)	(2,351)	(2,725)
(Loss)/gain on financial instruments, net	(190)	1,314	(349)	713
Foreign exchange gain/(loss), net	(413)	(2,385)	2,223	(4,750)
Profit before tax	**9,465**	**17,415**	**30,487**	**44,069**

5. Segment information (continued)

Seasonality of operations

The Group's services are impacted by seasonal trends throughout the year. Higher revenues and operating profits are usually expected in the second half of the year rather than in the first six months. Higher revenues during the period July to September are mainly attributed to the increased demand for telecommunication services during the peak holiday season. Higher revenues also occur in the month of December, due to increased demand for telecommunication services and equipment from private customers.

Also the number of working days is significantly higher in the second half of a calendar year than in the first half of the year due to long public holidays in January and May in Russia, which further contributes to higher revenues in the second half of the year. This information is provided to allow for a better understanding of the Group's results; however, management has concluded that these impacts on the results are not 'highly seasonal' as considered by IAS 34.

6. Property and equipment

During the nine months ended 30 September 2016, the Group acquired assets with a cost of 33,855 (30 September 2015: 38,609). Assets with a net book value of 807 were disposed of by the Group during the nine months ended 30 September 2016 (30 September 2015: 892), resulting in a net loss on disposal of 517 (30 September 2015: 405). Capitalised borrowing cost was 1,395 and 1,359 for the nine months ended 30 September 2016 and 2015, respectively.

7. Financial assets and liabilities

Loan receivable

In February 2016 the Group granted Strafor Commercial Ltd ("Strafor") a loan in the amount of $43.8 million (2,766 at the exchange rate as of 30 September 2016). 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 Svyaznoy Group, a telecommunications retailer in Russia, and was granted in the context of the Group's long term relations with the retailer.

Cash flow hedges of foreign currency risk

During the nine months ended 30 September 2016 the Group entered into a number of US dollar forward purchase agreements with a total notional amount of $531 million (33,537 at the exchange rate as of 30 September 2016) 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. The effective portion of changes in the fair value of the forwards of 1,449 (loss) for the nine months ended 30 September 2016 has been recorded in other comprehensive income/(loss) and will subsequently be reclassified into earnings in the period in which the hedged forecast transaction affects earnings. There has been no ineffective portion in the reporting period.

7. Financial assets and liabilities (continued)

Ruble bonds

On 12 April 2016 the Group re-purchased 1,636,213 Series 05 Ruble denominated bonds at their nominal value of 1,000 Rubles under a mandatory put option exercisable by the bond holders following a coupon rate reset on 23 March 2016.

The Group initially issued 10,000,000 Series 05 Ruble denominated bonds in October 2012. In October 2014 the Group re-purchased 8,249,296 Series 05 Ruble denominated bonds at their nominal value of 1,000 Rubles pursuant to a mandatory put option following a coupon rate reset on 24 September 2014.

The re-purchased bonds are kept in treasury and may be further placed in the market should the Group decide to do so. The remaining 114,491 Series 05 Ruble denominated bonds will continue trading in the market with a coupon rate of 0.1% per annum for a period of six months, after which the rate will be subject to further reset and the bonds will be subject to a further put option.

On 12 May 2016, the Group placed its Series BO-001P-01 Ruble denominated exchange bonds, in an aggregate principal amount of 10,000. The bonds have a term of 3 years following placement. The coupon rate was set at 9.95% per annum, payable semi-annually.

On 10 June 2016, the Group placed its Series BO-001P-02 Ruble denominated exchange bonds, in an aggregate principal amount of 10,000. The bonds have a term of 10 years following placement with two call options exercisable by the Group on the fifth and seventh anniversary of the placement date. The coupon rate was set at 9.90% per annum for the first five years after the placement. The coupon rate for the two years after the first call option will be determined based upon the two-year Russian government bonds (“OFZ”) yield plus 100 basis points. The coupon rate for the three years after the second call option will be determined based upon the three-year OFZ yield plus 100 basis points. The coupon will be paid quarterly.

Proceeds from the bonds will be used for general corporate purposes.

Loan refinancing

In July 2016 the Group agreed the extension of the tenor of certain ruble loans. The maturity date for a 29,500 loan, previously payable in 2018, has been extended to 2022, and the maturity for a 37,700 loan has been extended to 2023 from 2020.

Also in July 2016 the Group signed a new credit facility agreement for the total amount of up to 30,000 maturing in 2022, which has subsequently been fully drawn.

GARS earn-out settlement

In May 2016 the Group paid $5 million (325 at the exchange rate as of the payment date) out of escrow account to the sellers of GARS Holding Limited (“GARS”) in full settlement of the contingent consideration payable to such sellers under the GARS sale and purchase agreement based upon operating results. The final settlement approximated the estimate made at 31 December 2015. Additional payment recorded in earnings for the nine months ended 30 September 2016 was insignificant. The remaining deferred consideration of $4.3 million (272 at the exchange rate as of 30 September 2016) is due to be paid in September 2017.

7. Financial assets and liabilities (continued)

Fair values

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

		Carrying amount		Fair value	
		30 September 2016 (Unaudited)	**31 December 2015**	**30 September 2016 (Unaudited)**	**31 December 2015**
Financial assets					
Financial assets at fair value through profit or loss:					
Cross-currency swap not designated as hedge	Level 2	—	1,456	—	1,456
Financial assets at fair value through OCI:					
Cross-currency swap designated as hedge	Level 2	479	1,903	479	1,903
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	20,694	20,236	20,694	20,236
Loans receivable from Garden Ring and Strafor	Level 2	7,291	4,061	7,291	4,061
Other deposits	Level 2	2,784	3,419	2,556	3,178
Total financial assets		**31,248**	**31,075**	**31,020**	**30,834**
Financial liabilities					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	182,024	182,107	201,956	185,841
Ruble bonds	Level 1	56,369	37,573	54,859	35,696
Deferred and contingent consideration	Level 3	2,295	3,209	2,295	3,209
Finance lease obligations	Level 3	3,482	3,504	3,482	3,504
Long-term accounts payable	Level 3	491	1,048	562	1,200
Financial liabilities at fair value through profit or loss:					
Foreign currency forwards and cross-currency swap not designated as hedges	Level 2	29	7	29	7
Financial liabilities at fair value through OCI:					
Interest-rate swaps designated as hedges	Level 2	—	41	—	41
Foreign currency forwards and cross-currency swap designated as hedges	Level 2	3,710	15	3,710	15
Due to employees and related social charges, non-current	Level 3	—	109	—	109
Total financial liabilities		**248,400**	**227,613**	**266,893**	**229,622**

7. Financial assets and liabilities (continued)

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

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

The GARS escrow account (included in “Other deposits” in the “Fair values” table above) holds cash reserved for deferred consideration settlement under the sale and purchase agreement with the sellers of GARS. The fair value of the account approximates its carrying value.

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

The Group estimated the fair value of the SMARTS deferred consideration of 60 using a probability-weighted cash flow model. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement.

The fair value of the Garden Ring deferred consideration approximates its carrying value.

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

The fair values of the Group’s loans and borrowings and other liabilities carried at amortised cost (except for market quoted Ruble bonds) are determined by a discounted cash flow method using a discount rate that reflects the issuer’s borrowing rate as at the end of the reporting period. The own nonperformance risk as at 30 September 2016 and 31 December 2015 was assessed to be insignificant.

During the nine months ended 30 September 2016 there were no transfers between levels of the fair value hierarchy.

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

Valuation techniques and assumptions

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

8. Income tax

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

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

	Three months ended 30 September		Nine months ended 30 September	
	2016	**2015**	**2016**	**2015**
Current income tax	2,804	3,679	9,795	11,362
Deferred income tax	116	340	(1,746)	(1,006)
Total income tax expense	**2,920**	**4,019**	**8,049**	**10,356**

9. Related parties

As at 30 September 2016 and 31 December 2015, the Group is primarily owned by USM Group, which is an indirect controlling shareholder, and Telia Company, which is another major shareholder with significant influence over the Group, and is a publicly owned Swedish company, and its affiliates (Telia Group).

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

	Three months ended 30 September		Nine months ended 30 September	
	2016	**2015**	**2016**	**2015**
Revenues from USM Group	3	5	12	16
Revenues from Telia Group	113	198	425	501
Revenues from Euroset	25	36	370	58
	141	**239**	**807**	**575**
Services from USM Group	285	238	857	690
Services from Telia Group	284	415	689	1,230
Services from Euroset	304	277	933	843
Services from Garden Ring	386	—	1,165	—
	1,259	**930**	**3,644**	**2,763**
Other non-operating expenses from USM Group	—	—	1,293	1,826

9. Related parties (continued)

	30 September 2016	31 December 2015
Due from USM Group	785	477
Due from Telia Group	124	305
Due from Euroset	530	403
Due from Garden Ring	4,392	4,643
	5,831	**5,828**
Due to USM Group	1,307	809
Due to Telia Group	289	414
Due to Euroset	8	12
Due to Garden Ring	—	63
	1,604	**1,298**

Terms and conditions of transactions with related parties

Outstanding balances as at 30 September 2016 and 31 December 2015 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As at 30 September 2016 and 31 December 2015, the Group has not recorded any impairment of receivables relating to amounts owed by related parties.

USM Group

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

The Group purchased billing system and related support services from PeterService, a member of the USM Group, in the amount of 4,680 and 2,104 during the nine months ended 30 September 2016 and 2015, respectively.

The Group is a member of the not-for-profit partnership “Development, Innovations, Technologies” (the “Partnership”) which was established by companies in the USM Group. The Partnership may determine to incur education, science and other social costs as well as to maintain certain social infrastructure assets in Skolkovo Innovation Centre which are not owned by MegaFon and not recorded in the consolidated statement of financial position. The Group’s accrued contributions to the Partnership of 1,293 and 1,826 during the nine months ended 30 September 2016 and 30 September 2015, respectively, are included into other non-operating expenses in the interim condensed consolidated income statement.

9. Related parties (continued)

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 TeliaSonera International Carrier Russia.

Euroset

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

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 lease agreement with Garden Ring which qualifies as a related party transaction. This building will become the new corporate headquarters of the Group, permitting the consolidation of the Group's operations in Moscow into a single location. The Group also has loan receivable from Garden Ring. The balance due from Garden Ring at 30 September 2016 consists of the loan receivable.

10. Commitments, contingencies and uncertainties

Operating environment

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

During 2015 and the nine months ended 30 September 2016, the Russian economy was negatively impacted by low crude oil prices and sanctions imposed on certain Russian companies and individuals by several countries. The ruble exchange rate and interest rates have fluctuated significantly in 2015 and during the nine months ended 30 September 2016 and as at 30 September 2016 the key financing rate of the Central Bank of Russia was 10.0%. The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth in Russia, any or all of 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, Roskomnadzor granted the Company a licence and allocated frequencies to provide services under the 4G/LTE standard in Russia.

10. Commitments, contingencies and uncertainties (continued)

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

Equipment purchases agreements

In 2014 the Group entered into two separate 7-year agreements with two suppliers to purchase equipment and software for 2G/3G/4G network construction and modernisation. The software usage agreements contain various termination options, however the Group is specifically committed under the agreements to pay at least 3 years' worth of fees plus an amount equal to 50-60% of the fees 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 30 September 2016 is 9,485.

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 interim condensed 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 expenses in the interim condensed consolidated income statement *(Note 9)*.

Taxation

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

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

10. Commitments, contingencies and uncertainties (continued)

As at 30 September 2016 the Group’s management estimated that the possible effect of additional taxes, before fines and interest, if any, on the interim condensed consolidated financial statements, if the authorities were successful in enforcing different interpretations, is in the amount of up to approximately 570.

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 Company’s and its subsidiaries’ liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, 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.

The details of the package are currently under discussion and may undergo changes. The Group will estimate the potential effects of the laws on its capital commitments when more information about the final form of the anti-terror package is received.