MEGAFON

Consolidated Financial Statements

Years ended December 31, 2012, 2011 and 2010
With Report of Independent Auditors

ERNST & YOUNG

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Report of Independent Auditors

The Board of Directors and Shareholders of OJSC MegaFon

We have audited the accompanying consolidated financial statements of OJSC MegaFon and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012, 2011 and 2010, and the related consolidated statements of comprehensive income, cash flows and shareholders' equity for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC MegaFon and subsidiaries at December 31, 2012, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

February 28, 2013

Ernst & Young LLC

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Consolidated Balance Sheets

(In millions of Rubles)

	Note	December 31, 2012	2011	2010
Assets				
Current assets:				
Cash and cash equivalents	6	**2,387**	2,887	2,667
Short-term investments	7	**22,246**	84,509	63,554
Accounts receivable, net of allowances of 1,259, 1,447 and 1,029	8	**9,021**	9,547	6,859
Due from related parties	26	**1,086**	104	95
Inventory	9	**5,277**	4,551	3,081
Prepaid income taxes		**5,066**	6,957	6,975
VAT receivable		**1,297**	1,779	2,562
Deferred tax assets	20	**1,270**	1,972	1,166
Other current assets	10	**8,466**	7,987	7,114
Total current assets		**56,116**	120,293	94,073
Property, plant and equipment, net of accumulated depreciation of 201,984, 164,765 and 130,876	11	**215,383**	223,718	194,872
Goodwill and intangible assets:				
Goodwill	4, 12	**23,950**	15,393	7,041
Intangible assets, net of accumulated amortization of 29,457, 24,817 and 20,638	12	**18,073**	19,672	19,245
Equity method investments	5	**32,633**	—	—
Deferred tax assets	20	**932**	712	506
Deferred finance charges	14	**1,188**	729	665
Advances to related parties, less current portion	26	**681**	—	—
Other non-current assets		**1,113**	2,951	1,065
Total assets		**350,069**	383,468	317,467

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

Consolidated Balance Sheets (continued)

(In millions of Rubles)

	Note	December 31, 2012	2011	2010
Liabilities				
Current liabilities:				
Accounts payable	13	**8,631**	9,621	6,521
Accounts payable to equipment suppliers		**6,488**	8,034	10,308
Due to related parties	5, 26	**17,668**	465	404
Current portion of liability for marketing related licences	12	**529**	402	382
Current portion of liability for deferred and contingent consideration	4, 15	**2,769**	2,550	1,450
Accrued compensation	17	**5,033**	5,360	2,840
Prepayments received		**9,221**	7,895	7,303
Taxes payable	19	**2,887**	3,056	1,704
VAT payable		**6,603**	2,965	1,294
Current portion of deferred revenue		**1,315**	954	552
Short-term loans and current portion of long-term debt	14	**19,881**	7,415	12,171
Other current liabilities		**1,977**	1,256	845
Total current liabilities		**83,002**	49,973	45,774
Debt, less current portion	14	**126,541**	36,294	20,750
Deferred tax liabilities	20	**13,131**	10,543	8,256
Asset retirement obligations	11	**4,805**	5,248	4,304
Liability for marketing related licences, less current portion	12	**153**	621	893
Liability for deferred and contingent consideration, less current portion	4, 15	**—**	1,829	1,731
Deferred revenue, less current portion		**1,109**	1,569	1,968
Other non-current liabilities		**1,082**	759	665
Total liabilities		**229,823**	106,836	84,341
Equity				
MegaFon shareholders' equity:				
Ordinary shares par value of 0.1 Rubles 620,000,000 shares issued; 565,309,911 (2012) and 620,000,200 (2011 and 2010) shares outstanding		**581**	581	581
Treasury shares	3, 18	**(39,133)**	—	—
Reserve fund		**17**	17	17
Additional paid-in capital	18	**14,027**	13,852	13,855
Retained earnings	3	**144,722**	261,950	218,371
Accumulated other comprehensive loss		**(486)**	(291)	(261)
Total MegaFon shareholders' equity		**119,728**	276,109	232,563
Noncontrolling interests		**518**	523	563
Total equity		**120,246**	276,632	233,126
Total liabilities and equity		**350,069**	383,468	317,467

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

MegaFon

Consolidated Statements of Comprehensive Income

(In millions of Rubles, except share and per share amounts)

	Note	Years ended December 31, 2012	2011	2010
Revenues (including related party amounts of 280, 236 and 357)	21, 26	**272,637**	242,608	215,515
Cost of revenues (including related party amounts of 787, 1,382 and 1,220)	22, 26	**67,048**	58,896	48,423
Sales and marketing expenses (including related party amounts of 51, nil and nil)	23, 26	**19,747**	21,841	19,471
Operating expenses (including related party amounts of 3,177, 1,314 and 1,080)	24, 26	**68,486**	61,049	49,847
Depreciation	11	**47,514**	42,377	35,035
Amortization	12	**6,149**	5,299	3,839
Operating income		**63,693**	53,146	58,900
Other income/(expense):				
Interest expense	11	**(7,211)**	(706)	(837)
Interest income		**1,193**	3,591	4,008
Other income, net		**191**	30	18
Loss on derivatives, net	16	**—**	(51)	(203)
Share of earnings in equity investees	5	**266**	—	—
Foreign currency exchange loss, net		**(8,241)**	(105)	(700)
Total other income/(expense), net		**(13,802)**	2,759	2,286
Income before income taxes and noncontrolling interests		**49,891**	55,905	61,186
Provision for income taxes	20	**11,531**	12,320	11,962
Net income		**38,360**	43,585	49,224
Net income attributable to noncontrolling interests		**(54)**	(6)	(52)
Net income attributable to MegaFon		**38,306**	43,579	49,172
Basic EPS:	25			
Net income attributable to MegaFon per share		**68**	70	79
Weighted-average ordinary shares outstanding		**561,293,092**	620,000,200	620,000,200
Diluted EPS:	25			
Net income attributable to MegaFon per share		**68**	70	79
Weighted-average ordinary shares outstanding		**562,970,228**	620,000,200	620,000,200
Foreign currency translation adjustment, net of tax of nil		**88**	(39)	(8)
Change in fair value of derivatives, net of tax of nil	16	**(261)**	—	—
Other comprehensive loss		**(173)**	(39)	(8)
Total comprehensive income		**38,187**	43,546	49,216
Comprehensive (income)/loss attributable to noncontrolling interest		**(76)**	3	(50)
Comprehensive income attributable to MegaFon shareholders		**38,111**	43,549	49,166

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

MegaFon

Consolidated Statements of Cash Flows

(In millions of Rubles)

	Note	Years ended December 31, 2012	2011	2010
Cash flows from operating activities:				
Net income attributable to MegaFon		**38,306**	43,579	49,172
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		**47,514**	42,377	35,035
Amortization		**6,149**	5,299	3,839
Net loss on derivatives	16	**—**	51	203
Net foreign exchange loss		**8,241**	105	700
Net income attributable to noncontrolling interests		**54**	6	52
Bad debt expense	8, 24	**1,319**	1,437	1,182
Provision for deferred income taxes	20	**3,065**	850	3,240
Amortization of deferred finance charges		**564**	196	180
Share of earnings in equity investees	5	**(266)**	—	—
Changes in assets and liabilities:				
Accounts receivable		**(1,650)**	(3,870)	(1,927)
Inventory		**(724)**	(1,414)	(1,606)
Other current assets		**1,667**	(1,053)	(3,555)
Accounts payable and accrued expenses		**(76)**	6,962	448
Deferred revenue		**(99)**	3	151
Prepayments received		**1,326**	392	18
VAT, net		**4,020**	2,375	(519)
Net cash provided by operating activities		**109,410**	97,295	86,613
Cash flows from investing activities:				
Purchases of property, plant and equipment and intangible assets		**(46,674)**	(73,332)	(63,860)
Proceeds from sale of property, plant and equipment		**521**	449	743
Acquisitions of subsidiaries, net of cash acquired of 240, 274 and 849	4	**(8,439)**	(10,825)	(10,418)
Purchase of equity method investments and put option	5	**(16,491)**	—	—
Change in short-term investments and long-term deposits		**58,313**	(18,948)	(15,286)
Net cash used in investing activities		**(12,770)**	(102,656)	(88,821)
Cash flows from financing activities:				
Proceeds from long-term debt	14	**217,568**	21,486	13,728
Repayments of long-term debt	14	**(116,795)**	(14,365)	(20,105)
Deferred finance charges paid	14	**(1,023)**	(260)	(208)
Dividends paid to MegaFon shareholders	3	**(151,863)**	—	—
Purchase of treasury shares	3	**(63,883)**	—	—
Payments of contingent consideration	15, 26	**(1,490)**	(491)	—
Payments of liability for marketing related licences	12	**(369)**	(385)	(329)
IPO proceeds, net	3	**16,384**	—	—
Proceeds from exercise of stock options	18	**4,768**	—	—
Dividends paid to noncontrolling interests		**(81)**	—	(147)
Purchase of noncontrolling interest in subsidiaries		**—**	(40)	(100)
Net cash provided/(used in) financing activities		**(96,784)**	5,945	(7,161)
Effect of exchange rate changes on cash and cash equivalents		**(356)**	(364)	(514)
Net increase/(decrease) in cash and cash equivalents		**(500)**	220	(9,883)
Cash and cash equivalents at beginning of year		**2,887**	2,667	12,550
Cash and cash equivalents at end of year		**2,387**	2,887	2,667
Supplemental cash flow information:				
Cash paid during the year for income taxes		**13,675**	10,914	11,858
Interest paid during the year, net of interest capitalized		**5,630**	114	158
Non-cash activities – Deferred consideration for purchases of equity-method investments and acquisitions	4, 5, 15	**16,491**	1,231	3,166

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

Consolidated Statements of Shareholders' Equity

(In millions of Rubles, except share amounts)

		MegaFon shareholders' equity										
		Ordinary shares		Treasury shares								
	Note	Shares	Amount	Shares	Amount	Reserve fund	Additional paid-in capital	Retained earnings	Accumulated other comprehen-sive loss	Total attributable to MegaFon	Non-controlling interests	Total
As at December 31, 2009		**620,000,200**	**581**	**–**	**–**	**17**	**13,870**	**169,199**	**(255)**	**183,412**	**502**	**183,914**
Net income		–	–	–	–	–	–	49,172	–	49,172	52	**49,224**
Other comprehensive loss		–	–	–	–	–	–	–	(6)	(6)	(2)	**(8)**
Acquisitions	4	–	–	–	–	–	–	–	–	–	214	**214**
Purchase of noncontrolling interests		–	–	–	–	–	(15)	–	–	(15)	(56)	**(71)**
Dividends paid to noncontrolling interests		–	–	–	–	–	–	–	–	–	(147)	**(147)**
As at December 31, 2010		**620,000,200**	**581**	**–**	**–**	**17**	**13,855**	**218,371**	**(261)**	**232,563**	**563**	**233,126**
Net income		–	–	–	–	–	–	43,579	–	43,579	6	**43,585**
Other comprehensive loss		–	–	–	–	–	–	–	(30)	(30)	(9)	**(39)**
Purchase of noncontrolling interests		–	–	–	–	–	(3)	–	–	(3)	(37)	**(40)**
As at December 31, 2011		**620,000,200**	**581**	**–**	**–**	**17**	**13,852**	**261,950**	**(291)**	**276,109**	**523**	**276,632**
Net income		–	–	–	–	–	–	38,306	–	38,306	54	**38,360**
Other comprehensive loss		–	–	–	–	–	–		(195)	(195)	22	**(173)**
Dividends paid	3	–	–	–	–	–	–	(151,863)	–	(151,863)	–	**(151,863)**
Purchase of treasury shares	3	–	–	89,279,700	(63,883)	–	–		–	(63,883)	–	**(63,883)**
Sale of treasury shares in IPO	3	–	–	(26,839,411)	19,205	–	–	(3,033)	–	16,172	–	**16,172**
Sale of treasury shares upon exercise of stock options	18	–	–	(7,750,000)	5,545	–	(140)	(638)	–	4,767	–	**4,767**
Share-based compensation expense	18	–	–	–	–	–	315	–	–	315	–	**315**
Retirement of treasury shares	3	(200)	–	(200)	–	–	–	–	–	–	–	**–**
Dividends paid to noncontrolling interests		–	–	–	–	–	–	–	–	–	(81)	**(81)**
As at December 31, 2012		**620,000,000**	**581**	**54,690,089**	**(39,133)**	**17**	**14,027**	**144,722**	**(486)**	**119,728**	**518**	**120,246**

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

1. Description of Business

Open Joint Stock Company MegaFon (the “Company” or “MegaFon”) is a company incorporated under the laws of the Russian Federation (“Russia”) and registered in the Unified State Register of Legal Entities under number 1027809169585. Its registered office is at 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation.

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

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates on the dual band GSM 900/1800 standard. In May 2007, the Company was awarded a licence that expires on May 21, 2017, for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. In July 2012, the Company was awarded a licence which expires in July 2022 for the provision of fourth-generation (“4G”) technology services under Long Term Evolution (“LTE”) standard throughout the entire territory of Russia. As of December 31, 2012, the Company is providing and expanding 3G services in almost all of the regions in which it operates throughout Russia and has commenced providing 4G/LTE services in Moscow, and in certain other cities throughout Russia under a mobile virtual network operator (“MVNO”) agreement with Scartel LLC (“Scartel”), a related party *(Note 26)*. The Company also holds licences for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the whole territory of Russia. The Company has its own land-line and leased satellite transmission network capacities.

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

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Basis of Presentation

The statutory accounting records of the Company and its subsidiaries, except CJSC TT-Mobile (“TT-Mobile”), the Company’s subsidiary in the Republic of Tajikistan (“Tajikistan”), are maintained in Russian Rubles and except for TT-Mobile, CJSC Aquafon GSM, a subsidiary in the Republic of Abkhazia (“Abkhazia”), and CJSC Ostelecom, a subsidiary in the Republic of South Ossetia (“South Ossetia”), are prepared in accordance with the requirements of Russian accounting and tax legislation. Foreign subsidiaries of the Company maintain their accounting records in accordance with their local accounting and tax legislation. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The accompanying consolidated financial statements differ from statutory financial statements used in Russia, Tajikistan, Abkhazia and South Ossetia as they reflect certain adjustments, recorded in the entities’ accounts, which are necessary to present the financial position, results of operations and cash flows in accordance with US GAAP.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The principal adjustments are related to (1) revenue recognition; (2) recognition of interest expense and other operating expenses; (3) deferred income taxes; (4) valuation and depreciation of property, plant and equipment and intangible assets; (5) business combinations; (6) consolidation and accounting for subsidiaries; (7) accounting for financial instruments; (8) foreign currency translation; and (9) valuation allowances for unrecoverable assets.

The Company evaluated subsequent events up to February 28, 2013, the date these financial statements were issued.

The accompanying consolidated financial statements are presented in millions of Rubles, except for share amounts or unless otherwise indicated.

Use of Estimates in Preparation of Financial Statements

The preparation of consolidated financial statements, in conformity with US GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reported period. Significant estimates, among others, include the allocation of purchase price to the fair value of net assets acquired in connection with business combinations, useful lives related to tangible and intangible assets, impairment of long-lived assets, deferred revenue, asset retirement obligations, recoverability of deferred tax assets, fair value of financial instruments, long-term employee benefits, share-based compensation, income tax provision and allowance for doubtful accounts. Actual results could differ from these estimates.

Principles of Consolidation

Wholly-owned and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Consolidation is also required when the Company is a primary beneficiary of a variable interest entity.

All significant inter-company accounts and transactions are eliminated upon consolidation and net earnings/(losses) are reduced or increased by the amount of the net earnings/(losses) of subsidiaries attributable to noncontrolling interests.

Business Combinations

The Company applies the acquisition method of accounting and recognizes the assets acquired, the liabilities assumed and any noncontrolling interest in the acquired company at the acquisition date, measured at their fair values as of that date. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset 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.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Equity Method Investments

Investments in associated companies and corporate joint ventures in which the Company exercises significant influence and joint control over the operations and financial policies are reported according to the equity method of accounting. The Company's share of the earnings and losses of these companies are included in share of earnings in equity investees in the accompanying consolidated statements of comprehensive income.

Foreign Currency Translation

The functional currency of the Company's subsidiaries domiciled in Russia, Abkhazia and South Ossetia is the Russian Ruble as a majority of their revenues, costs, property and equipment purchases, debt and trade liabilities are either priced, incurred, payable or otherwise measured in Rubles.

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

Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and deposits in banks with original maturities of three months or less. The carrying value of cash and cash equivalents approximates fair value.

Short-Term Investments

Short-term investments comprise all highly liquid investments with original maturities of more than three months but less than twelve months. The carrying value of short-term investments approximates their fair value.

Accounts Receivable

Accounts receivable are stated net of allowance for bad debts. The Company makes judgments as to the recoverability of accounts receivable based on historical trends and future expectations. To determine the allowance for doubtful accounts, management reviews specific customer risks and the Company's analysis of the aged accounts receivable balances.

Inventories

Inventories, which primarily consist of telephone handsets, accessories, USB modems and SIM-cards, are stated at the lower of cost or market value. Cost is determined using the average cost method.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Value-Added Tax

Value Added Tax ("VAT") related to revenues is generally payable to the tax authorities on an accrual basis when invoices are issued to customers. VAT incurred on purchases may be offset, subject to certain restrictions, against VAT related to revenues, or can be reclaimed in cash from the tax authorities under certain circumstances. As of December 31, 2012, the VAT enacted statutory rate was 18% in Russia and Tajikistan and 10% in Abkhazia and South Ossetia.

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

Deferred Finance Charges

Commissions, arrangement and commitment fees and related legal fees paid to secure a firm commitment from lenders, premiums paid to secure vendor financing, and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the terms of the related loans, using the effective-interest method. Costs capitalized in connection with revolving credit facilities are amortized on a straight-line basis over the period the revolving line of credit is available.

Property, Plant and Equipment

Property, plant and equipment is stated at cost, less accumulated depreciation and impairment, if any. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Interest expense incurred during the construction phase is capitalized as part of property, plant and equipment until the asset is ready for use. Depreciation is recorded on a straight-line basis over the estimated useful life of the asset.

The estimated useful lives are as follows:

Buildings and structures	7 to 49 years
Switching equipment, including billing systems	3 to 7 years
Base stations, including software	7 years
Fiber-optic equipment	20 years
Other network equipment	5 to 7 years
Vehicles and office equipment	3 to 5 years

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

Repair and maintenance costs are expensed as incurred, while updates and improvements are capitalized.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

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

Asset Retirement Obligations

The Company 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.

The Company records the fair value of a legal liability for an asset retirement obligation in the period it is incurred. This cost is initially capitalized and amortized over the corresponding estimated economic useful life of 25 years.

Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as a gain or loss on disposition. The Company annually evaluates whether there are any indicators which suggest that the estimated cash flows underlying the liability have changed materially. If such indicators exist the Company changes estimates of the timing and amount of the cash flows and accounts for the effect as an increase or a decrease in the carrying amount of the liability for an asset retirement obligation and the related asset retirement cost is capitalized as part of the carrying amount of the related long-lived asset.

Goodwill

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

Intangible Assets

Intangible assets, which are stated at cost, less accumulated amortization and impairment, if any, consist principally of operating licences, frequencies, numbering capacity, customer base and marketing related licences.

Operating licences and frequencies provide the Company with the exclusive right to utilize certain radio frequency spectrum to provide wireless communication services. The Company capitalizes payments made to third party suppliers to acquire access to the resources and for use of telephone numbering capacity. These assets, except for GSM 900/1800 standard wireless licences and marketing related licences *(Note 12)*, are generally amortized on a straight-line basis over their estimated useful lives, generally from four to ten years.

Customer base and other intangible assets, such as software and trademarks, are amortized on a straight-line basis over their estimated useful lives.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The Company continues to evaluate the amortization period to determine whether events or circumstances warrant revised amortization periods. Additionally, the Company considers whether the carrying value of such assets should be impaired based on the expected future economic benefits.

Long-Lived Assets Impairment

Long-lived assets to be held and used by the Company are reviewed to determine whether an event or change in circumstances indicates that the carrying amount of the asset may not be recoverable. For long-lived assets to be held and used, the Company bases its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, the Company determines whether impairment has occurred through the use of an undiscounted cash flow analysis of assets at the lowest level for which identifiable cash flows exist. If impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the fair value of the asset. No such losses were recognized in the years ended December 31, 2012, 2011 and 2010.

Goodwill Impairment Assessment

Goodwill is reviewed for impairment annually, at the beginning of the fourth quarter, and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to 1) a significant adverse change in legal factors or in business climate, 2) unanticipated competition, or 3) an adverse action or assessment by a regulator. The Company determines whether impairment has occurred by assigning goodwill to the reporting units identified and comparing the carrying amount of the reporting unit, including goodwill, to the fair value of the reporting unit. The fair value of the reporting unit is estimated using a discounted cash flows approach. If goodwill impairment has occurred, the Company recognizes a loss for the difference between the carrying amount of reporting unit goodwill and its implied fair value. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. The Company's evaluation of goodwill completed during the years ended December 31, 2012, 2011 and 2010 resulted in no impairment losses.

Revenue Recognition

Wireless Revenue

The Company 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, and charges for Value Added Services ("VAS"). Interconnect revenue includes revenues from wireless and wireline

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

operators that was earned from the services rendered for traffic termination from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers using the network of the Company. VAS include SMS, MMS, content and media, commissions for mobile payments and others.

The content revenue relating to VAS is presented net of related costs when the Company acts as an agent of the content providers while gross revenues and related costs are recorded when the Company is a primary obligor in the arrangement.

Service revenue is generally recognized when the services are rendered. Revenues are stated net of value-added tax charged to customers.

The Company defers revenue resulting from fees paid by customers upon initial connection. Deferred revenues are subsequently recognized over the estimated average customer lives under tariff plans, which are periodically reassessed by management.

Revenue Recognition for Arrangements with Multiple Deliverables

The Company enters into multiple element revenue arrangements in which a customer may purchase a combination of equipment (e.g. USB modems, handsets) and telecommunication services (e.g. airtime, data, and other services). The Company allocates consideration received from subscribers to the separate units of accounting based on their relative selling price. The selling price used for each deliverable is based on vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. Revenue allocated to the delivered equipment and related costs are recognized in the profit and loss account at the time of sale provided that other conditions for revenue recognition are met. Amounts allocated to telecommunication services are deferred and recognized as revenue over the period of rendering the services.

Wireline Revenue

The Company 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 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 Company's wireline networks. Revenue from service contracts is recognized when the services are rendered. Billings received in advance of service being rendered are deferred and recognized as revenue as the service is rendered.

Advertising Costs

Advertising costs are expensed as incurred *(Note 23)*.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Dealer Commissions

Dealer commissions are expensed as incurred.

During the year ended December 31, 2012, the Company introduced changes to its third party dealer arrangements for provisions of post-sales services. As a result, dealer commissions are recognized as the services are performed, generally during a six-month period from the date a new subscriber is activated.

Government Pension Funds

The Company contributes to the local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended December 31, 2012, 2011 and 2010 were 4,308, 3,572 and 1,839 respectively.

Income Taxes

Provisions are recorded in the consolidated financial statements for taxation of profits in accordance with Russian and other local legislation currently in force. The Company accounts for income taxes under the liability method. Deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement bases of assets and liabilities and are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future.

The Company accounts for uncertain tax positions and reflects liabilities for unrecognized income tax benefits together with corresponding interest and penalties in the consolidated statement of comprehensive income as income tax expense.

Earnings per Share

Basic earnings per share ("EPS") are computed by dividing net earnings 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 earnings 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 have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options and convertible debt instruments. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method (for stock options) and "if-converted" method (for convertible debt).

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, short-term investments and accounts receivable. The Company deposits available cash with various banks in Russia. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within Russia. To manage the concentration of credit risk, the Company 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. Management periodically reviews the creditworthiness of the banks in which it deposits cash, cash equivalents and short-term investments.

The Company extends credit to certain counterparties, principally international and national telecommunications operators, for roaming services, and to certain dealers. The Company minimizes 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 preventive measures to minimize credit risk include obtaining advance payments, bank guarantees and other security.

Fair Value Measurement

US GAAP standards establish a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value. These levels include:

Level 1: Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are non-active; inputs other than quoted prices that are observable and derived from or corroborated by observable market data.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The Company, using available market information, appropriate valuation methodologies and management's estimates determines the approximate fair values of financial instruments.

Derivative Instruments and Hedging Activities

The Company records all derivative instruments on the balance sheet at their respective fair values. On the date a derivative contract is executed, and depending on the specific facts and circumstances, the derivative may be designated as a fair value hedge, cash flow hedge or foreign currency hedge of net investment in a foreign operation.

The Company has derivatives which it designated as cash flow hedges and derivatives which it did not designate as hedges *(Note 16)*.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of comprehensive income. 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 consolidated statement of comprehensive income.

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

Long-Term Incentive Program

Certain employees of the Company have been granted phantom share options. The value ascribed to the full package of each grant is based on the value of the Company calculated using operating results and net debt of the Company. The awards are contingent on the recipients' continuing employment with the Company and are settled in cash. The vesting period is every two years over a four year period. The compensation cost under the program is calculated based on the estimated Company value and the number of awards expected to vest and be accrued over the vesting period *(Note 17)*.

Share-Based Compensation

The Company evaluates and records the cost of equity instruments, such as stock options under the Chief Executive Officer ("CEO") Long-Term Incentive Plan *(Note 18),* in the statement of comprehensive income as a compensation expense. The cost of the equity instruments is measured based on the fair value of the instruments determined as of the grant date and recognized over the vesting period, which ends on the date on which the relevant employee becomes fully entitled to the award.

Recent Accounting Pronouncements

Fair Value Measurements. In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, "*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs"*, which clarifies Topic 820, "*Fair Value Measurements and Disclosures*", but also includes some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with US GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board ("IFRS"). The amendment is effective for public entities for interim and annual periods beginning after December 15, 2011. The adoption of the guidance did not have a material impact on the Company's financial statements.

Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. In July 2012, the FASB issued ASU 2012-02, *"Intangibles--Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment"*, which states that an

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with ASC 350-30, *Intangibles--Goodwill and Other, General Intangibles Other than Goodwill*. Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. The Company does not expect ASU 2012-02 to have a material impact on its financial statements.

Technical Corrections and Improvements. In October 2012, the FASB issued ASU 2012-04, *"Technical Corrections and Improvements"*, which includes substantive, limited-scope improvements. These are items that represent narrow and incremental improvements to U.S. GAAP and are not purely technical corrections. This ASU includes amendments that identify when the use of fair value should be linked to the definition of fair value in Topic 820, *Fair Value Measurement*, and contains conforming amendments to the Codification to reflect the measurement and disclosure requirements of Topic 820. These amendments are referred to as Conforming Amendments. The Conforming Amendments to U.S. GAAP included in this ASU are generally nonsubstantive in nature. Many of the amendments conform wording to be consistent with the terminology in Topic 820. The amendments in this ASU that will not have transition guidance will be effective upon issuance for both public entities and nonpublic entities. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. The Company does not expect ASU 2012-04 to have a material impact on its financial statements.

Offsetting Assets and Liabilities. In January 2013, the FASB issued ASU 2013-01, "*Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities"*, which clarifies the scope of ASU No. 2011-11, *"Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities"*. The amendment is effective for fiscal years beginning on or after January 1, 2013 and interim periods within those years. The Company does not expect ASU 2013-01 to have a material impact on its financial statements.

Comprehensive Income. In February 2013, the FASB issued ASU 2013-02, *"Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income"*, which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendment is effective for reporting periods beginning after December 15, 2012 and early adoption is permitted. The Company does not expect ASU 2013-01 to have a material impact on its financial statements.

3. Shareholders' Equity

Ordinary Shares

In July 2012, the Company retired 200 of its treasury shares held by MegaFon Investments (Cyprus) Limited ("MICL"), a wholly-owned subsidiary of the Company.

In August 2012, the Federal Commission for Financial Markets, the Russian securities market regulator, registered a 1-to-100 split of the Company's shares. As a result, the total amount of issued shares of the Company became 620,000,000, each with a par value of 0.1 Rubles. Accordingly, all share and per share amounts for all periods presented in these consolidated financial statements and notes thereto, have been adjusted retroactively, where applicable, to reflect this share split.

Equity Transactions

In April 2012, the Company's shareholders agreed to a series of transactions to permit the payment of the Company's first dividend and re-organize the shareholding structure. The principal impacts of these agreements on the Company's financial position were as follows:

- the special dividend, paid on April 24, 2012, resulted in an aggregate distribution of 151,863 to the shareholders (or 245 Rubles per ordinary share at the exchange rate as of April 24, 2012); and

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

The dividend payment and the re-purchase of 14.4% of ordinary shares were financed from the Company's then existing cash and short-term investments, and additional borrowings of approximately 142,400, net of repayments. As a result of these transactions, the Company substantially depleted its working capital, including available cash and short-term investments, although these have subsequently been partially rebuilt through positive operating cash flows and additional borrowings. As of February 28, 2013, the Company believes it will continue to be able to generate significant operating cash flows and have access to undrawn lines of credit of approximately 87,168 that can be used to cover capital and operating expenditures *(Note 14)*. Additionally, the Company can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating and financing activities will be sufficient for the Company to meet its obligations as they become due.

3. Shareholders' Equity (continued)

On November 28, 2012, the Company completed an IPO in which it sold 26,839,411 treasury shares at a public offering price of $20 per ordinary share or 619 Rubles at the exchange rate as of November 28, 2012 (the "IPO price"). The Company received net cash proceeds of 16,384 after deducting underwriting discounts and commissions of 31 and other offering expenses of approximately 132. As of December 31, 2012 commission fees in amount of 212 are payable by the Company.

Accumulated Other Comprehensive Loss

The accumulated balances for each component of other comprehensive loss are as follows as of December 31:

	2012	2011	2010
Foreign currency translation adjustment, net of tax of nil	**(225)**	(291)	(261)
Derivative financial instruments, net of tax of nil	**(261)**	—	—
Total accumulated other comprehensive loss	**(486)**	(291)	(261)

4. Business Combinations

Acquisitions in 2012

VAS Media

In September 2012, the Company completed the acquisition of a 100% ownership interest in Felebior Holding Limited, which holds a 100% interest in a group of subsidiaries that supply multi-media content, ring tones, geo-positioning services, mobile payments and other VAS in Russia ("VAS Media") for a total consideration of 9,207, of which 528 was effectively a settlement of pre-existing payable for VAS Media services. Before the acquisition VAS Media partnered with the Company on a variety of projects, such as provision of MegaFon branded VAS to MegaFon customers *(Note 26)*.

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

The acquisition of VAS Media was accounted for using the acquisition method. The valuation of certain acquired assets and liabilities assumed has not been finalized as of the date these consolidated financial statements were available to be issued; thus, the provisional measurements of certain intangible assets, deferred taxes and goodwill are subject to change.

The Company has consolidated the financial position and the results of operations of VAS Media from September 1, 2012.

4. Business Combinations (continued)

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

	VAS Media
Cash and cash equivalents	240
Other current assets	305
Property, plant and equipment	36
Intangible assets	6
Goodwill	8,544
Other non-current assets	183
Total assets acquired	9,314
Current liabilities	(633)
Non-current liabilities	(2)
Total liabilities assumed	(635)
Total cash consideration transferred net of settlement of pre-existing payable	**8,679**

The goodwill recognized is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of VAS Media. Management is still assessing the allocation of goodwill among reporting units. None of the goodwill recognized is deductible for income tax purposes.

Acquisitions in 2011

NetByNet

In June 2011, the Company completed the acquisition of a 100% ownership interest in Fairlie Holding and Finance Limited, which holds a 100% interest in a group of subsidiaries that provide broadband internet, IP telephony, IP TV and other multimedia services in Russia under the NetByNet brand ("NetByNet") for total consideration having a fair value of 8,731 as of the date of acquisition, consisting of cash consideration of 7,507 and contingent consideration of 1,224.

The primary reason for the acquisition was to facilitate the Company's entry into the broadband internet market in Moscow, the Moscow region and the Central Federal District, where the Company did not previously provide broadband internet services for end-customers.

Contingent consideration consisted of several payments due within approximately one year with the amounts due being linked to NetByNet's operating results for, and additional acquisitions made in, the year ending December 31, 2011. The Company estimated the fair value of the contingent consideration at 1,224 using a probability-weighted cash flow model. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. In June 2012, the Company paid a final settlement of all contingent consideration liability due in respect of the NetByNet acquisition *(Note 15)*.

4. Business Combinations (continued)

In January 2012, the principal shareholder of NetByNet joined the senior management of the Company and, in April 2012, became the Company's CEO *(Note 26)*.

As of December 31, 2012, the Company's management believes that the carrying amount of the NetByNet reporting unit approximates its fair value. However, if the Company does not achieve planned cost savings assumed in the original fair value calculation, the Company may recognize an impairment loss.

UgraTel

In December 2011, the Company completed the acquisition of a 100% ownership interest in OJSC UgraTel ("UgraTel"), a provider of broadband internet and wireline telephony services in the Urals region of Russia, for a total cash consideration of approximately 2,421. The primary reason for the acquisition of UgraTel was to strengthen the Company's position in the wireline market in the Urals Federal District.

Other Acquisitions in 2011

Also in 2011, the Company acquired 100% ownership interests in a number of other alternative wireline and broadband internet service providers in certain regions of the Russian Federation.

	Web Plus	**Nakhodka Telecom**	**ChebNet**	**Luchshe. Net**	**Total**
Cash	47	196	610	318	1,171
Liability for deferred and contingent consideration	7	—	—	—	7
Total consideration	**54**	**196**	**610**	**318**	**1,178**

Acquisitions in 2010

Synterra

In June 2010, the Company completed the acquisition of a 100% ownership interest in CJSC Synterra ("Synterra"), an alternative provider of integrated telecommunications services in Russia, from Synterra Cyprus Limited and Burnham Advisors Limited for the total purchase price of $745 million, including cash consideration of approximately $298 million (9,259 at the exchange rate as of June 2, 2010), deferred and contingent consideration in the notional amount of up to $110 million (3,418 at the exchange rate as of June 2, 2010) and the net debt of Synterra as of the date of acquisition.

Synterra provides wireline services in Russia and holds licences for local and long-distance telephony services, data transmission, wireless broadband access services, and communication channels leasing. The primary reason for the acquisition was to further strengthen the Company's position in the wireline market and to realize future operating and cost synergies resulting from fixed-to-mobile convergence opportunities.

4. Business Combinations (continued)

The acquisition-date fair values of each major class of consideration transferred are presented below:

Cash	9,267
Liability for deferred and contingent consideration	3,166
Total consideration transferred	**12,433**

Deferred and contingent consideration consists of an unconditional deferred payment amount of $43 million (1,336 at the exchange rate as of June 2, 2010) and several contingent payments aggregating up to $67 million (2,082 at the exchange rate as of June 2, 2010), payable on or prior to the third anniversary of the acquisition date. $70 million (2,175 at the exchange rate as of June 2, 2010) out of the total $110 million (3,418 at the exchange rate as of June 2, 2010) of deferred and contingent consideration bears interest at the rate of 2.75% per annum and the remaining $40 million (1,243 at the exchange rate as of June 2, 2010) is interest-free. Contingent payments depend upon satisfaction of certain conditions.

Metrocom

In October 2010, the Company completed the acquisition of a 100% ownership interest in CJSC Metrocom ("Metrocom"), a wireline operator which owns a backbone network in Saint Petersburg, for approximately 2,000 cash consideration. The primary reason for the acquisition was to strengthen the Company's position in the wireline market in Saint Petersburg.

Pro Forma Results of Operations (Unaudited)

The following unaudited pro forma data for the years ended December 31, 2012, 2011 and 2010 assume that the 2012, 2011 and 2010 acquisitions occurred on January 1, 2010. These pro forma amounts are provided for information purposes only and are not necessarily indicative of the results of future operations, nor of the actual results that would have been achieved had the acquisitions taken place at the beginning of 2010.

	(unaudited) Year ended December 31		
	2012	**2011**	**2010**
Revenues			
Total revenues as reported	**272,637**	242,608	215,515
VAS Media	**195**	242	61
Synterra	**n/a**	n/a	4,879
Metrocom	**n/a**	n/a	759
NetByNet	**n/a**	839	1,456
UgraTel	**n/a**	952	841
Other acquisitions	**n/a**	575	734
Total pro forma revenues	**272,832**	245,216	224,245

4. Business Combinations (continued)

	(unaudited) Year ended December 31		
	2012	**2011**	**2010**
Net income			
Total net income as reported	**38,306**	43,579	49,172
VAS Media	**702**	1,050	681
Synterra	**n/a**	n/a	(194)
Metrocom	**n/a**	n/a	(3)
NetByNet	**n/a**	(132)	(401)
UgraTel	**n/a**	73	101
Other acquisitions	**n/a**	(22)	6
Total pro forma net income	**39,008**	44,548	49,362
Pro forma EPS – basic and diluted	**69**	72	80

5. Equity Method Investments

Equity method investments as at December 31 are as follows:

Investee	Share, %	2012	2011	2010
Euroset	50.0	**32,451**	—	—
News Tube	37.6	**182**	—	—
Total		**32,633**	—	—

Euroset

In December 2012, MegaFon entered into agreements with Garsdale Services Investment Limited ("Garsdale"), a controlling shareholder of the Company, and Lefbord Investments Limited ("Lefbord") pursuant to which the Company subscribed for ordinary and redeemable preference shares in Lefbord representing 50% of its share capital for $535 million cash consideration, or 16,491 at the exchange rate as of December 6, 2012 (the "MegaFon Contribution"). Concurrently, Garsdale contributed certain equity holdings valued at $140 million (4,315 at the exchange rate as of December 6, 2012) and promissory notes pursuant to which Garsdale promises to pay Lefbord (or its assignees) in aggregate $395 million, 12,175 at the exchange rate as of December 6, 2012 (together, the "Garsdale Contribution").

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

The Company is required to make a further subscription for shares in Lefbord for up to $50 million (1,541 at the exchange rate as of December 6, 2012) to fund contingent consideration

5. Equity Method Investments (continued)

payable by Lefbord if certain targets are met by Euroset by June 30, 2013. If these targets are met, Garsdale will be required to make an equivalent subscription for shares in Lefbord thereby maintaining an equivalent 50% stake in Lefbord.

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

As a result of the obligation to acquire Garsdale's 50% interest in Lefbord, the Company has consolidated Lefbord and classified the convertible debt instrument payable to Garsdale as amounts due to related parties in the consolidated balance sheet as of December 31, 2012 *(Note 26)*. The transactions referred to above result in the holding by the Company of a 50% interest in Euroset by the Company. The liability and purchased put option components of convertible debt instruments that may be settled in cash upon conversion (at the discretion of the issuer) are accounted for separately.

Accordingly, the Company allocated the total of 1,118 to the purchased put option, being its cost at the date the convertible debt instrument was issued. The Company will use fair value to account for the changes in the fair value of the respective financial instrument going forward. Further, as the result of allocating 1,118 to the cost of purchased put option, the Company assigned 321 to the respective debt. After these allocations the total amount of the Company's investment in Euroset amounted to 32,185.

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

Cash, net of allocation to purchased put option	**15,694**
Due to related parties *(Note 26)*	**16,491**
Total consideration transferred	**32,185**

Contingent consideration of up to $100 million (3,082 at the exchange rate as of December 6, 2012) will be reflected as an additional investment at the time the targets are met and amounts became payable under the arrangement.

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

The acquisition was recorded under the equity method of accounting, that is the investment in the equity method investee was initially recognised in the consolidated balance sheet at cost and adjusted thereafter to recognise the Company's share of net earnings and other

5. Equity Method Investments (continued)

comprehensive income of the investee.

The total preliminary estimated share of the Company in the fair value of identifiable net assets acquired amounted to 13,718. The excess of the consideration transferred over the Company's share in the fair value of identifiable net assets of Euroset amounted to 18,467.

6. Cash and Cash Equivalents

Cash and cash equivalents as at December 31 are as follows:

	2012	2011	2010
Rubles	**1,654**	2,386	2,126
US dollars	**704**	406	228
Euros	**29**	95	313
Total cash and cash equivalents	**2,387**	2,887	2,667

7. Short-Term Investments

Short-term investments as at December 31 are as follows:

Bank deposits denominated in	2012	2011	2010
Rubles	**5,116**	26,641	32,280
US dollars	**17,130**	50,938	23,772
Euros	—	6,501	7,502
Norwegian krones	—	429	—
Total short-term investments	**22,246**	84,509	63,554

8. Accounts Receivable

Accounts receivable as at December 31 are as follows:

	2012	2011	2010
Local subscribers	**4,361**	2,797	3,140
Dealers	**3,108**	2,153	1,396
Interconnection charges	**1,715**	4,848	2,160
Roaming charges receivable	**281**	298	393
Other receivables	**815**	898	799
Less: allowance for doubtful accounts	**(1,259)**	(1,447)	(1,029)
Total accounts receivable	**9,021**	9,547	6,859

8. Accounts Receivable (continued)

The following summarizes the changes in the allowance for doubtful accounts for the years ended December 31:

	2012	2011	2010
Balance at beginning of year	**1,447**	1,029	861
Bad debt expense	**1,319**	1,437	1,182
Accounts receivable written off	**(1,507)**	(1,019)	(1,014)
Balance at end of year	**1,259**	1,447	1,029

9. Inventory

Inventory as at December 31 is as follows:

	2012	2011	2010
Handsets and accessories	**3,357**	2,220	1,380
USB modems	**718**	1,052	728
Information materials	**178**	406	298
SIM-cards	**274**	206	201
Other	**750**	667	474
Total inventory	**5,277**	4,551	3,081

10. Other Current Assets

Other current assets as at December 31 are as follows:

	2012	2011	2010
Roaming rebates received	**3,255**	636	410
Prepayments for services	**2,343**	2,402	3,135
Euroset settlement put option *(Note 5)*	**1,118**	—	—
Deferred expenses	**240**	415	459
Prepaid taxes, other than income	**183**	148	101
VAT from advances paid for long-lived assets	**169**	698	423
Prepayments for inventory	**631**	300	1,104
Interest receivable	**85**	3,006	987
Assets held for sale	**4**	154	—
Derivatives *(Note 16)*	—	—	196
Other	**438**	228	299
Other current assets	**8,466**	7,987	7,114

11. Property, Plant and Equipment

Property, plant and equipment as at December 31 is as follows:

	2012	2011	2010
Cost:			
Buildings, structures and leasehold improvements	**63,065**	52,931	44,029
Telecommunications network	**307,181**	272,352	231,559
Vehicles, office and other equipment	**23,062**	20,229	17,828
	393,308	345,512	293,416
Accumulated depreciation	**(201,984)**	(164,765)	(130,876)
Construction in-progress	**24,059**	42,971	32,332
Property, plant and equipment, net	**215,383**	223,718	194,872

Included in construction in-progress are advances to suppliers of network equipment of 3,299, 5,338 and 4,507 as at December 31, 2012, 2011 and 2010, respectively.

Software and licences for base stations and billing systems are included in the balances of telecommunications network assets. The net book value of such software was 7,861, 7,324 and 5,991 as at December 31, 2012, 2011 and 2010, respectively.

Interest capitalized was 1,885 (out of the total interest expense of 9,096), 1,224 (out of the total interest expense of 1,930) and 799 (out of the total interest expense of 1,636) for the years ended December 31, 2012, 2011 and 2010, respectively.

Asset Retirement Obligations

The following table describes the changes to the asset retirement obligations liability:

	2012	2011	2010
Balance at beginning of year	**5,248**	4,304	3,303
Revision in estimated cash flows	**(1,347)**	—	47
Net increase in liability during the year	**362**	453	542
Accretion expense	**542**	491	412
Balance at end of year	**4,805**	5,248	4,304

The accretion expense was included in depreciation in the consolidated statements of comprehensive income.

12. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the years ended December 31, 2012, 2011 and 2010 are as follows:

	2012	2011	2010
Balance at beginning of year	**15,393**	7,041	498
Acquisitions *(Note 4)*	**8,544**	9,050	6,543
Measurement period adjustments	**13**	(698)	—
Balance at end of year	**23,950**	15,393	7,041

Intangible assets as at December 31 are as follows:

	Average useful lives, years	Cost			Accumulated amortization		
		2012	2011	2010	2012	2011	2010
Operating licences	10	**20,034**	19,478	19,483	**(15,925)**	(14,959)	(13,773)
Frequencies	6	**5,309**	5,484	4,773	**(1,731)**	(1,500)	(1,276)
Software	4	**9,486**	7,254	4,486	**(5,881)**	(3,639)	(2,103)
Marketing related intangible assets	2	**3,535**	3,535	3,535	**(1,371)**	(668)	(218)
Customer base	9	**2,889**	2,907	2,057	**(951)**	(726)	(560)
Numbering capacity	1	**1,839**	1,798	1,882	**(1,622)**	(1,603)	(1,550)
Trademarks	4	**707**	671	295	**(316)**	(116)	(26)
Other intangible assets	4	**3,731**	3,362	3,372	**(1,660)**	(1,606)	(1,132)
Total intangible assets	**6**	**47,530**	44,489	39,883	**(29,457)**	(24,817)	(20,638)

Amortization expense for the succeeding five years is expected to be as follows:
2013 – 5,108; 2014 – 3,972; 2015 – 1,952, 2016 – 1,373 and 2017 – 1,207.

Operating Licences

Operating licences, primarily consisting of nationwide 3G licence, 4G licence and several GSM 900/1800 standard licences are integral to the wireless operations of the Company and any inability to extend existing licences on the same or comparable terms could materially affect the Company's business. While operating licences are issued for a fixed period, renewals of these licences previously had occurred routinely and at nominal cost. The Company determines that there are currently no legal, regulatory, contractual, competitive, economic or other factors that could result in delays in licence renewal, or even an outright refusal to renew. The weighted-average period until the next renewal date of GSM 900/1800 standard licences is approximately 2 years. GSM 900/1800 standard licences are amortized on a sum-of-the-years'-digits basis over the period of 10 years which reflects the pattern the economic benefits of these operating licences are consumed or otherwise used up and assumes a gradual decrease in the number of GSM 900/1800 standard subscribers.

3G and 4G licences were obtained at nominal cost but require the Company to meet certain conditions, including capital commitments and coverage requirements *(Note 27).*

12. Goodwill and Intangible Assets (continued)

Marketing Related Intangible Assets

In April 2009, the Company and OJSC Rostelecom ("Rostelecom") entered into an agreement with the Organizational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi to acquire rights and licences to use the Olympic mascot, logos and other Olympic symbols and, in the case of the Company, to be referred to as "the General Mobile Partner of the 2014 XXII Olympic Winter Games". Under the agreement the Company committed to a payment of $65 million (1,974 at the exchange rate as of December 31, 2012) in cash to be made in several installments from 2009 through 2014.

In addition, the Company and Rostelecom are jointly responsible to provide equal amounts of services in-kind of up to a combined total of $130 million (3,948 at the exchange rate as of December 31, 2012) from 2009 through 2014. The management of the Company believes that the risk of non-performance by Rostelecom of its responsibilities under the agreement is remote.

The Company obtained the rights and licences in 2009, at which time the Company assumed a liability with a net present value of future cash installments of 1,334 and deferred revenue with a fair value of 1,516 (Level 3).

The recognition of the intangible asset is treated as a non-cash item to the extent of the amount of the liability and deferred revenue recorded. The intangible asset is amortized using the reverse sum-of-the-years'-digits method over a period of approximately 5 years.

The fair value of deferred revenue recognized by the Company was estimated using the Discounted Cash Flow ("DCF") analysis (Level 3). The basis for the Company's cash flow assumptions included forecasted amounts and timing of services to be provided under the agreement. The Company used 7% as a discount rate.

13. Accounts Payable

Accounts payable as at December 31 are as follows:

	2012	**2011**	**2010**
Dealers	**1,710**	2,258	1,134
Interconnection charges	**1,562**	2,329	1,668
Rent and utilities	**874**	726	566
Advertising	**745**	584	317
Channels rental	**650**	686	542
Payables for inventory	**509**	471	426
Network repairs and maintenance	**472**	484	221
Content providers	**793**	900	514
Roaming charges payable	**279**	363	446
Other payables	**1,037**	820	687
Total accounts payable	**8,631**	9,621	6,521

14. Short-Term and Long-Term Debt

Short-term and long-term debt as at December 31 is as follows:

	Currency	Interest Rate	Maturity	2012	2011	2010
(1) Ruble Bonds	Ruble	8.05%	2022 with a put option in 2014	**10,000**	—	—
Bank Loans:						
(2) VTB Bank	Ruble	MosPrime+2.20%	2013	**11,000**	—	—
(3) Sberbank	Ruble	9.02%	2015 - 2016	**46,693**	—	—
(4) Sberbank	Ruble	8.71%	2014 - 2015	**29,512**	—	—
(5) Gazprombank	Ruble	9.05%	2016	**6,300**	—	—
(6) Nordic Investment Bank	Euro	EURIBOR+2.05%	2019	**3,218**	—	—
(7) Nordea Bank Moscow	US dollar	LIBOR+2.0%	2015	**1,519**	1,610	1,524
(8) UniCredit Bank Moscow	US dollar	LIBOR+3.5%	2013 - 2013	**304**	805	4,762
Equipment Financings:						
(9) China Development Bank and Bayerische Landesbank	US dollar	LIBOR+1.1% to +2.7%	2013 - 2016	**26,848**	25,042	10,017
(10) BNP Paribas London branch and Nordea Bank Finland	US dollar	2.91% to 4.54%	2013 - 2016	**5,776**	9,239	8,034
(11) Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft	Euro	3.74% and EURIBOR+0.35%	2013 - 2015	**2,277**	3,490	4,655
(12) Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	US dollar	1.92%	2013 - 2018	**2,842**	1,078	—
(13) Cisco Systems Finance International	US dollar	3.50% to 4.11%	Repaid in 2012	—	1,219	—
(14) Nordic Investment Bank, Nordea Bank Finland and Bayerische Landesbank	US dollar	LIBOR+0.85% to +2.2%	Repaid in 2012	—	358	1,016
(15) Citibank N.A. London branch and ING Bank	Euro	4.27%	Repaid in 2011	—	—	1,824
Other				**133**	868	1,089
Total debt				**146,422**	43,709	32,921
Less current portion				**(19,881)**	(7,415)	(12,171)
Non-current portion				**126,541**	36,294	20,750

14. Short-Term and Long-Term Debt (continued)

To finance the payment of a dividend to our shareholders and the re-purchase of the Company's ordinary shares *(Note 3)*, in April 2012, MegaFon entered into certain new financing facilities, pursuant to which the Company incurred additional borrowings (net of repayments) in an aggregate principal amount of approximately 142,400 million rubles.

These additional borrowings included a facility with Barclays Bank PLC, BNP Paribas and Citibank, N.A., London branch ("Bridge Facility"), under which the Company drew $1.5 billion (equivalent to 45,559 million rubles at the exchange rate as of December 31, 2012) in April 2012. The Bridge Facility was voluntarily repaid in full in June and July 2012 using part of the proceeds from the facilities entered into with Sberbank referred to in the table above.

(1) Ruble Bonds

In October 2012, the Company, through MegaFon-Finance LLC, a wholly-owned subsidiary of MegaFon, issued ruble-denominated bonds in an aggregate principal amount of 10,000. The bonds are due for bullet repayment in 2022, subject to a two-year put option. The coupon rate for the bonds was set at 8.05% per annum, payable semiannually, for two years period subject to revision thereafter. The net proceeds of the bonds issue were applied immediately to prepay in part the loan from VTB Credit Facility.

(2) VTB Bank

In April 2012, the Company entered into a revolving credit facility with VTB Bank ("VTB Credit Facility") for up to 30,000. The VTB Credit Facility was fully drawn for a one-year period subject to an interest rate of 3-months MosPrime plus 2.2% which is payable every three months. Subsequently, in October 2012 the Company issued ruble-denominated bonds in an aggregate principal amount of 10,000. The net proceeds of this issue were applied immediately to prepay in part of the VTB Credit Facility. In December 2012, the Company further prepaid 9,000 of the VTB Credit Facility.

(3, 4) Sberbank

In April 2012, the Company entered into two credit facility agreements with Sberbank, one for up to the Ruble equivalent of $1 billion (equivalent to 30,373 million rubles at the exchange rate as of December 31, 2012) and the other for up to the Ruble equivalent of $1.5 billion (equivalent to 45,559 million rubles at the exchange rate as of December 31, 2012) (together, the "Sberbank Credit Facilities"). As of December 31, 2012, the Company has fully drawn both the $1 billion Credit Facility in the amount of 29,512 and the $1.5 billion Credit Facility in the amount of 46,693. A payment of 564 as an arrangement fee was made for the Sberbank Credit Facilities.

(5) Gazprombank

In April 2012, the Company and Gazprombank modified the terms of the existing revolving credit facility agreement ("Gazprombank Credit Facility") by increasing the debt limit on the facility from 15,000 to 30,000. The Gazprombank Credit Facility is subject to fees of 0.15% per annum on the amount of the unutilized balance. On April 18, 2012, the Company drew

14. Short-Term and Long-Term Debt (continued)

the entire 30,000 and subsequently, on April 25, 2012, voluntarily repaid 23,700. The Gazprombank Credit Facility carries an interest rate of 9.05% per annum which is payable every three months. The interest rate can be changed by Gazprombank unilaterally in an event of revision of the refinancing rate by the Central Bank of Russia. The principal is due for repayment in September 2016.

The principal purpose of the VTB Credit Facility, the Sberbank Credit Facilities, the Gazprombank Credit Facility and the Bridge Facility was the funding of the dividend payout and the re-purchase of shares by the Company. Any excess is being used to fund operating, investment and financial activities. The covenants of these Credit Facilities are substantially consistent with those which the Company has in its other existing loan agreements.

(6) Nordic Investment Bank

In June 2012, the Company entered into a credit facility with Nordic Investment Bank ("NIB Credit Facility") for up to 80 million Euros (equivalent to 3,218 million rubles at the exchange rate as of December 31, 2012). The NIB Credit Facility carries interest at a rate of EURIBOR plus 2.05% per annum. The NIB Credit Facility is subject to payment of a commitment fee of 0.4% per annum on the amount of the unutilized balance and a front-end fee of 0.25% on the principal amount. The NIB Credit Facility can only be used for updating the network of the Company in the Moscow region and other regions of Russia preparing for the launch of 4G/LTE. In September 2012, the Company fully drew the NIB Credit Facility.

Other

As at December 31, 2012, the amount due from the Company to certain equipment suppliers was of 1,487 at the exchange rate as of December 31, 2012. The Company intends to pay this amount using the proceeds from China Development Bank and Bayerische Landesbank facility and Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken facility. In the accompanying consolidated balance sheet as at December 31, 2012 the Company has classified the amount due to these equipment suppliers as short-term and long-term debt according to the applicable repayment schedules.

The following is the summary of aggregate maturities of long-term debt at December 31, 2012:

2013	**19,881**
2014	**33,138**
2015	**51,859**
2016	**39,983**
2017	**818**
Thereafter	**743**
Total	**146,422**

14. Short-Term and Long-Term Debt (continued)

At December 31, 2012, the Company's debt is denominated in the following currencies:

	Borrowing currency	Millions of Rubles
Rubles	104,770	**104,770**
US dollars (in millions)	1,188	**36,090**
Euros (in millions)	138	**5,562**
Total long-term debt		**146,422**

Covenant Requirements

All financing facilities contain restrictive covenants, which, among other things, limit the Company's ability to incur debt, encumber assets, undertake mergers and acquisitions and make material changes in the nature of the business without prior consent from the required majority of lenders. In addition, these financing facilities require the Company to meet various financial covenants.

As at December 31, 2012, the Company's total undrawn credit facilities were as follows:

	Currency	Interest Rate	Fee rates	Available until	Available amount
Bank Loans:					
Gazprombank	Ruble	Either fixed (6% to 9%) or floating (MosPrime3M+1.5% to +2.5%)	0.15%	2016	**23,700**
VTB Bank	Ruble	MosPrime3M+2.2%	—	2016	**19,000**
UniCredit Bank Moscow	Ruble	Either fixed or floating. Depends on the tenor of the loan, market conditions	—	2015	**11,000**
Nordea Bank	Ruble	Either fixed (5.1% to 9.1%) or floating (MosPrime3M+1.75% to +2%)	0.40%	2016	**5,500**
Equipment Financings:					
China Development Bank	US dollar	LIBOR+2.4%	0.30%	2016	**26,791**
Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	US dollar	1.92%	0.18%	2013	**1,177**
Total					**87,168**

15. Settlement of Contingent Consideration

In June 2012, the Company paid approximately $43.6 million (1,431 at the exchange rates as of payment dates) in full and final settlement of all contingent consideration liability due in respect of the NetByNet acquisition completed in June 2011 *(Notes 4, 26)*. There were no significant changes to original estimates on any of the contingent consideration settled or outstanding during the three years ended December 31, 2012. The only balance of contingent consideration remaining unpaid as at December 31, 2012 is 2,769 in respect of the Synterra acquisition completed in 2010.

The Company estimated the fair value of the contingent consideration using a probability-weighted discounted cash flow model for Synterra acquisition and not discounted cash flow model for NetByNet and Web Plus acquisition. These fair value measurements are based on significant inputs not observable in the market and thus represent a Level 3 measurement. The significant unobservable inputs used are 6% discount rate for Synterra acquisition and several probability adjusted contingent payments for all acquisitions. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

16. Derivative Financial Instruments and Fair Value Measurement

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

Cash Flow Hedges of Interest Rate Risk

The Company's objective in using interest rate derivatives is to add certainty and stability to its interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

Interest rate swaps are recorded on the balance sheet at fair value (Level 2). The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in other comprehensive income/(loss) and is subsequently reclassified into earnings in the period that the hedged forecast transaction affects earnings. There has been no ineffective portion in the reporting years. The fair values of the swaps are based on a forward yield curve and represent the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

16. Derivative Financial Instruments and Fair Value Measurement (continued)

As at December 31 the Company had the following outstanding interest rate swaps stated at their notional amounts that were designated as cash flow hedges of interest rate risk:

	2012		**2011**		**2010**	
Original currency	**Millions of original currency**	**Millions of Rubles**	**Millions of original currency**	**Millions of Rubles**	**Millions of original currency**	**Millions of Rubles**
Euro	**34**	**1,368**	57	2,375	—	—
US Dollar	**666**	**20,228**	246	7,920	—	—

Non-Designated Hedges of Foreign Currency Risk

In 2010, the Company entered into a number of dual-currency deposits with various banks. The dual-currency deposits are financial instruments which combine features of a time deposit and a sold foreign currency put option. The dual-currency deposits were settled either in the original deposit currency (Euro or US Dollar) or in another pre-agreed currency (Ruble, US Dollar or Euro). The purpose of entering into these financial instruments was yield enhancement on the Company's foreign currency cash investments.

The respective embedded derivative financial instrument (put option) was bifurcated and measured at fair value using the Black-Scholes model (Level 2).

In the third quarter of 2006 and the second quarter of 2007, the Company entered into several long-term fixed-to-fixed rate cross-currency swaps. These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain long-term debt denominated in foreign currencies.

The swaps effectively converted, using the then-effective foreign currency exchange rates, some of the Company's outstanding fixed-to-fixed rate long-term US dollar and Euro denominated loans into synthetically equivalent Ruble long-term loans with fixed rates ranging from 3.95% to 6.65%. The carrying amount of such long-term loans was 972 as at December 31, 2010. These long-term loans were repaid in 2011.

For accounting purposes, the Company has chosen not to designate these derivatives as hedging instruments and, therefore has reported all gains and losses from the change in fair value of these derivative financial instruments directly in the consolidated statements of comprehensive income.

The derivatives are valued using standard valuation techniques. The principal technique used to value these instruments is through comparing the foreign currency exchange rates at the time that the derivatives were acquired to the forward exchange rates quoted in the existing market which is inactive as of the valuation date. The key inputs include interest rate yield curves, foreign exchange spot and forward rates. The fair value of these derivatives includes the effects of the counterparty's non-performance risk, including credit risk.

All of the foreign currency derivatives have been fully settled in 2011.

16. Derivative Financial Instruments and Fair Value Measurement (continued)

The table below presents the fair value of the Company's derivative financial instruments and their classification as of December 31:

	Balance sheet location	2012	2011	2010
Derivatives designated as cash flow hedges:				
Interest rate swaps	Other current liabilities	**(135)**	—	—
Interest rate swaps	Other non-current liabilities	**(126)**	—	—
Total		**(261)**	—	—
Derivatives not designated as hedges:				
Foreign currency swaps	Other current assets	—	—	196
Total		—	—	196

The table below (in which "OCI" means other comprehensive income) presents the effect of the Company's derivative financial instruments on the consolidated statements of comprehensive income for the years ended December 31:

	2012	2011	2010
Interest rate swaps designated as cash flow hedges:			
Amount of loss recognized in OCI	**(311)**	—	—
Amount of loss reclassified from accumulated OCI into interest expense	**50**	—	—
Total	**(261)**	—	—
Derivatives not designated as hedges:			
Amount of realized and unrealized gain/(loss) recognized in gain/(loss) on derivatives:			
Put options sold	—	—	65
Foreign currency swaps	—	(51)	(268)
Total loss on derivatives, net	—	(51)	(203)

At December 31, 2012, the amount recorded in other comprehensive income/(loss) which is expected to be reclassified to interest expense in the next twelve months is 122.

Fair Value Measurements

The carrying value of financial instruments, including cash, cash equivalents, accounts receivable and accounts payable approximates the fair value of these items due to the short-term nature of these amounts.

16. Derivative Financial Instruments and Fair Value Measurement (continued)

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

	Euroset settlement put option	Derivative financial instruments	**Total assets**	Contingent considera-tion liability	Derivative financial instruments	**Total liabilities**
Level 1	—	—	—	—	—	—
Level 2	—	—	—	—	(268)	**(268)**
Level 3	1,118	—	**1,118**	(2,769)	—	**(2,769)**
Total December 31, 2012	1,118	—	**1,118**	(2,769)	(268)	**(3,037)**
Level 1	—	—	—	—	—	**—**
Level 2	—	—	—	—	—	**—**
Level 3	—	—	—	(4,379)	—	**(4,379)**
Total December 31, 2011	—	—	—	(4,379)	—	**(4,379)**
Level 1	—	—	—	—	—	**—**
Level 2	—	196	**196**	—	—	**—**
Level 3	—	—	**—**	(3,181)	—	**(3,181)**
Total December 31, 2010	—	196	**196**	(3,181)	—	**(3,181)**

As of December 31, 2012, 2011 and 2010, the fair value (Level 3) of fixed and variable rate short-term and long-term debt (based on future cash flows discounted at current market rates) was as follows at December 31:

	2012		**2011**		**2010**	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Total debt	**146,422**	**147,381**	43,709	44,102	32,921	33,235

The Company, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of 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 Company could realize in a current market exchange. While management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

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

17. Long-Term Incentive Program

In April 2008, the Company's Board of Directors approved a long-term motivation and retention program. The program provides that certain key executive and senior level employees will be eligible for awards of phantom share options. The phantom share options have been awarded under the 2008 Grant, the 2009 Grant, the 2010 Grant and the 2011 Grant. Under all grants, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the value of the Company, which in turn is calculated as six times operating income before depreciation and amortization (OIBDA) reduced by debt, net of cash and cash equivalents and short-term investments (net debt). The awarded phantom share options vest every two years over a four-year period and are contingent upon the recipient's continuing employment with the Company and increase in the value of the Company. The in-the-money phantom share options are settled in cash upon vesting.

The following table summarizes information as at December 31, 2012 regarding outstanding phantom share options exercisable upon maturity:

	Number of phantom share options granted (in millions)	Total unrecognized compensation cost	Compensation expense, inclusive of all related taxes for the year ended December 31,		
			2012	**2011**	**2010**
2008 Grant	**4,068**	—	**37**	308	344
2009 Grant	**4,530**	24	**131**	155	524
2010 Grant	**4,349**	105	**238**	500	43
2011 Grant	**3,642**	102	**166**	—	—
Total	**16,589**	231	**572**	963	911

The total amounts of obligation included in accrued compensation liability of the accompanying consolidated financial statements as at December 31, 2012, 2011 and 2010 were 559, 1,604 and 1,026, respectively.

18. Share-Based Compensation

CEO Long-Term Incentive Plan

As part of a long-term incentive plan approved by the Company's Board of Directors in November 2012, Mr Tavrin, the CEO of the Company, agreed to purchase, within 30 days of the Company's IPO *(Note 3)*, 7,750,000 of the Company's treasury shares at the IPO price of $20 per share. In December 2012, Mr Tavrin exercised this option.

Pursuant to the plan, Mr Tavrin is also given three options to buy up to a further 7,750,000 treasury shares on each of his employment anniversary dates in May 2013, May 2014 and May 2015 at the IPO price. The options can be exercised, in whole or in part, on those dates or subsequently. Any unexercised portion of the options will continue to be capable of being exercised in whole or in part until they lapse in May 2017. Their exercise is subject to Mr

18. Share-Based Compensation (continued)

Tavrin's continued employment with the Company and Mr Tavrin's holding at least a 1.25% interest in the Company on the relevant exercise date.

The strike price of the options is subject to potential adjustment at the discretion of the Company's Board of Directors in case the Company declares a special dividend or a dividend that materially exceeds the contemplated dividend policy. Mr Tavrin agreed not to hold more than 5% of authorized share capital of the Company at any time prior to May 2017.

The awards are classified as equity. The fair value of the options has been estimated using the Black-Scholes model. The fair value of each grant is estimated on the date of grant. The Company used the following significant assumptions to estimate the fair value. Expected volatility was estimated based on the average historical volatility of publicly traded guideline companies over the period equal to the expected life of the option granted and other factors. The dividend yield was included into the model based on expected dividend payments. The risk free rate was determined on the basis of U.S. Treasury yield curve rates with a remaining term to maturity equal to the expected life of the options, approximated by line yield curve function based on publicly available data. The expected term of the options was determined as an average of vesting term and original contractual term ("simplified method") since the Company has limited employee share option exercises and the available data does not demonstrate consistent exercise behavior.

The following table illustrates the major assumptions of the Black-Scholes model for the options for the year ended December 31, 2012:

Expected term, years	2.5 - 3.5
Expected volatility	32.9% - 39.5%
Expected dividend yield	7.5%
Risk free interest rate	0.12% - 0.38%

The following table summarizes the weighted-average exercise prices and number of options:

	Number of options	Weighted-average exercise prices per option	
		US Dollars	**Rubles**
Outstanding as at January 1, 2012	—	—	—
Granted	31,000,000	20.00	619
Exercised	(7,750,000)	23.88	735
Forfeited	—	—	—
Expired	—	—	—
Outstanding as at December 31, 2012	**23,250,000**	**23.80**	**723**
Exercisable as at December 31, 2012	—	—	—

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

Nonvested as at January 1, 2012	—
Granted	2,070
Forfeited	—
Vested (recognized compensation cost)	(315)
Nonvested as at December 31, 2012	**1,755**

18. Share-Based Compensation (continued)

Long-Term Incentive Program 2012

In October 2012, the Company's Board of Directors approved a long-term motivation and retention program for certain key executive and senior level employees under which the parties which will be selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of OJSC MegaFon (equal to 7,000,000 phantom shares) at the base price of $17.86 per share. The plan has a three-year duration and the awarded share options shall vest in April-May 2014 and 2015 and be settled in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted-average price of the Company's shares in the period between January 15 and March 15 of the relevant year of vesting. Vesting of the options is contingent upon the recipient's continuing employment with the Company. As of December 31, 2012 no options have been granted under the program.

19. Taxes Payable

Taxes payable as at December 31 are as follows:

	2012	2011	2010
Social charges	**1,190**	1,035	314
Property tax	**735**	814	680
Unified Service Fund	**652**	617	558
Personal income tax	**155**	132	100
Income tax	**17**	372	29
Other	**138**	86	23
Total taxes payable	**2,887**	3,056	1,704

20. Income Taxes

The following presents the significant components of the Company's provision for income taxes for the years ended December 31:

	2012	2011	2010
Current income taxes	**8,466**	11,470	8,722
Deferred income tax expense	**3,065**	850	3,240
Total provision for income taxes	**11,531**	12,320	11,962

Income taxes represent the Company's provision for profit tax. Income tax is calculated at 20% of taxable profit for the years ended December 31, 2012, 2011 and 2010, respectively.

Starting from January 1, 2012 a new provision in Russian tax legislation that permits the taxpayers to calculate income taxes on a consolidated basis was introduced. If certain requirements are met, the corporate taxpayers are allowed to create a Consolidated Taxpayers' Group ("CTG"). The CTG is able to reduce taxable profits by offsetting tax losses generated by the CTG participants against profits generated by the other CTG

20. Income Taxes (continued)

members. In April 2012 the Company created the CTG which included OJSC “MegaFon” and three of its subsidiaries. The Company’s management believes that creation of the CGT does not result in significant changes of tax burden of the Company for the purpose of these consolidated financial statements.

The reconciliation between the provision for income taxes reported in the consolidated financial statements versus the provision for income taxes computed by applying the Russian enacted statutory tax rate to income before income taxes and noncontrolling interests is as follows:

	2012	**2011**	**2010**
Income before income taxes and noncontrolling interests	**49,891**	55,905	61,186
Statutory income tax rate	**20%**	20%	20%
Theoretical provision for income taxes	**9,978**	11,181	12,237
Non-deductible expenses	**1,093**	691	579
Effect of intragroup transactions	**852**	115	(578)
(Recognized)/unrecognized tax benefits	**(421)**	437	(530)
Effect of income tax preferences	—	(565)	(220)
Net change in valuation allowance	—	293	462
Other differences	**29**	168	12
Provision for income taxes	**11,531**	12,320	11,962

An increase in non-deductible expenses during the year ended December 31, 2012, was mainly due to social infrastructure expenses *(Notes 26, 27)* and share-based compensation expenses *(Note 18)*.

The effect of intragroup transactions, in the table above, represents the tax consequences of intragroup transactions with shares of subsidiaries (in 2010 and 2011) and taxable intragroup income (2012).

The effect of income tax preferences represents the impact of lower income tax rates for the Company under applicable regional laws of the Russian Federation. These laws provide that income tax exemptions up to 6.5% are granted to entities which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects. These exemptions are granted on an annual basis.

As at December 31, 2012, the tax years from 2010 to 2012 remained subject to examination by the tax authorities.

For income tax purposes of the Russian Federation and Tajikistan, certain of the Company’s subsidiaries have loss carry-forwards incurred from 2009 through 2012, which may be carried forward to offset future taxable income for ten and three years, respectively. The use of these carry-forwards is not restricted in 2012 or in future years. As at December 31, 2012, these subsidiaries had carry-forwards available aggregating approximately 7,098 with a related tax benefit of 1,420 of which 68 expires in 2019, 768 in 2020, 307 in 2021, 243 in 2022 and 34 in 2025.

20. Income Taxes (continued)

The amounts reported in the accompanying consolidated financial statements at December 31 consisted of the following:

	2012	2011	2010
Deferred tax assets:			
Revenue recognition	**769**	802	726
Loss carry-forwards	**1,419**	1,473	1,164
Accrued compensation	**914**	1,135	579
Accrued expenses	**821**	697	883
Other assets	**361**	260	263
Less: valuation allowance	**(463)**	(755)	(462)
Total deferred tax assets	**3,821**	3,612	3,153
Deferred tax liabilities:			
Intangible assets	**1,291**	1,337	1,645
Property, plant and equipment	**12,743**	9,640	7,707
Derivative financial instruments	**—**	22	37
Other liabilities	**717**	472	348
Total deferred tax liabilities	**14,751**	11,471	9,737
Net deferred tax liabilities	**10,929**	7,859	6,584
Add non-current deferred tax assets	**932**	712	506
Add current deferred tax assets	**1,270**	1,972	1,166
Total long-term deferred tax liabilities	**13,131**	10,543	8,256

As of December 31, 2012, 2011 and 2010, the Company recognized and recorded in prepaid income taxes an income tax benefit of 2,017, 3,963 and 2,323, respectively, related to acceleration of depreciation of property, plant and equipment for tax purposes. The recognition of the income tax benefit decreased the tax basis of property, plant and equipment with corresponding increase in the related non-current deferred tax liability. In November 2012, the Company won its litigation with the tax authorities with regards to its right to use accelerated depreciation of certain property, plant and equipment for tax purposes. Accordingly, the tax benefit recognized in prepaid income taxes decreased as it became realized.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2012	2011	2010
Balance at beginning of year	**269**	15	—
Additions based on tax positions related to current year	**—**	21	—
Additions based on tax positions related to prior years	**—**	518	5
Additions based on tax of acquired entities	**—**	150	10
Reduction in tax positions	**(166)**	(435)	—
Balance at end of year	**103**	269	15

20. Income Taxes (continued)

As of December 31, 2012, 2011 and 2010, the Company included accruals for uncertain tax positions in the amount of 103, 269 and 15, respectively, as a reduction of prepaid income taxes. No penalties or interest have been accrued in relation to unrecognized tax benefits as the Company has prepaid income tax in excess of the provisions for unrecognized tax benefits.

21. Revenues

Revenues for the years ended December 31 are as follows:

	2012	2011	2010
Wireless revenues	**241,375**	218,994	202,837
Wireline revenues	**17,938**	15,194	7,496
Sales of handsets and accessories	**13,324**	8,420	5,182
Total revenues	**272,637**	242,608	215,515

22. Cost of Revenues

Costs of revenues for the years ended December 31 are as follows:

	2012	2011	2010
Cost of services	**54,649**	47,644	41,648
Cost of handsets and accessories sold	**12,399**	11,252	6,775
Total cost of revenues	**67,048**	58,896	48,423

23. Sales and Marketing Expenses

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

	2012	2011	2010
Advertising	**8,136**	7,432	6,924
Dealer commissions	**7,098**	9,061	8,465
Cash collection commissions	**4,513**	5,348	4,082
Total sales and marketing expenses	**19,747**	21,841	19,471

24. Operating Expenses

Operating expenses for the years ended December 31 are as follows:

	2012	2011	2010
Salaries and social charges	**26,656**	23,604	19,061
Rent	**12,243**	10,765	8,603
Operating taxes	**6,684**	5,829	5,177
Network repairs and maintenance	**5,196**	5,162	4,322
Radio frequency fees	**3,940**	3,527	2,963
Utilities	**3,850**	3,275	2,628
Professional services	**1,886**	1,967	1,361
Office maintenance	**1,839**	1,743	1,407
Social infrastructure expenses *(Notes 26, 27)*	**1,816**	—	—
Bad debt expense	**1,319**	1,437	1,182
Vehicle costs	**647**	650	555
Materials and supplies	**238**	321	189
Insurance	**88**	113	111
Other expenses	**2,084**	2,656	2,288
Total operating expenses	**68,486**	61,049	49,847

Rent represents expenses relating to the operating leases of premises for offices, base stations and switches.

25. Earnings per Share

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

	2012	2011	2010
Numerator:			
Net income attributable to MegaFon	**38,306**	43,579	49,172
Add back: interest expense on convertible debt *(Note 5)*	**72**	—	—
Net income attributable to MegaFon	**38,378**	43,579	49,172
Denominator:			
Weighted-average ordinary shares outstanding	**561,293,092**	620,000,200	620,000,200
Effect of dilutive securities:			
Employee stock options *(Note 18)*	**66,839**	—	—
Assumed debt conversion *(Note 5)*	**1,610,297**	—	—
Weighted average diluted shares outstanding	**562,970,228**	620,000,200	620,000,200
EPS – basic, Rubles	**68**	70	79
EPS – diluted, Rubles	**68**	70	79

26. Related Party Transactions

The Company has entered into certain transactions with its equity investees, shareholders and their affiliates. The outstanding receivable and payable balances and the annual revenues and costs are as follows:

	As at December 31,		
	2012	**2011**	**2010**
Due from related parties			
USM Holdings Group	**850**	24	17
TeliaSonera Group	**154**	42	61
Alfa Group	—	38	17
Euroset	**82**	—	—
Total amounts due from related parties	**1,086**	104	95
Non-current advances to related parties			
USM Holdings Group	**681**	—	—
Total non-current advances to related parties	**681**	—	—
Due to related parties			
USM Holdings Group	**17,558**	373	286
TeliaSonera Group	**53**	92	118
Euroset	**57**	—	—
Total amounts due to related parties	**17,668**	465	404

	For the years ended December 31,		
	2012	**2011**	**2010**
Revenues			
USM Holdings Group	**101**	1	64
TeliaSonera Group	**179**	235	290
Alfa Group	—	—	3
Total revenues, related parties	**280**	236	357
Cost of revenues			
USM Holdings Group	**63**	428	29
TeliaSonera Group	**724**	954	1,191
Total cost of revenues, related parties	**787**	1,382	1,220
Sales and marketing expenses			
Euroset	**51**	—	—
Total sales and marketing expenses, related parties	**51**	—	—
Operating expenses			
USM Holdings Group	**2,912**	1,158	994
TeliaSonera Group	**1**	1	15
Alfa Group	**264**	155	71
Total operating expenses, related parties	**3,177**	1,314	1,080

26. Related Party Transactions (continued)

TeliaSonera Group

The outstanding balances and transactions with TeliaSonera Group relate to operations with a shareholder of the Company, TeliaSonera, its consolidated subsidiaries, its direct owners and their consolidated subsidiaries. Revenues and cost of services principally related to roaming agreements between MegaFon and members of the TeliaSonera Group located outside Russia and a wireline interconnection agreement with TeliaSonera International Carrier Russia.

Alfa Group

The outstanding balances and transactions with Alfa Group relate to operations with Altimo, AlfaStrakhovanie and Alfa Bank, members of Alfa Group who held a 25.1% interest in the Company through its member subsidiary Allaction Limited until April 24, 2012, when Allaction Limited ceased to hold any shareholding in the Company and ceased to be a related party *(Note 3)*. Operating expenses from transactions with the Alfa Group mainly related to an agreement with Altimo, a member of the Alfa Group, for the provision of legal and personnel services and with AlfaStrakhovanie, another member of the Alfa Group, for the provision of employees' medical and health insurance in 2012. The amounts on deposit accounts with Alfa Bank as at December 31, 2011 and 2010 were 7,239 and 6,553, respectively.

USM Holdings Group

The outstanding balances and transactions with USM Holdings Group relate to operations with AF Telecom Holding LLC, a shareholder of the Company, Garsdale, its direct owner, USM Holdings Limited, indirect owner of Garsdale and their consolidated subsidiaries.

The Company entered into an agreement with Telecominvest, a member of the USM Holdings Group, for provision of legal and personnel services effective from 2009. This agreement was renewed in 2010, 2011 and 2012. In addition, the Company purchased billing system and related support services from PeterService, another member of the USM Holdings Group, in the amount of 1,970, 2,013 and 1,759 during the years ended December 31, 2012, 2011 and 2010, respectively.

In February 2012, the Company entered into a MVNO agreement with Scartel, which operates under the "Yota" brand, for the joint development and provision of 4G/LTE services in Russia. The MVNO agreement enables the Company to provide 4G/LTE services to its customers using the frequencies and network of Scartel and enables Scartel to use network infrastructure of MegaFon to provide voice services to its customers. In March and April 2012, the Company prepaid Scartel an aggregate amount of $50 million (1,519 at the exchange rate as of December 31, 2012) for the provision of future interconnection services under the MVNO agreement. Starting from July 2012, both MegaFon and Scartel became indirect subsidiaries of Garsdale, a subsidiary of USM Holdings. As a result, Scartel became a related party of MegaFon. Before that date, Scartel was not one of the Company's related parties. 721 of the advance amount were included in current amounts due to related parties and 681 were included in non-current advances to related parties in the accompanying consolidated balance sheets as at December 31, 2012.

26. Related Party Transactions (continued)

At the time of the acquisition of VAS Media *(Note 4)*, a member of the Company's Board of Directors and the spouse of a member of the Company's management beneficially owned an aggregate of approximately 13% of Felebior Holding Limited. In addition, other sellers of significant interests in Felebior Holding Limited have from time to time been associated with companies in the USM Holdings Group. The transaction was unanimously approved by Board of Directors of the Company.

Cost of revenues for the eight months ended August 31, 2012 were 2,582 and for the years ended December 31, 2011 and 2010 were 2,518 and 1,375, respectively, related to services the Company received from VAS Media. The amounts of revenue and net income of VAS Media included in the Company's accompanying consolidated statement of comprehensive income from September 1 to December 31, 2012 were 1,640 and 449, respectively. These amounts are shown before elimination of intercompany transactions, which were mainly revenues from services provided by VAS Media to the Company of 1,521.

In 2011 the Company acquired 100% of shares of Web Plus from Telecominvest for a total consideration of 54 *(Note 4)*.

The amount on deposit accounts with Round Bank as at December 31, 2012 was 450.

In 2012, the Company became a member of the non-for-profit Partnership "Development, Innovations, Technologies" (the "Partnership") which was established by companies in the USM Holdings 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 the Company and not recorded in the accompanying consolidated balance sheets. The Company contributed 1,050 to the Partnership during the year ended December 31, 2012 and 766 was payable as of December 31, 2012.

Euroset

Beginning from December 2012, Euroset is the Company's equity method investee *(Note 5)*. In December 2012, the Company entered into a dealership agreement with Euroset which qualifies as a related party transaction.

CEO

In June 2012, the Company paid $43.6 million (equivalent to 1,431 million rubles at the exchange rates as of the payment dates) in full and final settlement of all contingent consideration liability for the NetByNet acquisition *(Note 4)*. A portion of this liability has been paid to a company the beneficiary of which is the CEO of the Company, Mr Tavrin. Mr Tavrin was not a related party at the time of NetByNet acquisition in June 2011.

27. Commitments, Contingencies and Uncertainties

Russian Environment and Current Economic Situation

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required for a market economy. The future stability of the Russian economy is

27. Commitments, Contingencies and Uncertainties (continued)

largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Russian government. The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. In 2011 the Russian Government continued to take measures to support its economy in order to overcome the consequences of the global financial and liquidity crisis. Despite some indications of recovery there continues to be uncertainty regarding further economic growth, significant capital flight, access to capital and the cost of such capital, any or all of which could negatively affect the Company's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above, or in others, could negatively affect the Company's results and financial position in a manner not currently determinable.

3G Licence Capital Commitments

In May 2007, MegaFon was awarded a licence that expires on May 21, 2017, for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G licence was granted subject to certain capital and other commitments. The three major conditions were that the Company builds a specified number of base stations that support 3G standards, starts commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also builds a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the licence. As of November 8, 2012, the Company believes it is in full compliance with these licence conditions, including constructing the number of base stations required at this time.

4G Licence Capital Commitments

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

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

Social Infrastructure Expenses

The Company may be required to maintain certain social infrastructure assets which are not owned by the Company and not recorded in the consolidated financial statements as well as to incur education, science and other social costs. Such activities are conducted in

27. Commitments, Contingencies and Uncertainties (continued)

collaboration with non-governmental charity organizations. These expenses are presented as part of the operating expenses in the consolidated statements of comprehensive income.

Taxation

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

The Company's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Company's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ. As of February 28, 2013, the Company's management estimated the possible effect of additional operating taxes, before fines and interest, if any, on these consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 227.

Litigation

The Company is not a party to any material litigation, although in the ordinary course of business, some of the Company'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, results of operations or liquidity of the Company.

Apple Commitment

In August 2008, the Company entered into a two-year fixed commitment with Apple Sales International ("Apple"), an Irish affiliate of Apple Computer Inc., to purchase a total of one million unlocked iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled this requirement with respect to the fourth quarter of 2008, but due to the significantly reduced handset demand caused by the economic crisis in Russia, the Company experienced difficulty re-selling these iPhones. While the Company placed several orders for iPhone handsets thereafter, none of these orders fulfilled the minimum quarterly requirement for the applicable quarters.

The contract with Apple terminated in August 2010 and, since such date, Apple has not asserted any claim against the Company with respect to any alleged non-fulfillment of its obligation to purchase iPhone handsets, and the Company has no basis to believe that any such claim will be asserted.

28. Segment Information

The Company 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, data transmission and VAS. The Company evaluates the performance of its operating segments based on revenue and operating income before depreciation and amortization (OIBDA). Operating segments with similar economic characteristics have been aggregated into an integrated telecommunication services segment, which is the only reportable segment. The remaining operating segments, including less significant subsidiaries and retail, do not meet the quantitative thresholds for reportable segments. Less than 1% of the Company's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

29. Subsequent Events

In February 2013, a total number of 2,233,000 phantom share options were granted to certain key executive and senior level employees under the 2012 long-term incentive program *(Note 18)*.