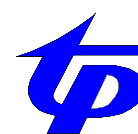

Telekomunikacja Polska S.A.

IAS Consolidated Financial Statements

For the years ended 31 December 1999 and 1998

Tuesday 13 June 2000

Report of certified auditors

To the Management Board of Telekomunikacja Polska S.A.:

1. We have audited the accompanying consolidated balance sheet of Telekomunikacja Polska Group ("the Group") which parent company is Telekomunikacja Polska S.A. (the "Company", "TP S.A.") as of 31 December 1999 and the related consolidated profit and loss account and cash flow statement for the year then ended. These financial statements are the responsibility of TPSA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

3. International Accounting Standard No. 29 "Financial Reporting in Hyperinflationary Economies" (IAS 29) requires that the carrying amounts of assets and liabilities reported in a period of hyperinflation should be expressed in the measuring unit current at the end of the hyperinflationary period and constitute the basis for the carrying amounts in the subsequent financial statements. The Polish economy was hyperinflationary until the end of 1996 and ceased to be hyperinflationary in 1997. The Group last revalued its fixed assets as of 1 January 1995 to reflect the effects of inflation by applying price indices determined by the Central Statistical Office for individual groups of assets. This revaluation was not performed in accordance with the provisions of IAS 29 since the Group did not use a general price index and did not subsequently revalue its fixed assets as of 31 December 1996. As a result, the cumulative balances of property, plant and equipment as of 31 December 1998 and 1999 which existed prior to 31 December 1996, have not been expressed in the measuring unit current at the end of 1996. The Group is unable to quantify the impact of non-compliance with IAS 29 on these financial statements. In all other respects the financial statements are prepared under historical cost convention.

4. The financial statements include 1998 financial information presented for comparative purposes. We audited the financial statements for the year ended 31 December 1998 and issued a qualified opinion thereon. Our qualification related to the non-compliance with IAS 29 referred to in paragraph 3 above.

5. In our opinion, except for the matter referred to in paragraph 3 above, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 1999 and the consolidated results of its operations and its cash flows for the year then ended in accordance with Statements of International Accounting Standards issued by the International Accounting Standards Committee.

6. Without further qualifying our opinion we draw attention to the following matter:

   In 1994-1999 the parent company took advantage of investment allowances and additional investment bonuses deducting PLN 3,533 million from its taxable profit. As more fully explained in Note 24(b), the right to investment allowances is conditional and may be questioned if the parent company has not or will not meet certain conditions prescribed by law.

Arthur Andersen

Warsaw, Poland
22 May 2000

TELEKOMUNIKACJA POLSKA
CONSOLIDATED BALANCE SHEETS AS AT 31 DECEMBER 1999 AND 1998

	Note	31 December 1999	31 December 1998
		(in PLN millions)	
ASSETS			
Current assets			
Cash and cash equivalents	6	783	3,642
Marketable securities	26(d)	16	-
Receivables	7	2,651	2,162
Current income taxes		313	258
Inventories	8	150	205
Current assets		3,913	6,267
Fixed assets			
Property, plant and equipment	9	21,555	17,230
Intangible assets	10	950	475
Investments	11	152	217
Fixed assets		22,657	17,922
Non-current receivables		2	1
Assets		**26,572**	**24,190**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Loans and other borrowings	12	721	3,329
Accrued expenses and other payables	13	3,801	2,849
Provisions	24(e)	90	-
Deferred income	14	195	224
Current liabilities		4,807	6,402
Non-current liabilities			
Loans and other borrowings	12	10,337	7,209
Accrued expenses and other payables	13	490	329
Deferred income	14	271	264
Deferred income taxes	15	288	576
Non-current liabilities		11,386	8,378
Minority interest	16	270	274
Shareholders' equity	17		
Common stock		4,200	4,200
Share premium		832	832
Revaluation reserve		2,332	2,332
Retained earnings		2,745	1,772
Shareholders' equity		10,109	9,136
Liabilities and shareholders' equity		**26,572**	**24,190**

TELEKOMUNIKACJA POLSKA
CONSOLIDATED PROFIT AND LOSS ACCOUNTS FOR THE YEARS ENDED 31 DECEMBER 1999 AND 1998

	Note	12 months ended 31 December 1999	1998
		(in PLN millions)	
Revenues	18	**13,160**	**10,887**
Employee related expenses		(3,048)	(2,723)
Depreciation and amortisation		(2,357)	(1,891)
Payments to other operators		(1,383)	(1,037)
Purchased services		(1,910)	(1,673)
Goods purchased for resale		(382)	(314)
Other operating expenses, net		(1,240)	(965)
Operating expenses		**(10,320)**	**(8,603)**
Operating profit		**2,840**	**2,284**
Interest and other charges, net	19	(1,345)	(883)
Profit before income tax		**1,495**	**1,401**
Income tax	15	(572)	(654)
Minority interest	16	106	27
Net income before obligatory dividend		**1,029**	**774**
Obligatory dividend	20	-	(160)
Retained income		**1,029**	**614**
Earnings per share (in PLN):			
Net income before obligatory dividend		0.74	0.55
Obligatory dividend		-	(0.11)
Retained income per share		0.74	0.44
Weighted average common stock outstanding (millions)		1,400	1,400

The notes to the financial statements are an integral part of these Consolidated Profit and Loss Accounts

TELEKOMUNIKACJA POLSKA
CONSOLIDATED CASH FLOW STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 1999 AND 1998

	12 months ended 31 December	
	1999	**1998**
	(in PLN millions)	
Cash flows from operating activities		
Net profit before extraordinary items and obligatory dividend	1,029	774
Adjustments for:		
Minority interest	(106)	(27)
Depreciation and amortisation	2,383	1,899
Foreign exchange (gains)/losses, net	878	87
Interest and dividend (income)/charges, net	781	741
Obligatory dividend paid	-	(160)
Result on investment activity	(8)	(13)
Income tax on current year profit	572	654
Net income tax recovered/(paid)	(913)	(852)
Decrease/(increase) in receivables	(489)	(49)
Decrease/(increase) in inventories	55	(22)
(Decrease)/increase in provisions	90	-
(Decrease)/increase in payables and other short-term liabilities	266	637
(Decrease)/increase in deferred income	(127)	(259)
Other cash flows applied in operations, net	18	(215)
Net cash flows from operating activities	**4,429**	**3,195**
Cash flows from investing activities		
Proceeds from sale of fixed assets	6	3
Proceeds from sale of marketable securities	22	3
Proceeds from sale of investments	1	-
Interest received	41	-
Dividends received	14	34
Proceeds from contingent sale of Bank Pocztowy S.A. shares (see Note 26(d))	50	-
Other cash flows generated from investing activities	3	-
Capital expenditures	(5,715)	(4,749)
Payments for concessions for DCS and GSM systems	(215)	(7)
Purchase of investments	(16)	(98)
Net cash flows applied in investing activities	**(5,809)**	**(4,814)**
Cash flows from financing activities		
Proceeds from non-current loans and borrowings	1,436	979
Proceeds from current loans and borrowings	5	1,736
Proceeds from issuance of short-term commercial papers	-	392
Proceeds from issuance of bonds	2,166	3,406
Proceeds from increase in share capital of Centertel	102	107
Redemption of short-term commercial papers	(755)	-
Repayment of non-current loans and borrowings	(1,124)	(831)
Repayment of current loans and borrowings	(2,145)	(371)
Dividends paid to minority shareholders	(56)	-
Interest paid	(923)	(626)
Other cash flows applied in financing activities, net	(168)	(55)
Net cash flows generated from/applied in financing activities	**(1,462)**	**4,737**
Effects of exchange rate changes on cash and cash equivalents	**(17)**	**37**
Net (decrease)/increase in cash and cash equivalents	**(2,859)**	**3,155**
Cash and cash equivalents at the beginning of period	**3,642**	**487**
Cash and cash equivalents at the end of period	**783**	**3,642**

TELEKOMUNIKACJA POLSKA
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY FOR THE YEARS ENDED 31 DECEMBER 1998 AND 1999

	Common stock	**Share premium**	**Revaluation reserve**	**Retained earnings**	**Total shareholders equity**
			(in PLN millions)		
1 January 1998	500	832	2,320	4,858	8,510
Transfers	3,700	-	-	(3,700)	-
Revaluation adjustment	-	-	12	-	12
Net income for 1998	-	-	-	614	614
31 December 1998	4,200	832	2,332	1,772	9,136
Dividends paid out of 1998 profit	-	-	-	(56)	(56)
Net income for 1999	-	-	-	1,029	1,029
31 December 1999	**4,200**	**832**	**2,332**	**2,745**	**10,109**

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Principal activities

Telekomunikacja Polska S.A. ("TPSA", "the Company"), a joint stock company incorporated in Poland, with its subsidiaries form the "Group". The Group is the principal supplier of telecommunications services in Poland. TPSA has exclusive rights to provide international public telephony services throughout Poland, which are expected to expire in December 2002. Until the end of June 2000 TPSA will retain its exclusive rights to provide domestic long distance public telephony services in Poland, as in February 2000 three other telecommunications operators were granted long distance services licences which will become effective from 1 July 2000. TPSA also has non-exclusive rights for an unspecified period to provide local public fixed line voice telephony services throughout Poland. Through its subsidiary, Polska Telefonia Komórkowa-Centertel Sp. z o.o. ("Centertel", "PTK-Centertel"), the Group was until August 1999 Poland's only NMT 450 and DCS 1800 mobile telecommunications provider. In August and September 1999 two other Polish mobile telephony operators were granted DCS 1800 licences. In July 1999 Centertel was granted GSM 900 concession, which makes it one of the three Polish GSM 900 mobile telecommunications providers. The NMT, DCS and GSM concessions expire in 2016, 2012 and 2014, respectively. In addition, TPSA provides leased lines, radiocommunication and other telecommunications value added services, sells telecommunications equipment and produces fibre optics cables and magnetic cards. TP Internet Sp. z o.o. is TPSA subsidiary established in 1999 to provide services in the area of internet, data transmission and multimedia. TPSA Finance B.V. and TPSA Eurofinance B.V. are special purpose companies incorporated in the Netherlands established in connection with issue of the bonds (see Notes 12(b) and 26(a)). The Group average employment in 1999 and 1998 amounted to 73,370 and 73,158 employees, respectively. In 1998 the registered office of Telekomunikacja Polska S.A. was located in Warsaw, ul. Świętokrzyska 3. In March 1999 the registered office has been moved to Warsaw, ul. Nowy Świat 6/12.

The Communications Act provides that the Minister of Communications may introduce maximum tariff levels for local and long distance telephony and that international telephony tariff levels must be set in agreement with the Minister of Communications. Furthermore, the President of the Office for Protection of Competition and Customers has the right to challenge tariffs proposed by TPSA if it considers them to be anti-competitive or abusing a dominant market position.

2. Basis of presentation

TPSA was incorporated in Poland and commenced business on 4 December 1991. With effect from that date, TPSA assumed the telecommunications business of Polska Poczta, Telegraf i Telefon ("PPTiT"), TPSA's predecessor. The opening cost of assets and liabilities contributed to TPSA on its formation was recorded at the values equal to those recorded in the books of PPTiT.

The Group maintains its books of accounts in accordance with accounting principles and practices employed by enterprises in Poland as required by Polish Accounting Standards ("PAS"). These financial statements include certain adjustments not reflected in TPSA's books to present these statements in accordance with Standards issued by International Accounting Standards Committee ("IAS"), except in respect of accounting for hyperinflation referred to in Note 3. These adjustments are presented in Note 27. IAS 16 "Property, plant and equipment" (revised 1998), IAS 22 "Business Combinations" (revised 1998), IAS 36 "Impairment of assets", IAS 37 "Provisions, contingent liabilities and contingent assets" and IAS 38 "Intangible assets" were adopted by the Group in 1999. Early adoption of these standards has had no effect on presented financial statements.

The preparation of financial statements in conformity with IAS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes thereto. Actual results could differ from those estimates.

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3. Reporting currency

These financial statements are reported in million of Polish złoty ("PLN"). They have not been adjusted for the effects of inflation as is required by International Accounting Standard No. 29 "Financial Reporting in Hyperinflationary Economies".

International Accounting Standard No. 29 "Financial Reporting in Hyperinflationary Economies" (IAS 29) requires that the carrying amounts of assets and liabilities reported in a period of hyperinflation should be expressed in the measuring unit current at the end of the hyperinflationary period and constitute the basis for the carrying amounts in the subsequent financial statements. The Polish economy was hyperinflationary until the end of 1996 and ceased to be hyperinflationary in 1997. The Group last revalued its fixed assets as of 1 January 1995 to reflect the effects of inflation by applying price indices determined by the Central Statistical Office for individual groups of assets. This revaluation was not performed in accordance with the provisions of IAS 29 since the Group did not use a general price index and did not subsequently revalue its fixed assets as of 31 December 1996. As a result, the cumulative balances of property, plant and equipment as of 31 December 1998 and 1999 which existed prior to 31 December 1996, have not been expressed in the measuring unit current at the end of 1996. The Group is unable to quantify the impact of non-compliance with IAS 29 on these financial statements. In all other respects the financial statements are prepared under the historical cost convention.

4. Statement of accounting policies

(a) Principles of consolidation

The consolidated financial statements include the financial statements of TPSA, its majority owned subsidiary Centertel (66%) and its wholly owned subsidiaries TPSA Finance B.V., TPSA Eurofinance B.V. and TP Internet. All significant intercompany balances and transactions have been eliminated in the consolidation. The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances.

Unconsolidated subsidiaries and affiliated companies (those with a TPSA shareholding over 20% and for which TPSA is able to demonstrate significant influence) are accounted for in the consolidated financial statements at cost due to their insignificance compared to the financial position and results of the Group.

(b) Cash and cash equivalents

Cash and cash equivalents include cash in hand, cash in banks and all highly liquid deposits with original maturities of three months or less.

(c) Receivables

Receivables are stated at face value, after provision for doubtful accounts.

(d) Inventories

Inventories are stated at the lower of acquisition cost (on a weighted average basis) and net realisable value, after provision for obsolete items.

(e) Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation, except where stated at revalued amounts.

The initial cost of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, as well as costs of cabling within the customers' premises are charged to the profit and loss account in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalised as an additional cost of property, plant and equipment.

Revaluations of property, plant and equipment were performed in Poland as mandated by the Minister of Finance and were designed to reflect the level of inflation. Revaluations were performed using the indices determined by Central Statistical Office for individual groups of fixed assets. This is a departure from IAS 29, which requires application of a general price index. The last revaluation took place on 1 January 1995 and was designed to reflect the specific price level as of September 1994. As a result of this revaluation both carrying amount and tax base of the assets subject to revaluation have been increased. The Group has not revalued its property, plant and equipment as of 31 December 1996 which is a departure from IAS 29 which requires that assets are restated to a measurement unit current as of the end of hyperinflationary period. Since inception of the Group the revaluations increased net book value of property, plant and equipment by a total of PLN 2,347 million. The Group's share in the revaluations amounts to PLN 2,332 million. Construction-in-progress is not subject to revaluations. Depreciation is based on the revalued amounts. Unless Poland is subject to a period of further hyperinflation, the Group does not intend to include effects of any further revaluations in its financial statements prepared under IAS.

As further described in Note 24(d), the Group receives certain assets from local authorities or municipalities. These assets are stated at their fair value at the date of transfer to the Group.

Property, plant and equipment are depreciated over their useful lives. Upon retirement or sale, the cost (or revalued amount) of assets disposed and the related accumulated depreciation are removed from the financial information and any resulting gain or loss is taken to the profit and loss account.

The following depreciation methods for fixed assets are used:

Part of equipment subject to fast technology development	-	straight-line method with doubled base depreciation rate
Part of telecommunications and other equipment issued to use after 1 January 1991	-	reducing balance method with doubled base depreciation rate
Other property, plant and equipment	-	straight-line method with base depreciation rate

Annual base depreciation rates are as follows:

Buildings	2.5%
Duct, cable and other outside plant	4.0%
Telephone exchanges and other plant and equipment	5.0-12.5%
Computer equipment	30.0%
Vehicles	7.0-20.0%
Other	12.5-20.0%

Construction-in-progress represents plant and properties under construction and is stated at cost. This comprises cost of construction, plant and equipment and other direct costs, including borrowing costs as described in Note 4(n). Construction-in-progress is not depreciated until such time as the relevant assets are completed and put into operational use. Low value items are expensed when first issued to use.

The Group reviews the net carrying value of property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable.

(f) Leased assets

Assets leased under agreements, which transfer to the Group substantially all of the benefits and risks of ownership of an asset, are treated as if the asset had been purchased outright. The Group recognises finance leases as assets and liabilities in the balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Depreciation on the relevant assets is calculated over their useful lives. The capital element of lease payments is applied to reduce the outstanding obligation and the interest element is charged to the profit and loss account. Finance leases of the Group are not material.

Costs in respect of operating leases are charged to the profit and loss account on a straight-line basis over the lease term.

(g) Intangible assets

Intangible assets are stated at cost, less amortisation on a straight-line basis using the following annual amortisation rates:

Concessions .... reflecting period of concession rights
Software 50.0%
Goodwill 20.0%

The Group reviews the net carrying value of intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable.

(h) Goodwill

The goodwill is stated as an excess of the purchase consideration over the Group's interest in the fair value of the net identifiable assets acquired. Goodwill on consolidation is being capitalised and amortised on a straight-line basis over 5 years.

(i) Investments

All investments held on a long-term basis are stated at cost less provision for any impairment in value. Unconsolidated subsidiaries and affiliated companies are accounted for in the consolidated financial statements at cost due to their insignificance compared to the financial position and results of the Group.

(j) Provisions

A provision is recognised when the Group has a present legal or constructive obligation as a result of past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(k) Deferred income

Investment contributions received in cash as contributions to the cost of network construction or constructed telephone infrastructure from local authorities (further referred to as "grants") are deferred and amortised to other operating income over the life of the assets to which the investment contributions relate.

Investment contributions received from customers to be connected to the fixed line network in exchange for free telecommunications services (further referred to as "prepayments") are deferred and recognised as revenues when the services are provided to the customers.

(l) Revenue recognition

Revenues, net of value added tax ("VAT"), for all services are recognised when earned.

Revenues are received from the Group's customers and other network operators, both domestic and foreign for the use of its network and for completing connections. A proportion of the revenue received is paid to other operators for the use of their networks, where appropriate. These revenues and costs are stated gross in these consolidated financial statements. Amounts due to and receivable from the same operators are shown net where a right of set-off exists. Revenues earned from connecting subscribers to the network are recognised upon service activation.

(m) Operating expenses

Operating costs are charged in the period to which they relate. Research and development costs are expensed when incurred except for certain development costs meeting criteria specified by IAS 38, which are recognised as assets and amortised over a period of 3 years. Capitalised development costs are not material. External and internal costs specifically associated with modifying internal-use computer software for the year 2000 is charged to expense as incurred.

In line with Polish business practice, shareholders are allowed to distribute profits for the benefit of employees to increase the social fund designed for the welfare of employees. In these financial statements such distributions were recharacterised and recognised as operating expense of the year to which the profit distribution related.

(n) Borrowing costs

Borrowing costs are written off to the profit and loss account as incurred net of an amount capitalised calculated using weighted average capitalisation rate. Borrowing costs are capitalised as part of the costs of the relevant fixed asset up to the date of commissioning and written off to the profit and loss account over the period in which the asset is depreciated. Borrowing costs include interest, amortisation of discounts on bonds and commercial papers issued, amortisation of ancillary costs incurred in connection with the arrangement of borrowings and foreign exchange differences.

(o) Jubilee awards and retirement bonuses

TPSA provides defined jubilee awards and retirement benefit plans for its employees. Jubilee awards are paid to employees upon completion of a certain number of years in service whereas retirement allowances as a one-off payments paid on retirement, both depending on employee's average remuneration and length of service. The jubilee awards and retirement benefits are not funded. An independent actuary has estimated the net present value of jubilee awards and retirement bonuses obligations using Projected Unit Credit Method. Accrued obligations are those future discounted payments, adjusted by employee attrition rates, which were earned by the employees prior to the balance sheet dates. Demographic and attrition profiles are based on the historical data. Valuation of those obligations was made in the amounts of PLN 382 million and PLN 342 million as at 31 December 1999 and 1998, respectively. In 1999 and 1998 TPSA paid PLN 53 million and PLN 30 million of jubilee awards and retirement bonuses, respectively.

(p) Termination indemnities

TPSA pays termination indemnities in case of the termination of employment without defined just cause within the framework of a reorganisation. TPSA is also obliged by law to pay termination indemnities in case of group reduction in labour force (group reductions are those reductions which in one time or in the period not longer than 3 months result in lay-off of at least 10% of employees in companies employing up to 1000 employees or at least 100 employees in companies employing more than 1000 employees). Expenses related to termination indemnities are accrued when management, having taken a firm decision, which would result in future payments of indemnities, started to implement the restructuring plan or communicated the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the company will carry out the restructuring.

(q) Foreign exchange transactions

Transactions denominated in foreign currencies are recorded in the local currency (Polish złoty) at current exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are reported at the rates of exchange prevailing at the balance sheet date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account except if capitalised as described in Note 4(n).

The Company translates its share of foreign monetary assets and liabilities for the purpose of incorporation of the financial statements of foreign subsidiaries in its financial statements at current exchange rates prevailing at the balance sheet date. Revenues and expenses from foreign operations are translated using average rates during the period. The ensuing foreign currency translation adjustment is included in the profit and loss account.

(r) Derivative financial instruments

The Group uses forward contracts, interest rate and currency swaps to mitigate exposure to interest rate and foreign exchange risks. Except when contracts qualify as hedges, changes in the fair value of financial instruments are recognised in the profit and loss account in the period of the change. When contracts qualify as hedges, the accounting for the financial instruments is symmetrical to the accounting for the hedged items.

(s) Income tax

The corporate income tax charge is based on profit for the year and takes into account deferred taxation. Deferred taxation is calculated using the liability method. Under the liability method the expected tax effects of temporary differences are determined using enacted tax rates and reported either as liabilities for taxes payable or assets representing advance payment of future taxes. Temporary differences are the differences between the carrying amount of an asset or liability in the balance sheet and its taxable base. For the purpose of deferred tax calculation the investment tax allowance bonus (see Note 24(b)) is considered a temporary difference and is recognised as deferred tax asset in the year the investment tax allowance deduction is taken. The net deferred tax liability is included in non-current liabilities.

Deferred taxation assets are only recognised on temporary differences where there is a reasonable expectation of realisation.

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(t) Earnings per share

Earnings per share for each period is calculated by dividing the income for the period, before and after extraordinary items and obligatory dividend, by the weighted average number of shares outstanding during that period. In order to calculate earnings per share for 1998 retroactive effect was given to shares split registered on 18 August 1998.

(u) Segments

The Group is organised into two major business segments being fixed line telecommunications and mobile telecommunications. The Group operates in one geographical segment being the territory of Poland.

Transactions between the segments are on arms-length basis. Intersegment transfers are accounted for at competitive market prices charged to unaffiliated customers for similar services. Those transfers are eliminated in consolidation.

5. Changes in Group's organisation

(a) Acquisitions

In September 1999 TPSA has established a wholly owned subsidiary TP Internet Sp. z o.o. with registered office in Warsaw, Poland and registered share capital amounting to PLN 1 million. TP Internet scope of activity is internet, data transmission and multimedia.

In October 1999 TPSA has established a special purpose company TPSA Eurofinance B.V. with registered office in Amsterdam, the Netherlands. TPSA Eurofinance B.V. is wholly owned by the Company's subsidiary TPSA Finance B.V. and its registered share capital is EUR 90 thousand. The company has been established for the purpose of the issuance of bonds (see Notes 12(b) and 26(a)).

(b) Discontinuing operations

The Company intends to discontinue in 2000 activities relating to fibre optic cable and magnetic and chip cards production as well as certification services for optic cables purchased by the Company from third parties. The total assets, revenues, expenses, results of operations and cash flows related to the discontinuing operations are not material to the financial statements of the Group.

6. Cash and cash equivalents

	31 December	
	1999	**1998**
	(in PLN millions)	
Polish złoty	450	403
Euro	304	9
U.S. dollar	25	3,223
Other currencies	4	7
	-----	-----
Total	**783**	**3,642**
	=====	=====

TELEKOMUNIKACJA POLSKA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 1999 the amount of PLN 50 million of cash was restricted. This amount represents restricted deposit at bank arising from contingent sales of Bank Pocztowy S.A. shares which was described in Note 26(d).

Concentrations of credit risk relating to cash and cash equivalents are limited because the Group places its cash with high credit quality institutions.

7. Receivables

	31 December	
	1999	**1998**
	(in PLN millions)	
Trade receivables	2,450	2,046
Tax receivables	166	72
Other receivables	270	210
Prepayments	52	49
Subtotal	**2,938**	**2,377**
Less allowance for doubtful accounts	(287)	(215)
Total	**2,651**	**2,162**

Total receivables include amounts of PLN 293 million and PLN 309 million of receivables denominated in foreign currencies as at 31 December 1999 and 1998, respectively. Trade receivables relate primarily to the billing of telecommunications services. Tax receivables balances comprise recoverable VAT on capital purchases and other overpaid taxes. Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising the Group's customer base and their dispersion across many different industries, principally in Poland.

The allowance for doubtful accounts and changes therein for 1999 and 1998 are as follows:

	12 months ended 31 December	
	1999	**1998**
	(in PLN millions)	
Allowance, beginning of period	215	134
Charged to expense	137	100
Written off	(65)	(19)
Allowance, end of period	**287**	**215**

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8. Inventories

	31 December 1999	31 December 1998
	(in PLN millions)	
Cables, wires, engineering inventory and other materials	98	109
Goods for resale	68	116
Subtotal	**166**	**225**
Less allowance for obsolete inventory	(16)	(20)
Total	**150**	**205**

9. Property, plant and equipment

	Land	Buildings, duct, cable and other outside plant	Telephone exchanges and other plant and equipment	Vehicles and other	Construction in progress	Total
	(in PLN millions)					
Cost or revalued amount						
s1 January 1998	8	9,872	9,515	426	1,496	21,317
Additions	1	2,496	2,892	124	-	5,513
Disposals	-	(163)	(341)	(17)	(246)	(767)
31 December 1998	9	12,205	12,066	533	1,250	26,063
Additions	2	2,517	3,760	135	404	6,818
Disposals	-	(102)	(491)	(23)	(17)	(633)
31 December 1999	**11**	**14,620**	**15,335**	**645**	**1,637**	**32,248**
Accumulated depreciation						
1 January 1998	-	2,460	4,492	276	-	7,228
Charge for 1998	-	449	1,466	85	-	2,000
Disposals	-	(123)	(259)	(13)	-	(395)
31 December 1998	-	2,786	5,699	348	-	8,833
Charge for 1999	-	484	1,703	99	-	2,286
Disposals	-	(59)	(350)	(17)	-	(426)
31 December 1999	**-**	**3,211**	**7,052**	**430**	**-**	**10,693**
Net book value 31 December 1998	**9**	**9,419**	**6,367**	**185**	**1,250**	**17,230**
Net book value 31 December 1999	**11**	**11,409**	**8,283**	**215**	**1,637**	**21,555**

Transfers between construction-in-progress and other categories are eliminated.

Property, plant and equipment include borrowing costs incurred in connection with the construction of these assets. In 1999 and 1998 the Group capitalised PLN 324 million and PLN 204 million of borrowing costs, respectively.

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The gross carrying amounts of certain property, plant and equipment items of PLN 2,149 million and PLN 2,014 million are fully depreciated as of 31 December 1999 and 1998, respectively, however these items are still in active use.

Property, plant and equipment pledged as a security for loans or bank guarantees have carrying value of PLN 816 million and PLN 431 million as at 31 December 1999 and 1998, respectively.

In respect of significant portion of its assets, the Group does not maintain insurance coverage with regard to, for example, property damage, natural catastrophes, environment contamination and loss of profits. Accordingly, the Group would not receive compensation in the event of loss of or damage to any such assets or interruptions in operations resulting therefrom.

10. Intangible assets

	DCS 1800 concession	GSM 900 concession	Software	Goodwill	Total
			(in PLN millions)		
Cost					
1 January 1998	331	-	104	41	476
Additions	-	-	112	-	112
Disposals	-	-	(3)	-	(3)
31 December 1998	331	-	213	41	585
Additions	-	410	178	-	588
Disposals	-	-	(5)	-	(5)
31 December 1999	**331**	**410**	**386**	**41**	**1,168**
Accumulated amortisation					
1 January 1998	-	-	50	8	58
Charge for 1998	6	-	41	8	55
Disposals	-	-	(3)	-	(3)
31 December 1998	6	-	88	16	110
Charge for 1999	27	-	78	8	113
Disposals	-	-	(5)	-	(5)
31 December 1999	**33**	**-**	**161**	**24**	**218**
Net book value 31 December 1998	**325**	**-**	**125**	**25**	**475**
Net book value 31 December 1999	**298**	**410**	**225**	**17**	**950**

The DCS 1800 and GSM 900 concessions are 15-year concessions acquired by Centertel in 1997 and 1999, respectively. Another concession owned by Centertel (NMT 450) has been obtained free of charge. The TPSA rights to provide telecommunication services are based on the Polish Communications Act.

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11. Investments

	31 December 1999	31 December 1998
	(in PLN millions)	
Unconsolidated subsidiaries	18	11
Affiliated companies	4	20
Other investments	130	186
Total	**152**	**217**

As at 31 December 1999 the Group's unconsolidated subsidiaries and affiliated companies, which are all incorporated in Poland, were as follows:

Subsidiaries	Group interest in capital	Scope of activity
PeBeTel Piła Sp. z o.o.	100%	design and network construction
NETBUD Sp. z o.o.	100%	design and network construction
TEL-ARP Sp. z o.o.	100%	publishing and advertising
Prywatne Sieci Telekomunikacyjne S.A.	100%	statutory activity not undertaken yet
POSTINFO Sp. z o.o.	60%	information technology services
TELEFON 2000 Sp. z o.o.	95%	design and network construction
Telefony Podlaskie S.A.	56%	local telecommunications operator

Affiliated companies	Group interest in capital	Scope of activity
OPTOTRAKT Sp. z o.o.	45%	optical fibre network production
ENERKOM Sp. z o.o.	40%	telecommunications and power equipment provider
RWT – Telefony Polskie S.A.	25%	telecommunications equipment manufacturer
Telefony Opalenickie S.A.	25%	local telecommunications operator

The voting power held by the Group is equal to the Group interest in capital in all subsidiaries and affiliates.

The Group owns shares in ICO Global Communications Ltd. (ICO). On 27 August 1999 ICO filed a voluntary petition for reorganisation under Chapter 11 of the United States Bankruptcy Code. On 16 December 1999 ICO shares were delisted from the Nasdaq stock exchange. At the present ICO is under reorganisation according to the plan approved by the U.S. Bankruptcy Court on 3 May 2000. Following permanent loss in the market value of ICO Global Communications Ltd. shares, the Group wrote off the investment in ICO amounting to PLN 89 million in 1999.

12. Loans and other borrowings

	Note	31 December 1999	31 December 1998
		(in PLN millions)	
Bank loans	(a)	4,700	6,150
Bonds	(b)	6,164	3,474
Commercial papers	(c)	93	773
Other borrowings and credits	(d)	101	141
Total		**11,058**	**10,538**
Less: short-term portion		721	3,329
Long-term portion		10,337	7,209

At 31 December 1999 principal repayments fall due in:

	(in PLN millions)
2000	721
2001	659
2002	797
2003	1,761
2004	2,983
Thereafter	4,137
Total	**11,058**

(a) Bank loans

Bank loans analysed by currency are as follows:

	31 December 1999	31 December 1998
	(in PLN millions)	
Polish złoty	1,921	3,009
U.S. dollar	1,956	2,277
Euro	563	8
German mark	147	705
French franc	113	142
Other	-	9
Total	**4,700**	**6,150**

Bank loans denominated in Polish złoty are primarily subject to floating interest rates linked to WIBOR. Weighted average interest rate on Polish złoty denominated loans were 18.9% and 22.7% in 1999 and 1998, respectively. Bank loans denominated in Polish złoty have maturities ranging from 2001 to 2006.

On 29 December 1997 TPSA entered into currency and interest rate swap transaction effectively converting seven-year U.S. dollar 100 million loan with a floating interest rate into Polish złoty

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denominated loan with a fixed rate of 20.95% p.a.. On 10 June 1999 TPSA entered into currency and interest rate swap transaction that reversed effects of the transaction described above.

In 1999 PTK-Centertel entered into currency swap transaction effectively converting EUR 20 million portion of seven-year loan with a fixed interest rate of 3.81% p.a. into Polish złoty denominated loan with a fixed rate of 11.7% p.a..

Bank loans denominated in foreign currencies were subject to both fixed and floating rates in the following proportions:

	31 December	
	1999	**1998**
Fixed rates	36.7%	17.2%
Floating rates	63.3%	82.8%
	100.0%	100.0%

Floating interest rates on foreign currency bank loans are primarily based on LIBOR rates, except for loan granted by International Bank for Reconstruction and Development where interest rate is regulated by this financial institution.

Bank loans denominated in foreign currencies are subject to the following effective interest rates:

	31 December	
	1999	**1998**
Less than 4% p.a.	24.1%	3.4%
Between 4% and 8% p.a.	71.1%	90.0%
Over 8% p.a.	4.8%	6.6%
	100.0%	100.0%

Bank loans denominated in foreign currencies have maturities ranging from 2000 to 2021.

At 31 December 1999 loans amounting to PLN 622 million are subject to government guarantee and PLN 752 million are secured on specific assets of the Group.

Bank loan agreements contain certain covenant restrictions, which in case of non-compliance may cause the loans to become due. These covenants require, among other things, maintenance of certain financial ratios. Some of the requirements stated in the loan agreement with International Bank for Reconstruction and Development with the outstanding amount of PLN 276 million as of 31 December 1999 were not complied with by the Company. However, in respect of the IBRD loan the Company was released from the covenant requirements from 1 January 1994 until 31 December 2000. Non-compliance with covenant restrictions imposed by this agreement causes cross defaults in respect of a significant portion of the Company's indebtedness.

The Company's subsidiary, PTK-Centertel, did not comply with certain loan covenants related to the loan amounting to PLN 639 million as at 31 December 1999. However, Centertel was released from the covenant requirements from 30 June 1999 until 31 December 1999.

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(b) Bonds

On 10 December 1998 TPSA Finance B.V. issued bonds of USD 1 billion total nominal value. The bonds issuance comprised two tranches: five-year bonds of USD 200 million nominal value, interest rate of 7.125% p.a. and maturity date on 10 December 2003 and ten-year bonds of USD 800 million nominal value, interest rate of 7.75% p.a. and maturity date on 10 December 2008. The total proceeds from the issuance of TPSA Finance B.V. bonds were USD 987 million. The underwriters and issue agents as well as primary buyers of the bonds were J.P. Morgan Securities Inc. and Salomon Smith Barney Inc..

Redemption of the bonds issued by TPSA Finance B.V. is guaranteed by TPSA.

On 10 June 1999 TPSA entered into currency swap transaction effectively converting five-year USD 200 million bonds and USD 100 million portion of ten-year bonds into Polish złoty denominated bonds. On 3 April 2000 the conditions of the transaction were renegotiated, which is described in Note 26(f).

On 27 October 1999 TPSA Eurofinance B.V. issued bonds of EUR 400 million total nominal value, EUR 395 million total issue price, interest rate of 6.125% p.a. and maturity date on 27 October 2004.

On 22 December 1999 TPSA Eurofinance B.V. issued bonds of EUR 100 million total nominal value, EUR 101 million total issue price, interest rate of 6.125% p.a. and maturity date on 27 October 2004.

The total proceeds from the issuance of the two tranches of TPSA Eurofinance B.V. bonds described above amounted to EUR 496 million. The underwriters and issue agents as well as primary buyers of the bonds were Deutsche Bank and Salomon Smith Barney International.

Redemption of the bonds issued by TPSA Eurofinance B.V. is guaranteed by TPSA.

The two tranches of TPSA Eurofinance B.V. bonds were issued within the scope of Euro Medium-Term Note Program signed on 22 October 1999. The program authorises TPSA Eurofinance B.V. to issue bonds of the total value up to the equivalent of USD 1 billion and maturity date at least one month and no more than 30 years after the date of issuance.

(c) Commercial papers

Commercial papers are denominated in Polish złoty. They are subject to interest rates between 15.61% and 18.11% and are repayable in 2000.

(d) Other borrowings and credits

Other borrowings and credits analysed by currency are as follows:

	31 December	
	1999	**1998**
	(in PLN millions)	
U.S. dollar	38	54
German mark	63	87
	------	------
	101	141
	======	======

Other borrowings and credits represent primarily vendor financing and are subject to fixed interest rates ranging from 0% p.a. to 7% p.a.. Their maturities range from 2001 to 2006.

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At 31 December 1999 other borrowings and credits amounting to PLN 63 million were secured on specific assets of the Group.

The Group uses various methodologies to assess and manage financial risk.

- In order to mitigate the currency and interest rate risk of its debt the Group entered into currency swap transactions in respect of a part of foreign currency indebtedness to effectively convert it into Polish złoty indebtedness.
- To reduce the interest rate risk of the loan portfolio, the proportion of the fixed and floating rates is determined by management based on historical trends and future predictions. As the interest rates are expected by management to decrease in Poland, the majority of Polish złoty loans have floating interest rates.
- The Group continuously monitors the achievable interest rates and attempts to replace its loans with more favourable ones in response to market conditions.

Based on arrangements made with the banks the Group has unused loan facilities in the amount of PLN 1,066 million as at 31 December 1999.

13. Accrued expenses and other payables

	31 December	
	1999	1998
	(in PLN millions)	
Trade and capital investment payables	2,651	1,922
Social security and taxes	195	110
Accrued expenses	255	338
Jubilee awards and retirement bonuses	382	342
Salaries and wages	285	282
Concessions payable	257	62
Other payables	266	122
Total	**4,291**	**3,178**
Less: short-term portion	3,801	2,849
Long-term portion	490	329

Accrued expenses and other payables include PLN 523 million and PLN 260 million of amounts denominated in foreign currencies as at 31 December 1999 and 1998, respectively.

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14. Deferred income

	31 December 1999	31 December 1998
	(in PLN millions)	
Grants	305	293
Prepayments	127	165
Other	34	30
Total	**466**	**488**
Less: short-term portion	195	224
Long-term portion	271	264

Changes in grants and prepayments were as follows:

	Grants	Prepayments
	(in PLN millions)	
At 1 January 1998	234	130
Net amounts received/deferred in 1998	78	341
Amortisation	(19)	(306)
At 31 December 1998	293	165
Net amounts received/deferred in 1999	46	251
Amortisation	(34)	(289)
At 31 December 1999	**305**	**127**

Amortisation of prepayments is recognised as revenues from telephone traffic.

15. Income tax

	12 months ended 31 December 1999	12 months ended 31 December 1998
	(in PLN millions)	
Income tax charge on the profit for the year	860	641
Deferred tax liability change	(288)	13
	572	**654**

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Reconciliation between the reported income tax expense and the theoretical amount arising by applying the statutory income tax rates is as follows:

	12 months ended 31 December	
	1999	**1998**
	(in PLN millions)	
Profit before income tax	1,495	1,401
Income tax calculated at statutory rate	508	504
Effect of investment tax allowance bonus (see Note 24(b))	(50)	(61)
Effect of income/expenses not subject to income tax	47	123
Valuation allowance	115	101
Tax rate changes	(38)	(34)
Prior year tax adjustments	(12)	18
Other	2	3
Income tax expense for the year	**572**	**654**

The Polish government enacted changes in the Corporate Income Tax rate from 36% to 34% in 1999 and from 34% to 30% in 2000.

Expenses not subject to income tax consist primarily of provisions made against debtors and certain expense items, which under Polish tax law, are specifically determined as non-tax deductible. Income not subject to income tax is not material.

The net deferred tax liability consists of the following:

	31 December	
	1999	**1998**
	(in PLN millions)	
Deferred tax liabilities:		
Accelerated tax depreciation	572	590
Accrued income	270	253
Other	23	19
	865	862
Deferred tax assets:		
Investment tax bonus	(44)	(58)
Unrealised foreign exchange losses	(260)	(27)
Accrued expenses	(153)	(85)
Jubilee awards and retirement bonuses	(115)	(116)
Other	(5)	-
	(577)	(286)
Net deferred tax liability	**288**	**576**

Under the Polish tax regulations, until the end of 1999 taxpayers were allowed to reduce the taxable income by the costs of purchasing qualifying fixed assets acquired in a given tax year (investment tax allowance deduction). In addition, the taxable income might have been further reduced in the following year by 50% of the previous year deduction (investment tax bonus). From 1 January 2000 taxpayers are no longer allowed to deduct costs of purchasing fixed assets form the taxable income, except for capital expenditures relating to qualifying fixed assets being still under construction as of

31 December 1999. In respect of the investment tax allowances utilised in 1999 and subsequent years taxpayers may take advantage of related investment tax bonus.

Both the initial deduction and the additional deduction applied in one year are subject to limits prescribed in the Corporate Income Tax Law (see table below). The opportunity to claim a deduction, which is not used in a given year due to lower pre-tax profit, is forfeited and cannot be carried over into the next year.

General limits applicable to investment deductions (percentage of taxable income) are as follows:

	1999	1998
Investment tax allowance	10%	15%
Investment tax bonus	15%	20%

TPSA took advantage of the above described investment tax allowance scheme in 1994-1999. TPSA has deducted PLN 2,454 million from taxable income over the period and took additional deduction (investment tax bonus) of PLN 1,079 million (see also Note 24(b)).

16. Minority interest

	12 months ended 31 December	
	1999	1998
	(in PLN millions)	
Beginning of period	274	194
Share capital contributed by minority shareholder	102	107
Share of results for the year	(106)	(27)
End of period	**270**	**274**

17. Shareholders' equity

As at 31 December 1999 the share capital represented by the parent company's share capital amounted to PLN 4,200 million and was divided into 1,400 million fully paid ordinary bearer shares of PLN 3 each.

No changes were made in the number of shares in 1999.

The ownership structure of the share capital as at 17 June 1999, i.e. as at the date of Annual Shareholders Meeting, was as follows:

	% of votes	Nominal value (in PLN millions)
State Treasury	85.00	3,570
Publicly traded	15.00	630
Total	100.00	4,200

On 13 September 1999 the Custody Department of Bank Polska Kasa Opieki S.A. on behalf of its client informed that number of shares and voting rights of GDR holders represented by Bank of New York amounted to 139,256,678, i.e. 9.95% of share capital and voting rights.

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According to the law 15% of TP S.A. shares (i.e. 210 million shares) were designated to be distributed free of charge to eligible persons.

In 1999 these shares were allocated to present and former employees of TP S.A. and Poczta Polska. Free of charge transfer of shares could have been effected till 29 December 1999. By that date the agreements for the transfer of 206,400,851 shares have been concluded.

The distributable reserves of TPSA under Polish law as at 31 December 1999 and 1998 amounted to PLN 1,079 million and PLN 1,021 million, respectively.

Share premium includes an amount of PLN 713 million, according to Notary Deed of 4 December 1991, relating to contribution of telecommunications business of PPTiT on the formation of TPSA. As regulations concerning the transformation of PPTiT are unclear, division of certain rights and obligations may be considered ineffective. As a result, share premium balance may be subject to change.

18. Revenues

	12 months ended 31 December	
	1999	**1998**
	(in PLN millions)	
Fixed line telephony services:		
Subscriptions, connections and similar charges	1,982	1,471
Traffic revenues	7,612	6,276
Interconnect revenues:		
LTOs and other licensed domestic operators	121	50
Mobile telephony operators	277	193
International incoming traffic	765	801
Payphone revenues	406	343
Other	65	54
Mobile telephony services	789	718
Leased lines	437	391
Radiocommunications	290	236
Data transmission	206	109
Telex and telegraphy	24	28
Manufacturing, equipment sales and other	186	217
Total	**13,160**	**10,887**

Revenues are generated in the territory of Poland. 6.3% and 7.6% of the total revenues for 1999 and 1998, respectively, were received from foreign parties, mostly in respect of interconnect arrangements.

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19. Interest and other charges, net

	12 months ended 31 December	
	1999	**1998**
	(in PLN millions)	
Interest expense	884	963
Foreign exchange losses	1,169	162
Commissions and other charges	352	146
Total interest payable and other charges	**2,405**	**1,271**
Interest and foreign exchange losses capitalised	(324)	(204)
Foreign exchange gains	(436)	(56)
Interest received	(160)	(85)
Profit on disposal of current investments	(18)	-
Dividends received	(32)	(34)
Other financial income	(90)	(9)
Net interest and other charges	**1,345**	**883**

20. Obligatory dividend

TPSA, similarly to other Polish joint stock companies wholly owned by the State Treasury, was obliged to pay obligatory dividend to the State Treasury which equals 15% of the statutory income before taxation less current corporate income tax. This dividend was paid in monthly advances based on monthly income returns and determined annually based on the results reported in the statutory financial statements. Amount reported in these financial statements is the actual amount due for 1998. TPSA is not subject to the obligatory dividend since its privatisation in November 1998.

21. Commitments

(a) Lease commitments

Lease commitments were mainly in respect of the lease of buildings, computer equipment and vehicles. Lease payments recognised in the profit and loss account were PLN 64 million and PLN 33 million in 1999 and 1998, respectively. Future minimum lease payments under non-cancellable operating leases with a term of more than one year as at 31 December 1999 were as follows:

	(in PLN millions)
2000	42
2001	33
2002	20
2003	7
2004	2
Thereafter	2
Total minimum lease payments	**106**

(b) Purchase commitments

As of 31 December 1999 and 1998 capital expenditures amounting to PLN 1,112 million and PLN 1,684 million, respectively, principally relating to the telecommunications network, were committed under contractual arrangements, with PLN 244 million and PLN 326 million due after one year, respectively.

(c) North-South Link

On the basis of the initial agreement dated 18 January 1991 signed between the legal predecessor of Telekomunikacja Polska S.A. – Polska Poczta, Telegraf i Telefon (PPTiT) and Danish Great Northern Telegraph Company (GN) and the final agreement dated 17 April 1991 between PPTiT and Danish-Polish Telecommunication Group (DPGT), the legal successor of GN, a fibre optical link called North-South Link (NSL) connecting north and south Polish borders of total length of 1,500 km was constructed and commissioned. Total cost of the investment was estimated at DKK 210 million and was shared between the parties. The share of PPTiT was DKK 84 million and DPTG accounted for DKK 126 million. Ownership rights to this investment were transferred to the Company on commissioning and DPTG was granted 14.8% of net profit on the cable during 15 years starting from the day when the first part of the cable was commissioned, i.e. from 16 November 1993. Net profit is calculated as an income from long-distance and international traffic transmitted via this link based on agreed usage fees per minute less maintenance costs, depreciation and income tax. The Company is responsible for maintenance of the cable. For the purpose of net profit calculation the parties agreed that annual maintenance costs would be 7% of the cable cost as adjusted for inflation index limited to 5% denominated in SDR. The Company was obliged to maximise data flow through the cable.

DPTG's share in cable net profit for 1999 and 1998 was approximately PLN 63 million and PLN 90 million, respectively, and was recognised as an expense.

22. Related party transactions

As at 31 December 1999 Polish State Treasury owned majority of shares of the parent company (for details see Note 17). Principally, the Group provides services to government organisations on normal commercial terms.

The minority shareholder, France Telecom, owns 34% of Centertel's shares. The Group provides and receives interconnect services from France Telecom on normal commercial terms. The Group purchased services in an amount of PLN 31 million and PLN 30 million in 1999 and 1998 respectively and sold services in an amount of PLN 34 million and PLN 26 million in 1999 and 1998 respectively.

Short-term employee benefits paid to the Company's Management and Supervisory Board were PLN 4 million and PLN 2 million in 1999 and 1998, respectively.

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23. Segment reporting

	Fixed line telecommunications	Mobile telecommunications	Eliminations	Consolidated
	31 December 1999			
Assets	24,934	2,899	(1,261)	26,572
Liabilities	14,845	2,115	(497)	16,463
	31 December 1998			
Assets	22,734	1,782	(326)	24,190
Liabilities	13,835	977	242	15,054
	12 months ended 31 December 1999			
Sales:	12,384	1,066	(290)	13,160
intersegment	84	206	(290)	-
external	12,300	860	-	13,160
Depreciation and amortisation	2,123	252	8	2,383
Operating result	3,102	(254)	(8)	2,840
Net profit	1,246	(321)	104	1,029
Capital expenditures	7,062	1,246	(855)	7,453
Net cash flows from:				
operating activities	4,363	75	(9)	4,429
investing activities	(5,695)	(998)	884	(5,809)
financing activities	(1,623)	1,035	(874)	(1,462)
	12 months ended 31 December 1998			
Sales:	10,127	956	(196)	10,887
intersegment	60	136	(196)	-
external	10,067	820	-	10,887
Depreciation and amortisation	1,711	180	8	1,899
Operating result	2,354	(62)	(8)	2,284
Net profit	675	(80)	19	614
Capital expenditures	4,913	779	(208)	5,484
Net cash flows from:				
operating activities	2,973	222	-	3,195
investing activities	(4,336)	(686)	208	(4,814)
financing activities	4,539	406	(208)	4,737

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24. Contingent liabilities and uncertainties

(a) Tax, customs and foreign exchange regulations in Poland

Regulations related to the value added tax, corporate income tax, and payroll (social) taxes have been recently radically changed in comparison with tax regulations existing before economic and political transformation in Poland. The lack of reference to the well established regulations and short practice of the new tax regulations results in obscurity and lack of integrity of the regulations. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. Tax settlements, together with other legal compliance areas (e.g. customs or foreign exchange law) are subject to review and investigation by a number of authorities, who are entitled to impose severe fines, penalties and interest charges. These facts create tax risks in Poland substantially more significant than typically found in countries with more developed tax systems.

There are no formal procedures in Poland to agree the final level of tax charge for a period. Tax settlements may be subject to a control within 5 subsequent years.

The Management Board is convinced that the Company in all crucial matters regarding its activities fulfils tax regulation requirements. However, there is a risk that the authorities may have a different opinion than companies constituting the Group as to the interpretation of the law, which could have significant influence on the Group's tax liabilities.

Tax settlements of the parent company for 1996 are currently subject to review by the Warsaw Tax Control Office, which commenced on 29 June 1999. As of the date of the preparation of the financial statements investigation procedures have been still in progress.

(b) Investment tax allowances

In 1994-1999 TPSA took advantage of investment tax allowance scheme. Under this scheme in arriving at its taxable income TPSA has deducted PLN 2,454 million in respect of investment in qualifying fixed assets and in 1995-1999 taken additional investment tax bonus amounting to PLN 1,079 million. These deductions have reduced the tax charges of TPSA by PLN 1,349 million in 1994-1999 as follows:

	(in PLN millions)
1994	138
1995	252
1996	311
1997	282
1998	207
1999	159
Total	**1,349**

According to tax regulations, taxpayers are obliged to refund utilised allowances, if over three years following the end of the year in which the deductions were made, any of the following events occurs:

- taxpayer has overdue tax, social security and other tax-related liabilities,
- ownership of assets subject to investment tax allowances is transferred to another party in any form (this does not relate to the transfer of ownership resulting from transformation of the legal status, merger or division of economic entities),
- leasing contract in respect of assets subject to investment tax allowances is no longer deemed a finance lease contract,
- taxpayer is put into liquidation or is declared bankrupt,
- taxpayer receives reimbursement of investment outlays in any form.

Furthermore, the Company can utilise the deduction only when certain conditions are fulfilled prior to taking the deduction, including lack of tax arrears. If those conditions had not been fulfilled at the moment of utilising the deductions the tax authorities may question the rights to the investment tax allowances. Tax reviews carried out at the Company identified certain irregularities in historical tax settlements. These reviews did not question the Company's rights to investment allowance. However, in the future tax reviews may question the Company's rights to the investment tax allowances or decide that the Company has lost its rights to allowances due to non-compliance with related requirements.

In 1999 tax legislation was modified allowing to retain the right to investment tax allowances despite having tax arrears provided that the taxpayer either adjusts its tax return and pays the arrears plus accrued interest due or within 14 days following receipt of tax authorities' decision establishing existence of tax arrears the taxpayer pays the overdue amount plus accrued interest due. However, these modifications do not relate to the right to investment allowances utilised in 1994 as well as arrears resulting from unpaid social security charges.

(c) Concessions for mobile telecommunications

TPSA's subsidiary, Centertel, has the only concession in Poland to provide NMT 450 services on the whole territory of Poland, the concession to provide DCS 1800 services in certain regions of Poland and the concession to provide GSM 900 services on the whole territory of Poland. These mobile licences are for set periods of time and require that Centertel fulfils certain licences objectives, including obligations to reach by DCS 1800 network a pre-determined number of subscribers and to reach by GSM 900 network a pre-determined coverage of the territory of Poland by specific deadline. If Centertel fails to meet these objectives, the Ministry of Communications has the right to withdraw a concession.

(d) Rights to assets and division of liabilities

TPSA was established as a result of a transformation of the state owned organisation PPTiT into two entities – Polish Post and TPSA. During the transformation process and transfer of the ownership rights to the new entities certain items of property and other assets that are currently under the Company's control were omitted and the documentation relating to the transformation process is incomplete in respect to certain items of property. According to the above, TPSA's rights to certain properties may be questioned.

In addition, as regulations concerning the transformation of PPTiT are unclear, a division of certain responsibilities of PPTiT may be considered ineffective, which may result in joint and several liability in respect of the Company's predecessor's liabilities existing at the moment of transformation.

Within the framework of normal operations PPTiT and Telekomunikacja Polska S.A. took over the network infrastructure and other assets free of charge from other parties based on concluded agreements or administrative decisions. Certain municipal authorities initiated proceedings in front of Office for Protection of Competition and Customers (OPCC) claiming that TPSA abused its dominant position requiring certain construction costs to be born by municipalities. The municipalities however, requested OPCC to determine that the agreements were invalid which would allow the municipalities to

claim reimbursement for such construction costs in additional court proceedings. Recently OPCC has issued verdicts against TPSA in three cases. In another case OPCC decided to discontinue administrative proceedings. TPSA has appealed the first three verdicts and is waiting for the appeal court decision.

The decisions of OPCC may encourage other municipalities to claim compensation for the capital expenditures related to the telecommunications infrastructure. Taking the current status of the proceedings the Company is not able to determine the timing of their final settlements and has no information which would allow to determine the amount of potential claims. The letter of the plenipotentiary of certain municipalities has estimated this amount at PLN 650 million excluding penalty interest.

(e) Real Estate Taxes

The Company is in dispute with local tax authorities and local Supreme Administrative Court divisions in respect of real estate taxes. Disputes are related to the value of the real estate, which is the basis for the calculation of real estate taxes. TPSA calculated the tax based on:

- Act on Local Taxes and Charges dated 12 January 1991,
- Ministry of Finance letter POM 469/95 directed to tax offices dated 26 September 1995,
- Statement of Constitutional Court dated 15 May 1996 on interpretation of art. 1 par. 4 item 2 of Act on Local Taxes and Charges dated 12 January 1991 in the context of art. 8 and 11 of Act on Privatisation of State-Owned Enterprises dated 13 July 1990.

Based on the Constitutional Court Statement TPSA adjusted previously filed returns of real estate tax. As a result the Company has recorded as receivables certain payments made as tax advances or has paid less real estate tax than amounts calculated by respective tax offices. Final settlements will depend on the decisions of the Supreme Administrative Court in individual cases. A number of local Supreme Administrative Court divisions already issued decisions unfavourable for TPSA. They stated that tax charges should be calculated based on higher value of the property. In conformity with the prudence concept the Company provided for its estimated tax liabilities in the amount of PLN 90 million.

25. Financial instruments

The fair value of cash and cash equivalents, receivables, marketable securities and current loans, borrowings and other payables approximates the carrying amounts reported in the balance sheet due to the relatively short-term maturity of these financial instruments. The fair value of non-current loans, borrowings and other payables with variable interest rates approximates their carrying amounts. As of 31 December 1999 and 1998 the fair value of non-current loans, borrowings and other payables with fixed interest rates amounted to PLN 7,339 million and PLN 4,322 million respectively (carrying amount: PLN 7,515 million and PLN 4,393 million respectively).

The fair values of the financial instruments are the amounts at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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The Group uses forward contracts, interest rate and currency swaps to cover against interest and foreign exchange risks. At 31 December 1999 and 1998 these instruments were as follows:

	31 December 1999		31 December 1998	
	Notional amount	Fair value	Notional amount	Fair value
	(USD million)		(USD million)	
Interest rate and currency swap (hedging)[(1)]	100	(0)	100	(32)
Interest rate and currency swap (hedging)[(2)]	(100)	0	-	-
Currency swap (hedging)[(3)]	300	(16)	-	-
	(EUR million)		(EUR million)	
Currency swap (non-hedging)[(4)]	25	(0)	-	-
Currency swap (non-hedging)[(4)]	25	(0)	-	-
Currency swap (hedging)[(5)]	20	(0)	-	-

(1) exchange of the amount in USD bearing floating interest rate into PLN bearing fixed interest rate
(2) exchange of the amount in PLN bearing fixed interest rate into USD bearing floating interest rate
(3) exchange of the amount in USD into PLN
(4) exchange of the amount in EUR into PLN and the amount in PLN into EUR
(5) exchange of the amount in EUR bearing fixed interest rate into PLN bearing fixed interest rate

The Group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. There has been no change in the risk profile between the year-end and the date of these financial statements.

26. Subsequent Events

(a) Bonds issuance

Within the scope of the Euro Medium-Term Note Program signed 22 October 1999 TPSA Eurofinance B.V. issued on 13 March 2000 the third tranche of bonds of EUR 475 million total nominal value, EUR 469 million total issue price, interest rate of 6.125% p.a. and maturity date on 13 March 2007. The underwriters and issue agents as well as primary buyers of the bonds are Deutsche Bank and Salomon Smith Barney International.

Redemption of the bonds issued by TPSA Eurofinance B.V. is guaranteed by TPSA.

(b) Concession for PTK-Centertel Sp. z o.o.

On 5 July 1999 TPSA subsidiary PTK-Centertel Sp. z o.o. was granted concession to provide ETSI/GSM 900 MHz services in Poland. Under this concession on 1 March 2000 Centertel started providing GSM 900 mobile telecommunications services.

(c) Second and third phase of privatisation

Following the rejection of the France Telecom offer placed in response to the invitation to purchase 25–35% shares of Telekomunikacja Polska S.A. announced on 2 August 1999, the Minister of State Treasury reannounced on 6 January 2000 the invitation to negotiations regarding purchase of 350 to 490 million TPSA shares constituting 25% to 35% of the Company’s share capital. On 22 May 2000 the State Treasury informed that the consortium of France Telecom and Kulczyk Holding S.A. was granted exclusive rights to proceed negotiations regarding the purchase of Telekomunikacja Polska S.A. shares.

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In April 2000 the Council of Ministers authorised the sale of up to 51% of the Company's shares to a strategic investor. Having acquired 25-35% of TPSA shares in the second phase of privatisation, the strategic investor will be granted an option to buy additional 10% of shares. Additionally, the investor will be granted the right to buy further 6% of the Company's shares in a public offering of 14% to 30% of TPSA shares. The offer will take place within the third phase of privatisation not later than 30 September 2001.

(d) Sale of shares in Bank Pocztowy S.A.

On 24 November 1999 TPSA and Poczta Polska signed a contingent agreement relating to the sales of TPSA shares in Bank Pocztowy S.A.. The agreement came into force on the date of signing, however the transfer of the ownership of these shares from TPSA to Poczta Polska was to be valid and effective depending on the permission of Banking Supervisory Board and Office for Protection of Competition and Customers (OPCC).

On 10 January 2000 OPCC informed that it did not have any objections as to the sale of Bank Pocztowy S.A. shares to Poczta Polska. On 10 May 2000 Banking Supervisory Board informed about its approval of the above transaction. As of the date of the preparation of the financial statements transfer of the ownership of the shares of Bank Pocztowy S.A. has not been concluded.

Shares of Bank Pocztowy S.A. are presented as marketable securities as at 31 December 1999.

(e) Transactions with Merrill Lynch Capital Services Inc.

According to the ISDA agreement signed on 15 October 1997 between TPSA and Merrill Lynch Capital Services Inc. (MLCS), the Company signed two agreements with trade dates 12 April 2000 and 13 April 2000 which transfer currency risk as to the total amount of EUR 100 million (each of the transactions relating to EUR 50 million) to MLCS subject to the following conditions:

- MLCS will pay to Telekomunikacja Polska S.A. the total amount of EUR 100 million on 26 October 2004.
- Telekomunikacja Polska S.A. will pay the total amount of PLN 395 million (each of the transactions relating to PLN 197.5 million) on 26 October 2004.
- TPSA will pay, annually, interest on the amount of PLN 395 million based on the fixed rate of 6.5% p.a. for the period from 12 April 2000 (transaction 1) and 13 April 2000 (transaction 2), respectively, to 26 October 2004 with the first interest period commencing on 12 April 2000 (transaction 1) and 13 April 2000 (transaction 2), respectively, and ending on 26 October 2000.

(f) Transaction with Credit Suisse First Boston (Europe) Limited

On 3 April 2000 TPSA renegotiated the transaction with Credit Suisse First Boston (Europe) Limited which is described in Note 12(b). As a result the Company, instead of USD 200 million five-year bonds, effectively converted USD 200 million portion of ten-year bonds into Polish złoty denominated indebtedness.

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27. Transformation for IAS purposes

TPSA maintains accounts in accordance with the accounting principles and practices employed by enterprises in Poland as is required by the Accounting Act. The financial statements set out above reflect certain adjustments not reflected in TPSA's consolidated financial statements prepared under Polish Accounting Standards to present these financial statements in accordance with IAS, except for non-compliance with IAS 29.

The adjustments to the consolidated financial statements prepared under Polish Accounting Standards ("PAS") are set out below:

	Net profit for 1999	Net assets as at 31 December 1999	Assets as at 31 December 1999	Net profit for 1998	Net assets as at 31 December 1998	Assets as at 31 December 1999
	(in PLN millions)					
PAS	860	10,104	26,466	960	9,576	24,329
Distribution from profit for the benefit of employees	-	-	-	(273)	(273)	-
Foreign exchange gains net effect	61	73	-	(58)	12	-
Assets received free of charge	(5)	(177)	-	(30)	(172)	-
Capitalisation of borrowing costs	201	201	206	-	-	-
Deferred tax effects	(71)	(75)	-	21	(4)	-
Other	(17)	(17)	(100)	(6)	(3)	(139)
IAS	**1,029**	**10,109**	**26,572**	**614**	**9,136**	**24,190**

(a) Foreign exchange gains

In accordance with the Polish Accounting Standards unrealised foreign exchange gains are deferred until realised. In financial statements compliant with IAS unrealised foreign exchange gains are recognised as income.

(b) Assets received free of charge

In the statutory financial statements assets received free of charge from local authorities representing contribution to the network construction cost are credited to the profit and loss account when the ownership of these assets is transferred to the parent company. In the financial statements prepared in accordance with IAS such donations are deferred and recognised as income over the useful life of the related assets.

(c) Capitalisation of borrowing costs

According to the Polish Accounting Standards only costs of borrowings related to financing construction of specifically identified assets during their construction period can be capitalised. In the absence of such borrowings or when construction of specifically identified assets is completed, borrowing costs are expensed. In the financial statements prepared in accordance with International Accounting Standards weighted average capitalisation rate for all borrowings is applied to the average outstanding balance of construction in progress.

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(d) Deferred tax effects

As a consequence of adjusting financial statements prepared in accordance with PAS by items (a) and (c) above, deferred tax position is changing. Item (b) does not affect deferred tax position as no temporary differences arise in its respect, except for amounts related to fixed assets received free of charge in 1999.

Additionally, until the end of 1998 TPSA employees were paid bonuses as part of net profit distribution. In the financial statements compliant with IAS such distributions were recharacterised and recognised as an expense of the year to which the profit distribution related. In 1999 the Company has changed its remuneration policy. The new policy doesn’t include bonuses to be paid as part of profit distribution. Instead, a new remuneration component – annual bonus – was introduced. The annual bonus is treated as an operating expense.

In addition, the scope of disclosures under International Accounting Standards is different from the scope of disclosures required by Polish Accounting Standards.
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