

**PROKOM SOFTWARE S.A.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**31 DECEMBER 1997**

## **Report of Independent Accountants**

### **To the Board of Directors and Shareholders of Prokom Software S.A.**

We have audited the accompanying consolidated balance sheets of Prokom Software S.A. (the Company) as at 31 December 1997 and 1996 and the related consolidated statements of operations, of consolidated changes in shareholders' equity and of consolidated cash flows for the years ended 31 December 1997 and 1996 prepared in accordance with International Accounting Standards and on the basis set out in Note 2 to the financial statements, expressed in Polish Złoty (PLN). These consolidated financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. 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 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 management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements audited by us present fairly, in all material respects, the financial position of the Company as at 31 December 1997 and 1996 and the results of its operations, changes in shareholders' equity and cash flows for the years ended 31 December 1997 and 1996 in accordance with International Accounting Standards.

Warsaw, Poland 7 May 1998

**Prokom Software S.A.**  
**Consolidated Balance Sheets**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

	Note	<u>31 December 1997</u>	<u>31 December 1996</u>
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Cash at bank and in hand		25,854	5,275
Cash in Escrow	4	192,487	-
Short term securities	5	862	-
Accounts receivable			
Trade		73,924	39,808
Related parties	21	1,629	16,460
Other		3,109	1,254
Inventories	6	12,286	12,402
Deferred tax	13	1,129	-
Prepaid expenses		<u>3,204</u>	<u>7,099</u>
<b>TOTAL CURRENT ASSETS</b>		314,484	82,298
<b>PREPAID EXPENSES</b>		-	760
<b>LONG TERM DEBTORS</b>	7	1,171	1,401
<b>RELATED PARTIES</b>	21	5,591	-
<b>DEFERRED TAX</b>	13	4,075	-
<b>INVESTMENTS, AT COST</b>	8	1,775	267
<b>INTEREST IN ASSOCIATED UNDERTAKING</b>	9	6,413	1,530
<b>GOODWILL ON CONSOLIDATION</b>	10	1,144	2,195
<b>INTANGIBLE FIXED ASSETS, NET</b>	11	6,705	11,846
<b>TANGIBLE FIXED ASSETS, NET</b>	12	<u>21,823</u>	<u>14,803</u>
<b>TOTAL ASSETS</b>		<u><u>363,181</u></u>	<u><u>115,100</u></u>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>			
Short term borrowings	22	1,800	3,934
Accounts payable and accruals			
Trade		37,349	30,788
Related party	21	5,479	-
Government	14	27,695	2,407
Employees		4,166	174
Unpaid dividends	15	11,412	10,742
Accruals and other		4,289	2,538
Deferred income	16	<u>13,025</u>	<u>23,745</u>
<b>TOTAL CURRENT LIABILITIES</b>		105,215	74,328
<b>DEFERRED INCOME</b>	16	-	1,260
<b>MINORITY INTEREST</b>		2,240	4,568
<b>LONG TERM LIABILITIES</b>		-	1,025
<b>SHAREHOLDERS' EQUITY</b>	13		
Share capital		12,994	480
Share premium		189,330	-
Retained earnings		53,402	33,439
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<u>255,726</u>	<u>33,919</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<u><u>363,181</u></u>	<u><u>115,100</u></u>

The accompanying notes are an integral part of these financial statements

**Prokom Software S.A.**  
**Consolidated Statements of Operations**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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	Note	Year ended 31 December 1997	Year ended 31 December 1996
REVENUES		273,583	249,771
COST OF SALES	17	<u>(184,459)</u>	<u>(157,893)</u>
GROSS MARGIN		89,124	91,878
SELLING COSTS	17	(11,129)	(6,620)
GENERAL AND ADMINISTRATIVE COSTS	17	(29,436)	(22,257)
OTHER OPERATING INCOME/(EXPENSES), NET	18	372	(9,677)
INTEREST IN ASSOCIATED UNDERTAKING	9	<u>(1,282)</u>	<u>-</u>
OPERATING PROFIT		47,649	53,324
FINANCIAL INCOME/ (EXPENSE), NET	19	4,210	(242)
LOSS ON NET MONETARY POSITION		-	(9,968)
PROFIT BEFORE INCOME TAXES		51,859	43,114
CORPORATE INCOME TAXES	20	(19,999)	(1,745)
MINORITY INTEREST		<u>(428)</u>	<u>(887)</u>
NET PROFIT		<u>31,432</u>	<u>40,482</u>
EARNINGS PER SHARE	25	<u>3,11</u>	<u>4,10</u>

The accompanying notes are an integral part of these financial statements

**Prokom Software S.A.**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

	Number of shares	Share capital	Share premium	Total Retained earnings	shareholders' equity
<b>Balance as at 1 January 1996</b>	301	480	-	39,244	39,724
Increase as result of merger with Prokom Investments SA at 1 January 1996 (see Note 23)	-	-	-	6,140	6,140
Net profit for the year	-	-	-	40,482	40,482
Excess of transfer value of subsidiaries purchased from parent company (see Note 23)	-			(9,277)	(9,277)
Dividend declared	-	-	-	(33,987)	(33,987)
Funding withdrawals by Prokom Investments SA out of IT business	-	-		(9,163)	(9,163)
<b>Balance as at 31 December 1996</b>	301	480	-	33,439	33,919
Net profit for the year		-	-	31,432	31,432
Dividend declared (see Note 13)		-	-	(22,000)	(22,000)
Increase in share capital	12,699,699	12,514	199,800-	212,314	
Share issue costs (see Note 13)		-	-	(10,470)-	(10,470)
Funding injection by Prokom Investments SA into IT business	-			10,531	10,531
<b>Balance as at 31 December 1997</b>	<u>12,700,000</u>	<u>12,994</u>	<u>189,330</u>	<u>53,402</u>	<u>255,726</u>

The accompanying notes are an integral part of these financial statements

**Prokom Software S.A.**  
**Consolidated Statements of Cash Flows**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

	Year ended 31 December 1997	Year ended 31 December 1996
<b>Net cash flow from operating activities:</b>		
Net profit before taxation	51,859	43,114
<b>Adjustments to reconcile net profit to net cash generated by operating activities</b>		
Depreciation and amortisation	12,068	10,431
Gain on sale of fixed assets	(343)	(226)
Loss in associated undertaking	1,282	-
Changes in working capital	(12,975)	1,152
Interest income	(5,722)	(1,068)
Interest expense	1,512	1,310
Other	102	295
<b>Net cash generated by/(used in) operating activities</b>	<b>47,783</b>	<b>55,008</b>
<b>Interest paid</b>	<b>(1,512)</b>	<b>(1,310)</b>
<b>Tax paid</b>	<b>(8,188)</b>	<b>(909)</b>
<b>Cash flow from investing activities:</b>		
Purchase of short term securities	(862)	-
Purchase of tangible fixed assets	(12,438)	(7,249)
Purchase of intangible fixed assets	(999)	(98)
Purchase of investments	(1,610)	-
Purchase of shares in associated undertaking	-	(1,530)
Capital contributions in associated undertaking	(6,293)	-
Purchase of subsidiaries (see Note 23)	(13,348)	(2,596)
Purchase of additional shares in subsidiaries (see Note 23)	(1,211)	-
Interest income received	3,424	1,068
Other	(1,171)	-
<b>Net cash used in investing activities</b>	<b>(34,508)</b>	<b>(10,405)</b>
<b>Cash flow from financing activities:</b>		
Repayment of long term loans	-	(1,552)
Increase/(decrease) in short term borrowings	(2,134)	2,767
Dividend payment	(22,703)	(23,245)
Proceeds from issue of shares	212,314	-
Share issue costs paid	(12,734)	-
Receipts/(payments) on related party loans	24,217	(4,415)
Funding injection (withdrawals) by Prokom Investments SA into IT business	10,531	(9,163)
<b>Net cash (used in)/ provided by financing activities</b>	<b>209,491</b>	<b>(35,608)</b>
<b>Net change in cash and cash equivalents</b>	<b>213,066</b>	<b>6,776</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<b>5,275</b>	<b>(1,501)</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>218,341</b>	<b>5,275</b>
<b>Changes in working capital and long term operating items:</b>		
Trade receivables	(34,178)	(7,333)
Other receivables	(1,186)	6,150
Inventories	116	5,015
Prepaid expenses	4,655	5,210
Long term debtors	1,401	16,508
Trade creditors	3,964	(5,403)
Due to related parties	5,479	-
Due to government	13,471	(3,479)
Due to employees	3,992	(485)
Accruals and other payables	732	3,133
Deferred income	(11,421)	(10,226)
Long term liabilities	-	(7,938)

The accompanying notes are an integral part of these financial statements

**Prokom Software S.A.**  
**Consolidated Statements of Cash Flows**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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Total	(12,975)	1,152
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The accompanying notes are an integral part of these financial statements

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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**1. The Company**

Prokom Software S.A. ("the Company") (formerly Prokom International Sp. z o.o.) based in Warsaw, Al. Jerozolimskie 65/79, was formed in 1991 under the laws of Poland.

In December 1997 the Company offered 2,700,000 shares in a public offering. The transaction was successfully completed in 1998 and since 10 February 1998 the Company's shares have been listed on the Warsaw Stock Exchange. In December 1997 the Company also signed an agreement with the Bank of New York on the basis of which Global Depository Receipts were issued which are currently listed in London and traded under Rule 144(a) in the United States of America.

The Company's principal activity in 1997 and in 1996 was the provision of information technology services comprising design, installation and implementation of comprehensive information technology solutions to large companies in Poland. The Company also trades in computer software and hardware. In October 1997 the Company acquired the information technology business, including all assets and liabilities, from Prokom Investments S.A. The acquired business has been recorded in the financial statements on a uniting of interests basis, see Note 23.

Details of subsidiaries and associates at 31 December 1997 are provided in Notes 2 and 8

**2. Basis of preparation of the financial statements**

*Basis of Accounting*

The Company maintains its accounting records and prepares statutory financial statements in accordance with Polish accounting and tax regulations. These financial statements have been prepared based upon the Company's accounting records in order to present the financial position, results of operations and of cash flows in accordance with International Accounting Standards (IAS). The Company has adopted IAS 1 and IAS 33 earlier than the effective dates.

*Currency of Presentation*

The accompanying financial statements are presented in Polish Złoty (PLN), which is the functional currency of the Company.

*Inflation Accounting*

At 31 December 1996 and for year then ended, Poland was considered to be a hyperinflationary environment. The financial statements for 1996 were prepared in accordance with the historical cost convention as adjusted for the effects of inflation. In accordance with International Accounting Standard 29, "Financial Reporting in Hyperinflationary Economies", the financial statements are restated to show amounts expressed in terms of the purchasing power of the Polish Złoty at 31 December 1996. The adjustment was calculated based on conversion factors derived from the Polish Consumer Price Index (CPI) published by the Główny Urząd Statystyczny. Based on a CPI rate of 100 as at 1 January 1990, the cumulative inflation index as at 31 December 1996 was 2,103.61.

IAS 29 was applied as follows:

- (1) Non-monetary assets and liabilities which are not carried at amounts current at the balance sheet date and components of shareholders' equity are restated by applying the relevant conversion factors.
- (2) All items in the statement of operations are restated by applying the average conversion factor for the month in which the transaction occurred.
- (3) The effect of inflation on the Company's net monetary position is included in the statement of operations as a component of financial income/(expense).

With effect from 1 January 1997, the Polish economy ceased to be considered hyperinflationary and the Company has therefore discontinued the preparation of adjusted financial statements in accordance with IAS 29. Amounts expressed in the purchasing power of the Polish Złoty (PLN) at 31 December 1996 form the opening balances in the financial statements for the year ended 31 December 1997.

*Principles of Consolidation*

In October 1997 the Company acquired from Prokom Investments S.A. all assets and liabilities that relate to its information technology business. This transaction has been accounted for on a uniting of interests basis, (see Note 23).

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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The consolidated financial statements include the following subsidiaries:

<b>Entity's name</b>	<b>Business activity</b>	<b>Percentage owned 31 December 1997</b>	<b>Percentage owned 31 December 1996</b>
Koma SA (Koma)	software trading, IT services	75.0%	51.0%
Combidata Poland Sp. z o.o. (Combidata)	information technology training	67.5%	51.0%
Zeto Sp. z o.o.(Zeto)	information technology services	100.0%	100.0%
Powszechna Agencja Informacyjna "Pagi" SA (Pagi)	telecommunications services	42.4%	42.4%

Koma and Combidata were purchased by the Company in May 1997 from Prokom Investments S.A. and have been accounted for on a uniting of interests basis.

Pagi was purchased in December 1996 and has been accounted for as an associate since 1 January 1997 using the equity method.

All the above companies are incorporated and operate principally in Poland.

Subsidiaries and associates which were not included in the consolidation due to the immateriality of balances involved are listed in Note 8 of the financial statements.

Goodwill arising on acquisition is capitalised and amortised over 5 years on a straight-line basis.

Where the purchase price of a subsidiary is less than the attributable fair value of the underlying assets acquired, the excess is recorded as deferred income and amortised over 5 years on a straight line basis.

### **3. Summary of significant accounting policies**

#### *Use of Estimates*

The preparation of financial statements in conformity with international accounting standards necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported expenses during the reported period. Actual results could differ from these estimates.

#### *Cash and Cash Equivalents*

The Company considers all debt instruments purchased with a maturity of three months or less to be cash equivalents.

#### *Investments at cost*

Shares in other entities and long term securities are valued on the basis of their purchase price less provision for any permanent diminution in value.

#### *Transfers of entities under common control*

Transfers from Prokom Investments SA are accounted for using the purchase method of accounting when both of the following criteria are met:

- (i) the change in the ownership interest is substantive; and
- (ii) the value of the transaction is supported by independent evidence, for example market valuation or similar transactions.

If these criteria are not met, such transactions are accounted for as unitings of interests.

#### *Inventories*

Inventories are valued on a FIFO basis at the lower of purchase price and net realisable value. The Company has recorded a provision for obsolete and slow moving inventory.

#### *Tangible and Intangible Fixed Assets*

Fixed assets are stated at cost plus related inflation up to 31 December 1996, and additions are at cost thereafter, less accumulated depreciation.

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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Depreciation expense is recorded utilising the straight-line method over the estimated useful life of the assets. These rates are summarised as follows:

<u>Type</u>	<u>Depreciation rate</u>	<u>Term</u>
Patents, licences and similar rights	25%	4 years
Vehicles	20 - 40%	2.5 to 5 years
Computers	30 - 60%	1.5 to 3 years
Leasehold improvements	10%	10 years
Buildings and structures	10%	10 years
Plant and equipment	10 - 50%	2 to 10 years

Land is not depreciated.

Long term leases and leasehold improvements are depreciated over the shorter of the lease term and the useful life of the asset.

*Foreign currency transactions*

Foreign currency transactions are valued according to the average exchange rate announced for a given currency by the central bank at the transaction date. Debtors and creditors are valued according to the central bank average exchange rate as at the balance sheet date for a given currency.

Gains and losses arising on foreign currency transactions are included in other operating income or expense, respectively.

*Corporate income tax provision*

Deferred tax is provided in respect of the difference in timing of recognising income and costs in accordance with the accounting and tax requirements.

A deferred tax asset is recorded if its realisation in subsequent periods is considered certain by management.

*Revenues*

Revenues (and the related profit) from information technology services are recognised based on completion of a given stage of the relevant contract. This is normally evidenced by formal customer acceptance procedures. Sales of hardware are recognised on delivery to the customer. Revenues from software licences are recognised rateably over the duration of the systems contract to which they relate.

*Royalties*

Royalties payable in respect of revenues from third party software products are accounted for in the same period as the related revenues.

*Borrowing costs*

All borrowing costs are expensed in the period to which they relate.

**4. Cash in Escrow**

Cash received by the Company from the public offering in December 1997 was paid into an Escrow account pursuant to the terms of the offering, and released to the Company on 16 January 1998.

**5. Short term securities**

Short term securities comprise short term securities purchased by Koma SA, including 6,000 shares of Prokom Software SA at cost of PLN 450,000 which were subsequently sold in February 1998.

**6. Inventories**

	<u>31 December 1997</u>	<u>31 December 1996</u>
Raw materials and components used in systems installations	6,817	7,759
Computer equipment for resale	5,469	4,643
	<hr/> 12,286	<hr/> 12,402

**7. Long term debtors**

Long term debtors at 31 December 1997 include loans to employees repayable on 1 January 2000 at an interest rate of 5%. Long term debtors at 31 December 1996 comprised principally debtors for sale of software licences repayable in 1998.

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

**8. Investments at cost**

31 December 1997                      31 December 1996

The following table provides a summary of investments at cost.

<b>Company</b>	<b>Percentage Ownership</b>	<b>Number of votes</b>		
Grupa Inwestycyjna Pro S.A.	58%	58%	89	89
International Data System	15%	15%	51	51
Prokom Sp. z o.o.	56%	56%	124	-
Optix Polska Sp. z o.o.	60%	67%	313	-
Postdata S.A.	49%	49%	798	-
Multitrade Sp. z o.o.	99%	99%	240	-
Other			160	127
<b>Total</b>			<u>1,775</u>	<u>267</u>

Other includes shares in Koma Nord Sp. z o.o., Technimex SA and Gliwicki Bank Handlowy SA owned by Koma SA. In 1997 the Company recorded a full provision for permanent diminution in value for Technimex SA (PLN 102 th. at 31 December 1996) and also increased its capital contribution in Koma Nord to PLN 155,000 (PLN 20,000 as at 31 December 1996).

The above companies, all of which are incorporated and operate principally in Poland, were not included in the consolidated financial statements due to the immateriality of the amounts involved.

31 December 1997                      31 December 1996

**9. Interest in associated undertaking**

The Company's interest in Pagi is as follows:

Share of net assets at acquisition	578	578
Goodwill	952	952
Amortisation of goodwill	(190)	-
Share in post acquisition loss	(1,282)	-
Capital contributions	6,293	-
Other	62	-
<b>Total</b>	<u>6,413</u>	<u>1,530</u>

Pagi was acquired in December 1996 and is included above at cost, at that date.

**10. Goodwill on consolidation**

	<u>Goodwill</u>
<b>Gross value</b>	
1 January 1996	-
Additions	<u>2,608</u>
31 December 1996	2,608
Other movements	<u>(529)</u>
31 December 1997	<u>2,079</u>
<b>Accumulated depreciation</b>	
1 January 1996	-
Charge for the year	<u>413</u>
31 December 1996	413
Charge for the year	<u>522</u>
31 December 1997	<u>935</u>
<b>Net, at 31 December 1997</b>	<u>1,144</u>

Goodwill arising in 1996 relates to the acquisition of Koma (see Note 23) and the amount reflects the goodwill arising in Prokom Investments SA as a result of the original purchase of Koma by that company in 1996. In 1997 the Company purchased additional 24% of shares in Koma which gave rise to negative goodwill of PLN 529 th. which has been set-off against the goodwill which arose from the previous transaction. In the opinion of the management, there was no impairment to the carrying value of goodwill as at 31 December 1997.

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

**11. Intangible fixed assets**

Intangible fixed assets include patents, licences and similar rights.

*Changes in intangible assets:*

	<u>1 January 1996</u>	<u>Additions</u>	<u>31 December 1996</u>	<u>Additions</u>	<u>31 December 1997</u>
Gross value	23,467	98	23,565	999	24,564
Amortisation	(5,829)	(5,890)	(11,719)	(6,140)	(17,859)
<b>Total</b>	<b>17,638</b>	<b>(5,792)</b>	<b>11,846</b>	<b>(5,141)</b>	<b>6,705</b>

**12. Tangible fixed assets**

31.12.1997

31.12.1996

*Tangible fixed assets by category:*

Land	2,302	51
Buildings	4,354	2,750
Long term lease and leasehold improvements	5,514	2,466
Vehicles	3,473	3,215
Plant and other equipment	4,540	4,741
Payments on account	1,640	1,580
<b>Total</b>	<b>21,823</b>	<b>14,803</b>

**Changes in tangible fixed assets**

	<u>Land</u>	<u>Buildings</u>	<u>Long term lease and leasehold improvements</u>	<u>Vehicles</u>	<u>Plant and equipment</u>	<u>Payment on account</u>	<u>Total</u>
<b>Gross value</b>							
1 January 1996	-	25	1,565	3,415	5,906	1,875	12,786
Additions	-	60	1,073	3,313	2,803	-	7,249
Acquisitions through business combinations	51	2,667	-	246	326	-	3,290
Other	-	-	-	-	-	(295)	(295)
31 December 1996	51	2,752	2,638	6,974	9,035	1,580	23,030
Additions	2,251	1,864	1,778	1,854	3,051	1,640	12,438
Transfer	-	-	1,580	-	-	(1,580)	-
31 December 1997	<u>2,302</u>	<u>4,616</u>	<u>5,996</u>	<u>8,828</u>	<u>12,086</u>	<u>1,640</u>	<u>35,468</u>
<b>Accumulated depreciation</b>							
1 January 1996	-	-	63	1,780	2,256	-	4,099
Charge for the year	-	2	109	1,979	2,038	-	4,128
31 December 1996	-	2	172	3,759	4,294	-	8,227
Charge for the year	-	260	310	1,596	3,252	-	5,418
31 December 1997	<u>-</u>	<u>262</u>	<u>482</u>	<u>5,355</u>	<u>7,546</u>	<u>-</u>	<u>13,645</u>

**Prokom Software S.A.**  
**Notes to consolidated financial statements**  
**(Expressed in Polish Złoty (PLN) all amounts in thousands)**

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**13. Share capital**

	<b>Number of shares and paid for</b>	
	<b>31 December 1997</b>	<b>31 December 1996</b>
Shares in limited liability company (see note below)	-	301
Series A preferred shares	185,416	-
Series B shares	9,814,584	-
Series C shares	<u>2,700,000</u>	-
	<u>12,700,000</u>	<u>301</u>

**Nominal value of shares**

All shares at 31 December 1997 are issued at nominal value of PLN 1.

**Transformation to joint stock company (spółka akcyjna).**

On 14 May 1997 an Extraordinary Shareholders' Meeting of Prokom International Sp. z o.o. transformed Prokom International Spółka z ograniczoną odpowiedzialnością (limited liability company) into Spółka Akcyjna Prokom Software S.A. (joint stock company). This change was formally registered on 28 May.

On 26 May 1997 an Extraordinary Shareholders' Meeting of the Company resolved to re-designate the share capital of Prokom Software S.A. The Company's share capital remained at PLN 185,416 (nominal amount) and was changed to consist of 185,416 A series registered preferred shares of PLN 1 nominal value. Each A series registered preferred share bears five voting rights at the Shareholders' Meeting, and is not redeemable.

The A series preferred shares were subscribed as follows:

	<b>number of series A preferred shares</b>
Prokom Investments SA.	73,920
Nihonswi A.G.	64,680
Ryszard Krauze	46,200
Krzysztof Wilski	<u>616</u>
	<u>185,416</u>

At 31 December 1997 Ryszard Krauze was the beneficial owner of 93 % of the shares of Prokom Investments SA.

**Shares B series**

On 16 June 1997 an Extraordinary Shareholders' Meeting decided to increase the share capital from PLN 185,416 to PLN 10,000,000 by issuing 9,814,584 B series shares. Series B shares are ordinary bearer shares of PLN 1 nominal value each. Series B shares participate in dividends out of profits earned from 1 January 1997 and their issue price was PLN 1. The series B shares were subscribed by the existing shareholders in proportion to the number of series A preferred shares they owned as follows:

	<b>number of series B Shares</b>
Prokom Investments S.A.	3,912,791
Nihonswi A.G.	3,423,692
Ryszard Krauze	2,445,494
Krzysztof Wilski	<u>32,607</u>
	<u>9,814,584</u>

In the public offering of shares in December 1997, Nihonswi AG disposed of 1,118,020 of its series B shares.

**Shares C series**

On 24 June 1997 an Extraordinary Shareholders' Meeting resolved to increase the share capital from PLN 10,000,000 to PLN 12,700,000 by creating 2,700 thousand series C shares. Series C shares are ordinary bearer shares of PLN 1 nominal value each and were sold in a public offering for a price of PLN 75 for one share. The difference between the issue price and the nominal value of PLN 199,800,000 was recorded as share premium capital

The increase in capital resulting from the public offering was registered by the court in Warsaw at 16 December 1997.

**Share issue costs**

Total share issue costs of shares sold in the public offering of PLN 15,674,000 were set off, net of tax effect, against share premium capital.

Total share issue costs	15,674
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Short term deferred tax	(1,129)
Long term deferred tax	<u>(4,075)</u>
	<u><u>10,470</u></u>

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**Shareholders rights**

With the exception of the special voting rights attaching to the series A preferred shares, all classes of shares rank equally for dividend and on a return of capital from 1 January 1997.

**Dividend paid**

In 1997 the Company declared a dividend out of retained earnings as at 31 December 1996 payable as follows:

Prokom Investments SA	14,691
Nihonswi AG	<u>7,309</u>
	<u><u>22,000</u></u>

The Company's management board has proposed to pay a dividend in 1998 of PLN 4,411,660 out of the Company's profits for 1997.

**Significant shareholders as at 31 December 1997**

Following the public offering, the following shareholders had more than 5% of the shares:

	<u>shares A</u>	<u>shares B</u>	<u>Total</u>	<u>% in total</u>
Prokom Investments SA	73,920	3,912,791	3,986,711	31.39%
Ryszard Krauze	46,200	2,445,494	2,491,694	19.62%
Nihonswi AG	64,680	2,305,672	2,370,352	18.66%

	<u>31 December 1997</u>	<u>31 December 1996</u>
<b>14. Government payables</b>		
Corporate income tax	12,256	158
Value added tax	8,179	1,577
Other	7,260	672
	<u>27,695</u>	<u>2,407</u>

Other includes mainly payables for customs duties, personal income taxes withheld on payroll and social security.

**15. Dividend payable**

The balance as at 31 December 1997 comprises dividends payable to Nihonswi A.G. The dividend was fully paid in February 1998.

**16. Deferred income**

Deferred income on software licences	12,251	23,996
Other deferred income	<u>774</u>	<u>1,009</u>
	13,025	25,005
less long term portion of deferred income on software licences	-	(1,260)
	<u>13,025</u>	<u>23,745</u>

Other deferred income includes principally the difference between the purchase price of Combidata and Zeto in 1996 and also of additional shares in Combidata in 1997 and the attributable fair value of the underlying assets acquired. The excess is amortised over 5 years on a straight line basis. Total amount of amortisation of the balance in 1997 was PLN 202 zł.

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	<b>Year ended 31 December 1997</b>	<b>Year ended 31 December 1996</b>
<b>17. Operating expenses</b>		
Cost of hardware supplied and materials used in installations	122,249	105,939
External services	34,168	34,582
Payroll	35,449	22,283
Social security	15,522	8,350
Depreciation and amortisation of goodwill	12,068	10,431
Other	5,568	5,185
<b>Total</b>	<b>225,024</b>	<b>186,770</b>
Cost of sales	184,459	157,893
Selling costs	11,129	6,620
General and administrative costs	29,436	22,257
<b>Total</b>	<b>225,024</b>	<b>186,770</b>
<b>18. Other operating income/(expenses), net</b>		
Gain on sale of fixed assets	343	226
Provision for loans	2,010	(4,301)
Foreign exchange losses, net	(1,819)	(2,117)
Other, net	(162)	(3,485)
<b>Total</b>	<b>372</b>	<b>(9,677)</b>

In 1996 the Company made provision against certain loans which were not expected to be recoverable. These amounts were however repaid in full in June 1997.

<b>19. Financial income /(expense), net</b>		
Interest income	5,722	1,068
Interest expense	(1,512)	(1,310)
<b>Total</b>	<b>4,210</b>	<b>(242)</b>

**20. Corporate income tax**

On the basis of the Act of 23 December 1988 on economic activity with foreign capital participation the Company was exempted from corporate income tax from 30 March 1994 to 29 March 1997. The corporate income tax charge therefore covers the period from 30 March 1997 to 31 December 1997.

**Reconciliation of the tax expense and accounting profit multiplied by tax rates:**

Profit before income taxes	51,859	43,114
Profits exempted	(13,304)	(41,246)
Losses recorded by Prokom Investments SA accounted for as uniting of interests	11,502	215
other, net	<u>2,572</u>	<u>2,279</u>
	<u><u>52,629</u></u>	<u><u>4,362</u></u>
<b>Tax expense</b>	<b>19,999</b>	<b>1,745</b>

The corporate tax rate in Poland for 1997 was 38% (40% in 1996).

There is no procedure for final agreement of tax assessments. The tax fiscal authorities may examine the accounting records for up to five years after the end of the year to which they relate. Consequently, the Company may be subject to additional tax liabilities in the event of such an audit. However, the Management Board is not aware of any significant unaccrued potential tax liability which might arise in these circumstances.

The Company has not had a deferred tax liability throughout the periods covered by these financial statements.

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**21. Related party transactions**

	<u>31.12.1997</u>	<u>31.12.1996</u>
Related party receivables include:		
Loans to Prokom Investments SA	5,591	16,460
Receivables from non-consolidated subsidiaries and associates	1,158	-
Receivables from other related parties	<u>471</u>	<u>-</u>
	7,220	16,460
less long term loans to Prokom Investments	(5,591)	-
	<u>1,629</u>	<u>16,460</u>

The loans to Prokom Investments SA include mainly non-interest bearing loans with no fixed repayment date. The Company regards the loans to Prokom Investments SA at 31 December 1997 as long-term in nature, all other amounts are current assets.

Amounts payable to related parties at 31 December 1997 consists of amounts due to Prokom Investments SA in respect of the transfer of that company's information technology business to the Company.

Prokom Software SA purchased the following subsidiaries from related parties in the year ended 31 December 1997.

Company	Transaction	Date	Cost (in thousand)	Percentage ownership
Combidata Sp. z o.o.	purchase from Prokom Investments SA	24.05.1997	4,503	51.3
Postdata S.A.	purchase from Prokom Investments SA	24.05.1997	273	25.0
KOMA S.A.	purchase from Prokom Investments SA	24.05.1997	10,557	51.0
Optix Sp. z o.o.	purchase from R. Krauze	17.06.1997	160	60.0
Prokom Sp. z o.o.	purchase from R. Krauze	17.06.1997	121	56.0
Total			15,614	

All of the above purchases were in cash.

**22. Short term borrowings**

At 31 December 1996 the balance comprises bank borrowings secured on certain trade receivables. These borrowings were at rates linked to WIBOR and were repaid in 1997.

At 31 December 1997 this comprises a short term bank borrowing taken by Combidata secured on certain buildings. The loan bears interest of 24.5% and is repayable by 31 August 1998.

**23. Purchase of businesses**

In May 1997, the Company purchased Koma S.A. and Combidata Poland Sp. z o.o. from Prokom Investments S.A. These purchases have been accounted for as unitings of interests. The book values of assets and liabilities acquired were as follows:

Cash	1,712
Net current assets	5,115
Investments at cost	127
Tangible assets	479
Minority interest	<u>(3,611)</u>
Total	3,822
Excess of acquisition cost over net assets acquired	<u>11,238</u>
Total purchase price	15,060

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Less cash acquired	<u>(1,712)</u>
Cash flow on acquisition, net of cash acquired	<u><u>13,348</u></u>

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Total excess of acquisition cost over net assets acquired has been treated as follows:

Goodwill on consolidation	2,608
Deferred income	(647)
Reduction of shareholders' equity	9,277
	<u>11,238</u>

In October 1997 the Company acquired the information technology business previously undertaken by Prokom Investments SA. This acquisition has been accounted for as a uniting of interests and the amounts below reflect the values of the assets and liabilities as at 1 January 1996 (the deemed merger date). The book values of assets and liabilities acquired as at 1 January 1996, expressed in terms of the purchasing power of the Polish Złoty at 31 December 1996, were as follows:

Net current assets	(12,135)
Long term assets	21,737
Investments	51
Tangible fixed assets	5,723
Intangible fixed assets	17,638
Long term liabilities	<u>(19,874)</u>
	13,140
less consideration payable	<u>(7,000)</u>
	<u>6,140</u>

The difference between the purchase price and the value of the net assets acquired has been treated as an adjustment to shareholders' equity. Movements in the value of the net assets acquired between 1 January 1996 and the date of acquisition in October 1997 have been treated as funding movements with Prokom Investments SA and adjusted against shareholders' equity in these financial statements.

In addition in 1997 the Company increased its interest in Koma to 75% of that company's share capital (51% as at 31 December 1996) and in Combidata to 67.5% (51% as at 31 December 1996) for total consideration of PLN 1,211,000.

**24. Financial instruments**

Credit risk

Financial assets which potentially subject the Company and its affiliates to concentration of credit risk consist principally of cash and cash equivalents, balances with related parties and trade receivables. The Company's cash deposits are with the major Polish banks.

Trade receivables, which are presented net of the allowance for doubtful receivables, generally include significant amounts from a small number of customers, reflecting the nature of the Company's business which is focused on a small number of large contracts for major Polish corporations.

At 31 December 1997 three customers accounted for 83% of the total amount of trade receivables; at 31 December 1996, one customer accounted for 45% of the total.

Foreign currency risk

The Company's revenues and costs are predominantly denominated in Polish zloty; the exception to this is equipment purchased in foreign currency for ultimate resale to customers. For such revenues the Polish zloty sale price is, as far as possible, linked to the underlying foreign currency purchase and invoiced in Polish zloty based on a foreign currency value converted at the exchange rate prevailing at date of sale. In view of the costs involved management do not believe it is cost effective to use financial instruments to hedge or otherwise seek to reduce foreign currency risk.

Fair values

At 31 December 1997 and 31 December 1996 the carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, short-term borrowings and long-term investments approximated their fair values.

**25. Earnings per share**

Earnings per share have been calculated based on net profit for each period divided by the weighted average number of shares in issues.

The weighted average number of shares was 10,095,372 (1996: 9,869,188).

There is no actual or potential dilutive impact on earnings per share at 31 December 1997.

**26. Management Board and Supervisory Board Remuneration**

The total remuneration, including salary and bonuses, paid or accrued by the Company to the members of the Management and Supervisory Boards in the period 1 January 1997 to 31 December 1997 was PLN 1,075,428

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**27. Subsequent events (amounts in PLN thousands)**

- a) As at 23 April 1998 the Company signed an amendment to the contract with ZUS. Total revenues for this contract remained unchanged. The new agreed timetable will enable pillar 1 and pillar 2 of the national pension scheme to start from 1 January 1999.
- b) In 1998 the Company purchased more than 5% (less than 10% ) of the shares of Kompap SA, a company listed on the Warsaw Stock Exchange for total consideration of PLN 5,648,800.
- c) In January 1998 the Company agreed to make a further capital contribution of PLN 1,836,200 to PAGI.

**28. Guarantees given**

As at 31 December 1997 the Company gave the following guarantees:

- a) Zakład Ubezpieczeń Społecznych - total amount of guarantee is equal to PLN 10,549,005 for proper conduct of the contract, guarantee is valid till 28 February 2002 (deemed date of the completion of the contract),
- b) guarantee given to BIG Bank Gdański SA for the bank loans given to Prokom Investments SA for the maximum amount of PLN 11,500,000
- c) guarantee given to BIG Bank Gdański for the letter of credit issued to Petrolinvest Sp. z o.o. , in which Prokom Investments SA has got a financial interest, for the maximum amount of USD 900,000.
- d) other guarantees given for the total amount of PLN 1,462,600