

PROKOM Software SA

**CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 1999**

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 1999 and 1998 and the related consolidated statements of operations, of changes in shareholders' equity and of cash flows for the years ended 31 December 1999 and 1998 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 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 financial statements audited by us present fairly, in all material respects, the financial position of the Company as at 31 December 1999 and 1998 and the results of its operations, changes in shareholders' equity and cash flows for the years ended 31 December 1999 and 1998 in accordance with International Accounting Standards.

PricewaterhouseCoopers Sp. z o.o.
Warsaw, Poland
15 May 2000

PROKOM Software S.A.

**CONSOLIDATED FINANCIAL STATEMENTS
FOR 12 MONTH PERIODS ENDED 31 DECEMBER 1999 AND 1998**

Table of contents	Page
I Financial information	
- consolidated balance sheets	1
- consolidated statements of operations	2
- consolidated statements of changes in shareholders' equity	3
- consolidated statements of cash flows	4
II Notes to consolidated financial statements	5

This report contains 18 consecutively numbered pages, from page 1 to 18.

The accompanying Financial Statements have been approved by the Board of Directors of PROKOM Software S.A. on 15 May 2000.

On behalf of the Board of Directors:

Bogdan Bartkowski
Member of the Board of Directors

Krzysztof Wilski
Member of the Board of Directors

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

	<u>Note</u>	<u>31 December 1999</u>	<u>31 December 1998</u>
ASSETS			
CURRENT ASSETS			
Cash at bank and in hand		80,780	27,274
Short term securities	4	30,842	87,832
Related parties	21	39,943	59,384
Accounts receivable			
Trade		120,504	91,257
Other		8,569	7,604
Inventories	5	71,693	25,116
Prepaid expenses	6	<u>15,952</u>	<u>18,264</u>
TOTAL CURRENT ASSETS		368,283	316,731
LONG TERM RECEIVABLES	7	17,910	15,213
RELATED PARTIES	21	46,374	21,761
DEFERRED TAX	8	9,199	9,071
INVESTMENTS, AT COST	9	10,981	6,521
INTEREST IN ASSOCIATED UNDERTAKINGS	10	20,582	7,476
GOODWILL ON CONSOLIDATION	11	7,672	763
INTANGIBLE FIXED ASSETS, NET	12	6,829	2,052
TANGIBLE FIXED ASSETS, NET	13	<u>55,406</u>	<u>30,322</u>
TOTAL ASSETS		<u><u>543,236</u></u>	<u><u>409,910</u></u>
LIABILITIES			
CURRENT LIABILITIES			
Short term borrowings		404	946
Accounts payable and accruals			
Trade		102,729	63,135
Government	15	11,498	10,786
Employees		766	181
Accruals and other		8,135	5,534
Deferred income	16	<u>11,261</u>	<u>10,690</u>
TOTAL CURRENT LIABILITIES		134,793	91,272
MINORITY INTEREST		3,198	2,399
SHAREHOLDERS' EQUITY	14		
Share capital		13,081	12,994
Share premium		195,348	188,847
Retained earnings		<u>196,816</u>	<u>114,398</u>
TOTAL SHAREHOLDERS' EQUITY		<u>405,245</u>	<u>316,239</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u><u>543,236</u></u>	<u><u>409,910</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)

	Note	Year ended 31 December <u>1999</u>	Year ended 31 December <u>1998</u>
REVENUES		713,292	374,414
COST OF SALES	17	<u>(474,306)</u>	<u>(229,538)</u>
GROSS MARGIN		238,986	144,876
SELLING COSTS	17	(24,448)	(13,744)
GENERAL AND ADMINISTRATIVE COSTS	17	(80,048)	(53,066)
OTHER OPERATING INCOME/(EXPENSES), NET	18	(9,634)	(5,180)
SHARE OF RESULTS OF ASSOCIATES	10	<u>(650)</u>	<u>(860)</u>
OPERATING PROFIT		124,206	72,026
FINANCIAL INCOME/ (EXPENSES), NET	19	24,568	31,217
PROFIT BEFORE INCOME TAXES		148,774	103,243
CORPORATE INCOME TAXES	20	(52,857)	(37,032)
MINORITY INTEREST		<u>(799)</u>	<u>(770)</u>
NET PROFIT		<u>95,118</u>	<u>65,441</u>
BASIC AND DILUTED EARNINGS PER SHARE (in PLN):	24	<u>7.48</u>	<u>5.15</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 (not in thousand)	Share capital	Share premium	Retained earnings	Total shareholders' equity
Balance as at 1 January 1998	12,700,000	12,994	189,330	53,402	255,726
Net profit for the year	-	-	-	65,441	65,441
Dividend paid	-	-	-	(4,445)	(4,445)
Share issue costs, net of deferred tax effect	-	-	(483)	-	(483)
Balance as at 31 December 1998	<u>12,700,000</u>	<u>12,994</u>	<u>188,847</u>	<u>114,398</u>	<u>316,239</u>
Share series D (See Note 14)	87,264	87	6,501	-	6,588
Net profit for the year	-	-	-	95,118	95,118
Dividend paid	-	-	-	(12,700)	(12,700)
Balance as at 31 December 1999	<u><u>12,787,264</u></u>	<u><u>13,081</u></u>	<u><u>195,348</u></u>	<u><u>196,816</u></u>	<u><u>405,245</u></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 1999	Year ended 31 December 1998
Net cash flow from operating activities:		
Net profit before taxation	148,774	103,243
Adjustments to reconcile net profit to net cash generated by operating activities		
Depreciation and amortization	21,034	15,960
Loss in associated undertakings	650	860
Changes in working capital	(25,809)	(49,977)
Interest expense	161	380
Investment income	(24,729)	(31,597)
Other	365	(1,960)
Net cash generated by operating activities	120,446	36,909
Interest paid	(161)	(380)
Tax paid	(53,302)	(49,129)
Cash flow used in investing activities:		
Sale of short term securities, net of purchases	67,445	(71,013)
Purchase of tangible fixed assets	(41,884)	(32,904)
Purchase of intangible fixed assets	(6,625)	(1,853)
Purchase of investments	(625)	(4,696)
Advances made for the acquisition of shares in subsidiary	(4,200)	-
Capital contributions to associated undertaking	-	(2,181)
Purchases of shares in associated undertaking	(14,411)	-
Purchase of subsidiaries, net of cash acquired (see Note 22)	(894)	-
Contribution to real estate projects with related party (see Note 21)	(24,251)	(14,530)
Loans (given)/repaid, net	(10,037)	(6,748)
Bank interest received	2,607	13,341
Net cash used in investing activities	(32,875)	(120,584)
Cash flow from financing activities:		
Decrease in short term borrowings	(542)	(854)
Dividends paid	(12,700)	(15,857)
Share issue costs paid	-	(3,657)
Loans to related parties received	20,615	-
Loans to related parties advanced	-	(1,260)
Payments for short term securities from related parties	(111,229)	(57,571)
Receipts from sales of short term securities issued by related parties	134,404	20,898
Interest received from loans and commercial papers to related parties	8,530	418
Advances made for office rental to related party (see Note 21)	(19,680)	-
Net cash provided by / (used in) financing activities	19,398	(57,883)
Net change in cash and cash equivalents	53,506	(191,067)
Cash and cash equivalents at the beginning of the period	27,274	218,341
Cash and cash equivalents at the end of the period	80,780	27,274
Changes in working capital and long term operating items:		
Trade receivables	(17,072)	(17,197)
Other receivables	(4,802)	(379)
Inventories	(46,566)	(12,830)
Prepaid expenses	2,336	(15,060)
Long term receivables	(2,773)	(13,749)
Trade creditors	39,430	28,728
Due to related parties	-	(5,479)
Due to government	959	(9,145)
Due to employees	549	(3,985)
Accruals and other payables	1,563	1,252
Deferred income	567	(2,133)
Total	(25,809)	(49,977)

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)

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.

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 1999 and in 1998 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 1999 and in 2000 the Company also acquired interests in internet companies.

Details of subsidiaries and associates are provided in Notes 2 and 9.

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 cash flows in accordance with International Accounting Standards (IAS). These financial statements are prepared in accordance with and comply with International Accounting Standards.

Currency of Presentation

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

Principles of Consolidation

Subsidiary undertakings, which are those companies in which PROKOM Software S.A., directly or indirectly, has an interest of more than half of the voting rights have been consolidated. Subsidiaries are consolidated from the date on which the effective control is transferred to the Company and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealized surpluses and deficits on transactions between group consolidated subsidiaries have been eliminated. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Company. Separate disclosure is made of minority interests.

Investments in associated undertakings are accounted for by the equity method of accounting. These are undertakings over which the Company has between 20% and 50% of the voting rights. Provisions are recorded for long-term impairment in value.

Investments are shown at cost and provision is only made where, in the opinion of Directors, there is a permanent diminution in the value of an investment.

Transfers of entities under common control 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 substantial; 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.

The consolidated financial statements include the following subsidiaries and associates:

Entity's name	Business activity	Percentage owned 31 December 1999	Percentage owned 31 December 1998
Koma S.A. (Koma)	Software trading, IT services	75.0%	75.0%
Combidata Poland Sp. z o.o. (Combidata)	Information technology training	83.8%	83.8%
Powszechna Agencja Informacyjna "Pagi" S.A. (Pagi)	Telecommunications services	42.4%	42.4%
Zeto Sp. z o.o.(Zeto)	Information technology services	100.0%	100.0%
The Polished Group S.A. (TPG)	Information technology services	100.0%	N/A
Wirtualna Polska S.A. (Wirtualna Polska)	Internet portal operator	25%	N/A

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

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. On 3 September 1999, the Company acquired 25% of shares issued by Wirtualna Polska (see Note 10). On 27 October 1999, the Company acquired 100% of shares in TPG (see Note 22).

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

2. Basis of preparation of the financial statements (cont.)

Subsidiaries and associates, which were not included in the consolidation due to the immateriality of balances involved, are listed in Note 9 of the financial statements.

Goodwill arising on acquisition is capitalized and amortized over its useful life, generally over 5 years. Amortization of goodwill is included in general and administrative expenses. The carrying amount of goodwill is reviewed annually and written down for permanent impairment where it is considered necessary.

3. Summary of significant accounting policies

Use of Estimates

The preparation of financial statements in conformity with IAS 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 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.

Short Term Securities

Government and commercial bonds are carried at market value. Investments in companies listed on the Warsaw Stock Exchange are valued at the lower of cost and market value. Market value is calculated by reference to quoted selling prices at the close of business on the balance sheet date. Changes in carrying amount are charged or credited to the income statement. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the income statement.

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 Fixed Assets

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

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

Type	Depreciation rate	Term
Vehicles	20 - 40%	2.5 to 5 years
Computers	30 - 60%	1.5 to 3 years
Leasehold improvements	10%	10 years
Buildings	10%	10 years
Office equipment	10 - 50%	2 to 10 years

Land is not depreciated.

When the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Intangible Fixed Assets

Expenditure on acquired patents, licenses and similar rights is capitalized and amortised using the straight-line method over their useful lives, generally over 4 years. The carrying amount of each intangible fixed asset is reviewed annually and adjusted for permanent impairment where it is considered necessary.

Foreign currency transactions

Foreign currency transactions are valued according to the average exchange rate announced 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 income tax is provided, using the liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred income tax.

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

3. Summary of significant accounting policies (cont.)

Revenues

Revenues (and the related profit) from information technology services are recognized based on completion of a given stage of the relevant contract. This is normally evidenced by formal customer acceptance procedures. Sales of hardware are recognized on delivery to the customer. Revenues from software licenses are recognized 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.

Research and development

Research and development expenditure is recognized as an expense except that costs incurred on development projects are recognized as intangible assets to the extent that such expenditure is expected to have future benefits.

Shares issued at price below fair value

Proceeds from issue of new shares are credited to shareholders' equity and no adjustment is made in respect of the difference between their purchase price and fair value of shares issued.

Comparatives

Comparative figures have been adjusted to conform with changes in presentation in the current year. In particular, the comparatives have been adjusted or extended to take into account the requirements of the following revised or new International Accounting Standards which the Company implemented in 1999 in advance of their effective dates:

IAS 16 (revised)	-Property, Plant and Equipment;
IAS 22 (revised)	-Business Combination;
IAS 36	-Impairment of Assets;
IAS 37	-Provisions, Contingent Liabilities and Contingent Assets;
IAS 38	-Intangible Assets.

No amendments have resulted in changes to previously presented results or shareholders' equity.

4. Short term securities

	<u>31 December 1999</u>	<u>31 December 1998</u>
Equity securities	13,078	31,547
Government Bonds	17,764	56,285
	<hr/> 30,842	<hr/> 87,832

Government bonds include 26-week and 52-week bonds issued by the Polish government. Equity securities include investments in companies listed on the Warsaw Stock Exchange. The market value of equity securities was PLN 14,126 at 31 December 1999 (PLN 31,795 at December 1998).

Government bonds of PLN 13,502 were pledged as security given for the proper conduct of contracts by the company and for the timely payments of trade payables.

5. Inventories

	<u>31 December 1999</u>	<u>31 December 1998</u>
Raw materials and components used in systems installations	27,517	10,385
Computer equipment for resale	13,035	2,041
Costs incurred relating to work not yet invoiced	31,141	12,690
	<hr/> 71,693	<hr/> 25,116

6. Prepayments

Prepayments principally include software license fees prepaid.

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

7. Long term receivables	<u>31 December 1999</u>	<u>31 December 1998</u>
Long term trade receivables	12,117	12,117
Long term loans	11,162	1,067
Loans to employees	3,004	1,058
Deposits and other	3,744	971
	<u>30,027</u>	<u>15,213</u>
Less current portion of long term receivables	(12,117)	-
	<u>17,910</u>	<u>15,213</u>

Long-term trade receivables comprise amounts in respect of the sale of third party software licences which are scheduled to be repaid in 2000. Long-term loans comprise of loans to non-related companies, which bear market interest rates and have no fixed repayment date; they are therefore regarded as long term in nature. Loans to employees are repayable on demand and bear interest at 2-7% per annum, there is a presumption that these loans will be not repaid before 31 December 2000.

8. Deferred tax		
1 January 1998		5,204
Deferred tax on additional share issue costs		233
Deferred tax – income statement credit		<u>3,634</u>
31 December 1998		<u>9,071</u>
Deferred tax – income statement credit		<u>128</u>
31 December 1999		<u>9,199</u>

Deferred taxation arises in respect of the following:

	<u>31 December 1999</u>	<u>31 December 1998</u>
Share issue costs	3,056	4,222
Prepaid expenses	-	(748)
Tangible fixed assets	-	(161)
Deferred income	2,910	3,454
Accounts payable and accruals	3,710	2,819
Other, net	(477)	(515)
	<u>9,199</u>	<u>9,071</u>

Deferred tax on share issue costs was calculated on costs incurred in the public offering in 1997 and in 1998, which were charged against share premium account.

9. Investments at cost

The following table provides a summary of investments at cost.

Company	Percentage Ownership	Number of votes	<u>31 December 1999</u>	<u>31 December 1998</u>
Grupa Inwestycyjna Pro S.A.	58%	58%	89	89
Prokom Sp. z o.o.	67%	67%	54	174
Optix Polska Sp. z o.o.	60%	67%	313	313
Postdata S.A.	49%	49%	798	798
Multitrade Sp. z o.o.	99%	99%	-	240
Edison S.A.	51%	51%	4,200	-
Koma Nord Sp. z o.o.	75%	75%	155	155
International Data System	15%	15%	51	51
NKA Investments Sp. z o.o.	15%	15%	1,803	1,803
Elterix S.A.	10%	10%	3,518	2,893
Other	-	-	-	5
Total			<u>10,981</u>	<u>6,521</u>

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

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

9. Investments at cost (cont.)

These are investments in companies which operate in the IT and telecommunication services sector, except for the following:

NKA Investments Sp. z o.o. - real estate development
 Grupa Inwestycyjna Pro S.A. – business and financial consulting

In 1999 the Company booked a provision for the permanent diminution in value of its investments in Prokom Sp. z o.o. of PLN 120 and in Multitrade Sp. z o.o. of PLN 240.

In 1999 the Company made an advance of PLN 4,200 to the shareholders of Edison S.A., an internet service provider, for the acquisition of 51% of the ownership interest of this company. The transaction was completed on 13 March 2000.

10. Interest in associated undertaking

	<u>Pagi</u>	<u>Wirtualna Polska</u>	<u>Total</u>
1 January 1998, net book value	6,351	-	6,351
Capital contributions	2,175	-	2,175
Share in post-acquisition losses	(860)	-	(860)
Amortisation of goodwill	(190)	-	(190)
31 December 1998, net book value	7,476	-	7,476
1 January 1999, net book value	7,476	-	7,476
Acquisition	-	14,411	14,411
Share in post-acquisition losses	(343)	(307)	(650)
Amortisation of goodwill	(190)	(465)	(655)
31 December 1999 net book value	6,943	13,639	20,582

On 3 September 1999, the Company acquired 25% of shares issued by Wirtualna Polska for a consideration of PLN 14,411. On the day of acquisition, the share of net assets acquired in Wirtualna Polska was PLN 5,103.

11. Goodwill on consolidation

	<u>1 January 1998</u>	<u>Additions</u>	<u>31 December 1998</u>	<u>Additions</u>	<u>31 December 1999</u>
Gross value	2,608	-	2,608	7,414	10,022
Amortization	(1,464)	(381)	(1,845)	(505)	(2,350)
Total	1,144	(381)	763	6,909	7,672

Additions to goodwill in 1999 include goodwill that arose on the acquisition of TPG (see Note 22). In the opinion of the management of the Company, there was no impairment to the carrying value of goodwill as at 31 December 1999.

12. Intangible fixed assets

Intangible fixed assets includes patents, licenses and similar rights.

Changes in intangible assets:

	<u>1 January 1998</u>	<u>Additions</u>	<u>31 December 1998</u>	<u>Additions</u>	<u>31 December 1999</u>
Gross value	24,564	1,864	26,428	7,620	34,048
Amortization	(17,859)	(6,517)	(24,376)	(2,843)	(27,219)
Total	6,705	(4,653)	2,052	4,777	6,829

Amortisation of intangible fixed assets is included in general and administrative expenses.

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

13. Tangible fixed assets

Changes in tangible fixed assets:

	Land & buildings	Long-term lease and leasehold improvements	Computers and office equipment	Vehicles	Payment on account	Total
Year ended 31 December 1998:						
Opening net book amount	6,689	5,514	4,507	3,473	1,640	21,823
Additions	13,456	3,079	14,049	1,933	-	32,517
Disposals	(13,304)	-	-	-	-	(13,304)
Reclassification	-	-	-	-	(1,640)	(1,640)
Depreciation charge	(321)	(444)	(6,533)	(1,776)	-	(9,074)
Closing net amount	<u>6,520</u>	<u>8,149</u>	<u>12,023</u>	<u>3,630</u>	<u>-</u>	<u>30,322</u>
At 31 December 1998						
Cost	7,103	9,075	26,102	10,761	-	53,041
Accumulated depreciation	(583)	(926)	(14,079)	(7,131)	-	(22,719)
Net book amount	<u>6,520</u>	<u>8,149</u>	<u>12,023</u>	<u>3,630</u>	<u>-</u>	<u>30,322</u>
Year ended 31 December 1999:						
Opening net book amount	6,520	8,149	12,023	3,630	-	30,322
Additions	56	6,272	32,065	3,491	-	41,884
Acquisition of subsidiary (see Note 22)	-	12	170	49	-	231
Depreciation charge	(214)	(572)	(14,286)	(1,959)	-	(17,031)
Closing net amount	<u>6,362</u>	<u>13,861</u>	<u>29,972</u>	<u>5,211</u>	<u>-</u>	<u>55,406</u>
At 31 December 1999						
Cost:	7,159	15,359	58,337	14,301	-	95,156
Accumulated depreciation	(797)	(1,498)	(28,365)	(9,090)	-	(39,750)
Net book amount	<u>6,362</u>	<u>13,861</u>	<u>29,972</u>	<u>5,211</u>	<u>-</u>	<u>55,406</u>

Computers with net book value of PLN 538 are pledged as security for bank borrowings.

14. Shareholders' equity (amounts not in thousands)

	Number of shares	
	<u>31 December 1999</u>	<u>31 December 1998</u>
Series A preferred shares	185,416	185,416
Series B shares	9,814,584	9,814,584
Series C shares	2,700,000	2,700,000
Series D shares (not yet issued)	87,264	-
Inflation effect	294,000	294,000
	<u>13,081,264</u>	<u>12,994,000</u>

Each series A preferred share carries five voting rights. The shares series B and series C carry one vote per share. The shares series D were not issued as at 31 December 1999.

Nominal value of shares

All shares at 31 December 1999 are issued at a nominal value of PLN 1.

Shareholders rights

With the exception of the special voting rights attached to the series A preferred shares, all classes of issued shares rank equally for dividend and on a return of capital from 1 January 1999.

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

14. Share capital (amounts not in thousands) (cont.)

Series D shares

On 15 December 1999, the shareholders of the Company passed a resolution to issue 384,642 new ordinary shares to the management of the Company and 377,358 ordinary shares to the management of TPG. The Company has not decided on the terms of the new shares to be issued to the management of the Company. The shares allocated to the management of TPG can be acquired, at the option of certain members of management board of TPG, upon meeting certain technical and financial targets by TPG as follows:

<u>Date of issue</u>	<u>Exercise price</u>	<u>Number of shares</u>
30 June 2000	1	87,264
30 July 2001	1	72,524
30 July 2002	1	72,524
31 July 2003	1	65,271
31 July 2004	1	79,775
		<u>377,358</u>

87,264 shares, which are to be issued at 30 June 2000, are treated as part of the purchase consideration of TPG (see Note 22). As at 31 December 1999, the management of TPG has met the conditions to obtain the option to acquire these shares at PLN 1 and as at 31 December 1999 these shares were credited to shareholders' equity of the Company. If the conditions to sell the remaining shares are met in the future, the intention is that the proceeds from the issue of new shares will be credited to share capital and no adjustment will be made in respect of the difference between its purchase price and fair value.

Dividend

In 1999 the Company declared and paid a dividend out of retained earnings as at 31 December 1998 of PLN 12,700. The Company's management has proposed to pay a dividend in 2000 of PLN 18,178 out of the Company's profits for 1999.

Significant shareholders as at 31 December 1999

The following shareholders had more than 5% of shares:

	<u>% of ownership</u>	<u>% of voting rights</u>
Prokom Investments S.A.	30.04%	30.58%
Ryszard Krauze	15.84%	16.34%
Nihonsvi AG	4.60%	6.27%

15. Government payables

	<u>31 December 1999</u>	<u>31 December 1998</u>
Corporate income tax	3,690	3,810
Value added tax	1,861	1,877
Other	5,947	5,099
	<u>11,498</u>	<u>10,786</u>

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

16. Deferred income

	<u>31 December 1999</u>	<u>31 December 1998</u>
Deferred income on software licenses	8,430	10,199
Deferred income on maintenance services	2,713	-
Other deferred income	118	491
	<u>11,261</u>	<u>10,690</u>

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

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
17. Operating expenses		
Cost of hardware supplied and materials used in installations	(310,170)	(137,785)
External services	(117,883)	(66,339)
Payroll	(105,202)	(51,054)
Social security	(16,082)	(22,688)
Depreciation and amortization of goodwill	(21,034)	(16,162)
Other	(23,399)	(14,904)
Changes in work in progress	14,968	12,584
Total	(578,802)	(296,348)
Cost of sales	(474,306)	(229,538)
Selling costs	(24,448)	(13,744)
General and administrative costs	(80,048)	(53,066)
Total	(578,802)	(296,348)

The average number of employees in 1999 in the Company was 1,908 (1,433 in 1998).

Operating expenses include PLN 9,000 (PLN 12,300 in 1998) for research and development.

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
18. Other operating income/(expenses), net		
Foreign exchange losses, net	(2,006)	(247)
Gain on sale of land	-	1,960
Donations	(7,077)	(7,268)
Other, net	(551)	375
Total	(9,634)	(5,180)

Donations comprise amounts given by the Company for religious, health protection, sport, educational and charitable purposes.

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
19. Financial income /(expense), net		
Interest from bank deposits	2,607	11,016
Gains on sales of government bonds	10,275	11,494
Gains on sales of equity investments	1,883	6,984
Dividend received from equity investments	702	277
Write-down of equity securities to market value	(1,989)	(7,191)
Increase in market value of government bonds	1,118	5,374
Financial income from related parties (see Note 21)	10,351	4,597
Interest on loans from non-related parties	1,311	576
Bank charges, fees and commissions	(972)	(1,276)
Bank interest payable	(161)	(380)
Other, net	(557)	(254)
Total	24,568	31,217

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

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
20. Corporate income tax		
Current tax	(52,985)	(40,666)
Deferred tax credit	<u>128</u>	<u>3,634</u>
	<u>(52,857)</u>	<u>(37,032)</u>

Reconciliation of tax expense:

The Company's corporate income tax charge differs from the amount that would arise using the statutory tax rate as follows:

Profit before tax	<u>148,774</u>	<u>103,243</u>
Expected income tax expense at statutory rates	(50,583)	(37,167)
Increase/(decrease) resulting from:		
Tax losses in subsidiaries and associates not utilized	(485)	(373)
Effect on enacted future rate changes on deferred taxation	(1,283)	-
Tax on other, net	(506)	508
	<u>(52,857)</u>	<u>(37,032)</u>

The corporate tax rate in Poland for 1999 was 34% (36% in 1998).

There is no procedure for final agreement of tax assessments in Poland. The tax 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 that might arise in these circumstances.

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

21. Related party transactions

a. Related party receivables

	<u>31.12.1999</u>	<u>31.12.1998</u>
Amounts due from Prokom Investments S.A.	67,251	73,575
Long term amounts due from NKA Investments Sp. z o.o.	11,971	926
Amounts due from Nihonsvi AG	5,004	4,288
Other balances with non-consolidated subsidiaries	<u>2,091</u>	<u>2,356</u>
	86,317	81,145
Less long term portion	(46,374)	(21,761)
	<u>39,943</u>	<u>59,384</u>

Prokom Investments S.A. is a shareholder of the Company, in which Mr Ryszard Krauze, the chairman of the management board and a major shareholder of the Company, has a controlling interest. NKA Investments Sp. z o.o. ("NKA Investments"), which is a real estate company in Warsaw, is controlled by Mr Ryszard Krauze. Nihonsvi AG is one of the shareholders of the Company and it also has a financial interest in Prokom Investments S.A.

Amounts due from Prokom Investments S.A.:

	<u>31.12.1999</u>	<u>31.12.1998</u>
Funding for joint real estate projects (i)	29,376	16,170
Prokom Investments S.A. commercial papers (ii)	13,168	24,072
Advance for lease of office space (iii)	19,680	-
Other long term loans (iv)	5,027	-
Bills of exchange drawn on Prokom Investments S.A. (v)	-	12,392
Other long term (vi)	-	5,591
Short term loan (vii)	-	15,024
Other short-term	<u>-</u>	<u>326</u>
	67,251	73,575
Less long term (i), (iv), (vi)	(34,403)	(21,761)
	<u>32,848</u>	<u>51,814</u>

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

21. Related party transactions (cont.)

- (i) In 1999 the Company advanced an additional PLN 13,206 to Prokom Investments S.A. to provide funding for a real estate project undertaken by that company. As at 31 December 1999, the total amount invested in this project was PLN 29,376. The amount does not bear interest and has no fixed repayment date; it is therefore regarded as long term in nature. The return to the Company on this advance will be based on the performance of the underlying real estate project in proportion to the amounts contributed by each party.
- (ii) The commercial papers issued by Prokom Investments S.A. bear interest at market rates and are treated by the Company as a short term investments of excess of cash.

Changes in commercial papers issued by Prokom Investments S.A.

	Year ended 31 December 1999	Year ended 31 December 1998
1 January	24,072	-
Commercial papers purchased	111,229	37,076
Interest accrued	4,912	2,537
Commercial papers redeemed plus accrued interest paid	(127,045)	(15,541)
31 December	13,168	24,072

In addition, the Company purchased the following commercial papers from Prokom Investments S.A. after 31 December 1999:

On 10 January 2000 for consideration of PLN 12,043, interest of 19%, redemption date 10 July 2000
On 25 January 2000 for consideration of PLN 5,018, interest of 19%, redemption date 25 July 2000
On 31 January 2000 for consideration of PLN 5,549, interest of 19%, redemption date 24 January 2001
On 15 March 2000 for consideration of PLN 5,002, interest of 18%, redemption date 9 March 2001
On 3 April 2000 for consideration of PLN 5,065, interest of 18,5%, redemption date 28 March 2001
On 17 April 2000 for consideration of PLN 4,728, interest of 18,5%, redemption date 11 April 2001
On 28 April 2000 for consideration of PLN 5,492, interest of 18,5%, redemption date 20 April 2001
On 4 May 2000 for consideration of PLN 5,068, interest of 18,5%, redemption date 27 April 2001

On 15 May 2000, the total amount of receivables from Prokom Investments S.A. in relation to the above transactions is PLN 61,133 plus accrued interest.

- (iii) In July 1999, the Company signed an agreement with Prokom Investments to lease office space from 1 April 2000 for 10 years. In August 1999, the Company advanced PLN 19,680 to Prokom Investments as a guarantee payment in respect of the lease contract. On 14 February 2000, the Company paid an additional PLN 4,297 to Prokom Investments to pay for additional costs incurred by Prokom Investments S.A. in relation to the office space. This amount will be expensed by the Company in 2000.
- (iv) Other long-term loans include loans to companies which are not related parties but where the repayment of the loans is guaranteed by Prokom Investments S.A. The interest rate charged on these loans is at market terms.
- (v) On 24 August 1999, the Company redeemed a bill of exchange from Prokom Investments S.A. of PLN 13,705 which included interest of PLN 2,375 of which PLN 1,313 was recognised in 1998.
- (vi) On 24 August 1999, Prokom Investments S.A. repaid a long-term loan of PLN 5,591.
- (vii) On 20 December 1999, Prokom Investments S.A. repaid a short-term loan of PLN 15,024 and related interest of PLN 2,331.

Long term amounts due from NKA Investments

In 1999 the Company advanced an additional PLN 10,670 to NKA Investments in order to construct an office building in Warsaw. The Company's further commitments relating to this project are USD 7,400.

Amounts due from Nihonsvi AG

In 1998 the Company purchased two bills of exchange from Nihonsvi AG for PLN 3,000 and 3,300 which bear interest of 19.39% and 18% respectively. The bills of exchange were payable at the Company's call. In October 1998 Nihonsvi AG repaid PLN 2,242. Total amount of interest receivable related to the balance was PLN 716 (PLN 345 in 1998). On 10 February 2000, the Company redeemed all outstanding bills of exchange and as at 15 May 2000 the Company had no receivable from Nihonsvi A.G. for bills of exchange.

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

21. **Related party transactions (cont.)**

b. Financial income from related parties (see Note 19)

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
Prokom Investments S.A.	9,272	3,603
Nihonsvi AG	716	345
Other	363	649
	<u>10,351</u>	<u>4,597</u>

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
Interest from commercial papers (see point a (ii))	4,912	2,537
Interest on other long term loans (see point a (iv))	716	-
Interest on bills of exchange drawn by Prokom Investments (see point a(v))	1,313	1,066
Interest on short term loan (see point a (vii))	2,331	-
	<u>9,272</u>	<u>3,603</u>

c. Services purchased from related parties in 1999

	<u>Year ended 31 December 1999</u>	<u>Year ended 31 December 1998</u>
Prokom Investments S.A.	15,476	6,851
Baltway S.A.	3,910	643
	<u>19,386</u>	<u>7,494</u>

The services purchased from Prokom Investments S.A. comprise:

Rental costs of aircraft	7,234	3,604
Rental of cars	1,434	1,294
Marketing costs	5,576	1,568
Other	1,232	385
	<u>15,476</u>	<u>6,851</u>

In July 1998, the Company signed an agreement to rent an aircraft from Prokom Investments S.A. until November 2000. In addition Prokom Investments S.A. has re-invoiced the insurance costs to the Company. The total amount outstanding under this rental agreement at 31 December 1999 was PLN 7,919.

In October 1998, the Company signed an agreement to rent cars for business purposes from Prokom Investments S.A. until September 2000. The total amount outstanding under this rental agreement at 31 December 1999 was PLN 540.

Marketing costs include mainly costs of marketing incurred by Prokom Investments S.A. recharged to the Company.

In June 1998, the Company signed an agreement with Baltway S.A., a company controlled by Prokom Investments S.A., to lease office space from 1 July 1998 for 5 years. In addition, the total cost of leasehold improvements incurred by the Company to the offices was PLN 1,876. The total amount outstanding under this rental agreement at 31 December 1999 was PLN 10,271.

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

21. Related party transactions (cont.)

d. Future lease commitments

The future minimum lease payments under non-cancellable operating leases (with related parties) are as follows:

	Year ended 31 December 1999	Year ended 31 December 1998
Amounts falling due:		
In less than 1 year	16,097	11,490
After 1 year and not later than 5 years	53,552	17,036
Later than 5 years	46,494	-
	<u>116,143</u>	<u>28,526</u>

The future minimum lease payments include the future lease commitments for rental of office space from Prokom Investments and Baltway, rental of aircraft and cars from Prokom Investments.

Guarantees given

In addition the Company gave guarantees to BIG Bank Gdański S.A. for a maximum amount USD 900,000 as surety for a letter of credit issued by the bank to Petrolinvest Sp. z o.o., in which Prokom Investments S.A. has a financial interest.

22. Purchase of business

On 27 October 1999, the Company purchased 100% of the shares of TPG.

Details of net assets acquired and goodwill are as follows:

Purchase consideration:	
Cash paid	1,020
Fair value of contingently issuable shares	<u>6,588</u>
Total purchase consideration	7,608
Fair value of net assets acquired	<u>(194)</u>
Goodwill (see Note 11)	7,414

The assets and liabilities arising from the acquisition are as follows:

Cash	126
Net current assets	(155)
Tangible fixed assets	231
Intangible fixed assets	996
Other liabilities	<u>(1,004)</u>
Net assets acquired	194
Goodwill	<u>7,414</u>
Total purchase consideration	7,608
Less:	
Fair value of contingently issuable shares	(6,588)
Cash in subsidiary acquired	<u>(126)</u>
Cash outflow on acquisition	<u>894</u>

The shares, which will be granted to the management of TPG at 30 June 2000 (see Note 14), were treated as part of a contingent purchase consideration for the acquisition of interest in TPG. The option to acquire these shares was valued at market value at the date of acquisition less the amount payable for the shares to be issued.

23. Financial instruments

Credit risk

Financial assets, which potentially subject the Company and its affiliates to a 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.

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

23. Financial instruments (cont.)

At 31 December 1999 four customers accounted for 67% of the total amount of trade receivables; at 31 December 1998, four customers accounted for 73% 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 the foreign currency value converted at the exchange rate prevailing at the 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 1999 and 31 December 1998, the carrying amounts of cash at bank and in hand, short term securities, accounts receivable, accounts payable and accrued expenses, short-term borrowings and long-term investments approximated their fair values. The Company does not use any derivative financial instruments.

24. Earnings per share (not in thousands)

Basic and diluted earnings per share have been calculated based on net profit for each year divided by the weighted average number of shares. Contingently issuable shares are included in the calculation of basic and diluted earnings per share as the conditions for issue are deemed to have been met at the end of the reporting period.

	Year ended 31 December 1999	Year ended 31 December 1998
Net profit attributable to shareholders	95,118,000	65,441,000
Weighted average number of shares	12,721,810	12,700,000
Basic and diluted earnings per share	7.48	5.15

The weighted average number of shares was calculated as follows:

Weighted average number of shares issued	12,700,000	12,700,000
Weighted average number of share under option	22,426	-
Number of shares that would have been issued at fair value	(616)	-
Weighted average number of shares	12,721,810	12,700,00

25. 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 1998 to 31 December 1999, was PLN 5,304 (1998: PLN 2,843).

26. Subsequent events

- a. On 31 January 2000, the Company acquired a 52.5% of interest in Safe Computing Sp. z o.o., an e-commerce company, for a consideration of PLN 186.
- b. On 21 January 2000, the Company acquired a 96% of shares in Internet Wizards Sp. z o.o., an e-commerce company, for a consideration on PLN 336.
- c. On 24 January 2000, the Company formed a new subsidiary PROKOM Internet S.A ("PROKOM Internet"). It is intended that PROKOM Internet will coordinate all internet activities of the Company. The Company holds the 99.99% of shares of this company.
- d. On 3 March 2000, PROKOM Internet, CR Media Sp. z o.o. and Dom Maklerski Penator S.A. formed a new company – Ad.net S.A. PROKOM Internet holds 49% of the shares of this company.
- e. On 18 March 2000, the Company signed a letter of intent, with Centrum Nowych Technologii Sp. z o.o., a shareholder of Wirtualna Polska, whereby the Company will acquire an additional 15% of the shares of Wirtualna Polska to be issued by this company for an amount of USD 7,750. After the acquisition, the Company will held 40% of the shares of Wirtualna Polska.
- f. On 18 March 2000, the Company signed a letter of intent with Wirtualna Polska to sell 5% of shares to be issued by PROKOM Internet to Wirtualna Polska.
- g. On 6 April 2000, the Company signed a letter of intent with Stopklatka s.c., whereby the Company will acquire 80% of the shares in Stopklatka Sp. z o.o., an e-commerce company, for a consideration of PLN 400.

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

27. Future lease commitments

The future minimum lease payments under non-cancellable operating leases (other than those disclosed in Note 21) are as follows:

	Year ended 31 December 1999	Year ended 31 December 1998
Amounts falling due:		
In less than 1 year	7,564	5,485
After 1 year and not later than 5 years	495	5,748
	<hr/> 8,059	<hr/> 11,233

The above amounts relate mainly to rental of office space.

28. New accounting standards

For the consolidated financial statements for 2001, a new International Accounting Standard will come into effect in respect of Financial instruments, recognition and measurement. The Company intends to adopt this standard in 2001. The Company has not yet determined the effect, if any, of this standard.