Annual Financial Report

<u>Containing:</u>

- Independent auditor's report
- Consolidated financial statements
  as at and for the year ended December 31, 2006

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INDEPENDENT AUDITOR'S REPORT

To the Supervisory Board and Shareholders of Netia S.A.

We have audited the accompanying consolidated financial statements of Netia S.A. (the "Company") and its subsidiaries (together, the "Netia Group") which comprise the consolidated balance sheet as of December 31, 2006, and the consolidated income statement, consolidated statement of changes in shareholders' equity and consolidated cash flow statement for the year then ended, all of them expressed in Polish Złoty ("PLN") and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Netia Group as at December 31, 2006 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

PricewaterhouseCoopers Sp. z o.o.

Warsaw, Poland
March 1, 2007

NETIA S.A.
CONSOLIDATED FINANCIAL STATEMENTS
As at and for the year ended December 31, 2006

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NETIA S.A.
CONSOLIDATED BALANCE SHEET
as at December 31, 2006

(All amounts in thousands, except as otherwise stated)

	Note	December 31, 2005 (PLN)	December 31, 2006 (PLN)	Convenience Translation December 31, 2006 (EUR)
ASSETS				
Non-current assets				
Property, plant and equipment, net	6, 7	1,766,911	1,458,029	380,567
Intangible assets	6, 9	309,430	239,597	62,539
Investments in associates	11	105,633	141,394	36,906
Deferred income tax assets	27	14,182	4,865	1,270
Available for sale financial assets		10	10	3
Long term receivables	14	-	484	126
Prepaid expenses		3,636	3,303	862
Other long term assets		323	-	-
Total non-current assets		**2,200,125**	**1,847,682**	**482,273**
Current assets				
Inventories	13	2,262	1,584	413
Trade and other receivables	14	156,924	131,833	34,410
Current income tax receivables		38	-	-
Prepaid expenses		7,240	6,888	1,798
Derivative financial instruments	16	-	600	157
Financial assets at fair value through profit and loss	17	63,059	14,757	3,852
Restricted cash	18	-	6,100	1,592
Cash and cash equivalents	19	197,387	143,586	37,478
		426,910	**305,348**	**79,700**
Non-current assets classified as held for sale	15	-	2,329	608
Total current assets		**426,910**	**307,677**	**80,308**
Total assets		**2,627,035**	**2,155,359**	**562,581**

Mirosław Godlewski
President of the Company

Piotr Czapski
Member of the Management Board

Jonathan Eastick
Member of the Management Board
Chief Financial Officer

Paul Kearney
Member of the Management Board

Paweł Karłowski
Member of the Management Board

Tom Ruhan
Member of the Management Board

Warsaw, Poland
March 1, 2007

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

NETIA S.A.
CONSOLIDATED BALANCE SHEET (CONT'D)
as at December 31, 2006

(All amounts in thousands, except as otherwise stated)

	Note	December 31, 2005 (PLN)	December 31, 2006 (PLN)	Convenience Translation December 31, 2006 (EUR)
EQUITY				
Share capital		408,615	389,168	101,579
Treasury shares		(122,806)	-	-
Supplementary capital		1,939,572	1,809,434	472,289
Other reserves		1,758	29,644	7,738
Retained earnings		126,502	(283,248)	(73,932)
Total capital and reserves attributable to the Company's equity holders	20	**2,353,641**	**1,944,998**	**507,674**
Minority interest	21	6,349	6,902	1,802
Total equity		**2,359,990**	**1,951,900**	**509,476**
LIABILITIES				
Non-current liabilities				
Liabilities for licenses	10	14,000	-	-
Provisions	22	1,231	630	164
Deferred income		-	8,116	2,118
Deferred income tax liabilities	27	-	990	258
Financial guarantee contract	23	-	558	146
Other long term liabilities	25	741	774	202
Total non-current liabilities		**15,972**	**11,068**	**2,888**
Current liabilities				
Liabilities for licenses	10	43,413	-	-
Trade and other payables	25	193,957	168,267	43,921
Current income tax liabilities		-	38	10
Provisions	22	2,969	4,166	1,087
Financial guarantee contract	23	-	8,847	2,309
Deferred income		10,734	11,073	2,890
Total current liabilities		**251,073**	**192,391**	**50,217**
Total liabilities		**267,045**	**203,459**	**53,105**
Total equity and liabilities		**2,627,035**	**2,155,359**	**562,581**

NETIA S.A.
CONSOLIDATED INCOME STATEMENT
for the year ended December 31, 2006

(All amounts in thousands, except as otherwise stated)

	Note	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)	Convenience Translation Year ended December 31, 2006 (EUR)
Telecommunication revenue	28	899,183	853,348	222,737
Radio communication services revenue		9,931	8,709	2,273
Total revenue		**909,114**	**862,057**	**225,010**
Interconnection charges		(191,322)	(213,330)	(55,682)
Services purchased	29	(177,973)	(218,092)	(56,925)
Salaries and benefits	30	(132,664)	(134,016)	(34,980)
Restructuring costs	22	-	(1,377)	(359)
Depreciation of fixed assets	7	(199,985)	(220,508)	(57,556)
Amortization of intangible assets	9	(48,472)	(51,957)	(13,562)
Impairment charges for specific individual assets	6, 7, 15	-	(6,371)	(1,663)
Impairment charges for non-current assets	6, 7, 9	-	(354,672)	(92,575)
Reversal of impairment charges	6, 7	2,289	2,968	775
Cancellation and reassessment of the carrying value of license fee liabilities	10	-	64,469	16,827
Other gains / (losses), net	31	3,125	843	220
Other income	32	10,613	10,038	2,620
Other expenses	33	(84,416)	(81,436)	(21,256)
Operating profit / (loss)		**90,309**	**(341,384)**	**(89,106)**
Finance income	34	15,453	8,234	2,149
Finance costs	34	(7,205)	(7,259)	(1,895)
Share of losses of associates	11	(3,073)	(30,724)	(8,019)
Profit / (Loss) before income tax		**95,484**	**(371,133)**	**(96,871)**
Income tax charge	27	(35,294)	(7,222)	(1,885)
Profit / (Loss)		**60,190**	**(378,355)**	**(98,756)**
Attributable to:				
Equity holders of the Company		59,027	(378,908)	(98,900)
Minority interest		1,163	553	144
		60,190	**(378,355)**	**(98,756)**
Basic earnings per share for profit / (loss) attributable to the equity holders of the Company (expressed in PLN per share)	36	**0.16**	**(0.98)**	**(0.26)**
Diluted earnings per share for profit / (loss) attributable to the equity holders of the Company (expressed in PLN per share)	36	**0.15**	**(0.97)**	**(0.25)**

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

NETIA S.A.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended December 31, 2006

(All amounts in thousands, except as otherwise stated)

	Note	Attributable to the Company's equity holders						Minority interest	Total equity
				Supplementary capital					
		Share capital	Treasury shares	Share premium	Other supplementary capital	Other reserves	Retained earnings		
		(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)
Balance as at January 1, 2005		**366,956**	**(2,812)**	**1,605,357**	**203,565**	**1,892**	**188,131**	**5,186**	**2,368,275**
Issuance of series J shares		32,662	-	49,973	-	-	-	-	82,635
Cost of issuance of series J shares		-	-	(582)	-	-	-	-	(582)
Issuance of series I shares		5,876	-	485	-	-	-	-	6,361
Cost of issuance of series I shares		-	-	(1,334)	-	-	-	-	(1,334)
Employee share option scheme:									
- value of services provided		-	-	-	-	904	-	-	904
- issuance of series K shares		3,121	-	408	-	(1,038)	-	-	2,491
Appropriation of Netia's 2004 net profit:									
- dividend		-	-	-	-	-	(38,710)	-	(38,710)
- transfer to other supplementary capital		-	-	-	81,946	-	(81,946)	-	-
Repurchase of shares and warrants		-	(119,994)	-	(6)	-	-	-	(120,000)
Cost of repurchase of shares and warrants		-	-	(240)	-	-	-	-	(240)
Profit		-	-	-	-	-	59,027	1,163	60,190
Balance as at December 31, 2005		**408,615**	**(122,806)**	**1,654,067**	**285,505**	**1,758**	**126,502**	**6,349**	**2,359,990**

	Note	Attributable to the Company's equity holders						Minority interest	Total equity
				Supplementary capital					
		Share capital	Treasury shares	Share premium	Other supplementary capital	Other reserves	Retained earnings		
		(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)
Balance as at December 31, 2005		**408,615**	**(122,806)**	**1,654,067**	**285,505**	**1,758**	**126,502**	**6,349**	**2,359,990**
Cash flow hedges, net of tax	16, 20	-	-	-	-	486	-	-	486
Net income recognised directly in equity		-	-	-	-	486	-	-	486
Profit / (Loss)		-	-	-	-	-	(378,908)	553	(378,355)
Total recognised income / (expense) for the year 2006		**-**	**-**	**-**	**-**	**486**	**(378,908)**	**553**	**(377,869)**
Issuance of series J shares	20	7,662	-	11,723	-	-	-	-	19,385
Cost of issuance*		-	-	(175)	-	-	-	-	(175)
Employee share option scheme:									
- value of services provided	20	-	-	-	-	721	-	-	721
- issuance of series K shares	20	1,053	-	601	-	(1,483)	-	-	171
Coverage of negative difference in retained earnings related to adoption of International Financial Reporting Standards by Netia S.A.	20	-	-	-	(42,605)	-	42,605	-	-
Appropriation of Netia's 2005 net profit:									
- dividend	20, 37	-	-	-	-	-	(50,323)	-	(50,323)
- transfer to reserve capital	20	-	-	-	-	2,812	(2,812)	-	-
- transfer to other supplementary capital	20	-	-	-	20,312	-	(20,312)	-	-
Transfer related to repurchase of series C and E shares	20	-	-	2,343	469	(2,812)	-	-	-
Cancellation of treasury shares	20	(28,162)	122,806	(2,343)	(120,463)	28,162	-	-	-
Balance as at December 31, 2006		**389,168**	**-**	**1,666,216**	**143,218**	**29,644**	**(283,248)**	**6,902**	**1,951,900**

*Transaction costs deducted from share premium for both series J shares and series K shares.

The total income and expense for the year ended December 31, 2005 recognized in the equity are equal to the profit / (loss) for the period.

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

NETIA S.A.
CONSOLIDATED CASH FLOW STATEMENT
for year ended December 31, 2006

(All amounts in thousands, except as otherwise stated)

	Note	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)	Convenience Translation Year ended December 31, 2006 (EUR)
Cash flows from operating activities:				
Profit / (loss)		**60,190**	**(378,355)**	**(98,756)**
Adjustments for:				
Depreciation and amortization	7, 9	248,457	272,465	71,117
Impairment charges for non-current assets	6, 7, 9	-	354,672	92,575
Impairment charges for specific individual assets	6, 7, 15	-	6,371	1,663
Reversal of impairment charges	6, 7	(2,289)	(2,968)	(775)
Share of losses of associates	11	3,073	30,724	8,019
Deferred income tax charge	27	34,720	6,802	1,775
Cancellation and reassessment of the carrying value of license fee liabilities	10	-	(64,469)	(16,827)
Interest expense accrued on license liabilities	10	6,495	5,247	1,370
Financial guarantee contract	23	-	(88)	(23)
Interest accrued on loans		(351)	(17)	(4)
Share-based compensation	20	3,395	892	233
Fair value gains on financial assets at fair value through profit and loss	17, 34	(2,631)	(2,251)	(588)
Fair value adjustments on other receivables	32	-	(4,613)	(1,204)
Decrease / (increase) in other long term assets		(573)	323	84
Foreign exchange (gains) / losses		(3,946)	3,298	861
Gain on sale of fixed assets	31	(345)	(2,574)	(672)
Gain on sale of subsidiaries and other investments	12, 31	(11)	(20)	(5)
Changes in working capital	38	(7,847)	9,798	2,557
Net cash provided by operating activities		**338,337**	**235,237**	**61,400**
Cash flows from investing activities:				
Purchase of fixed assets and computer software		(146,102)	(180,574)	(47,132)
Proceeds from sale of fixed assets		2,077	4,280	1,117
Investment in associate	11	(109,465)	(57,000)	(14,878)
Purchase of subsidiary, net of cash received	8	5,051	(68,288)	(17,824)
Sale of subsidiaries and other investments, net of cash in subsidiaries	12	260	25	7
Sale of financial assets at fair value through profit and loss		4,953	49,834	13,007
Loans granted		(24,899)	(1,533)	(400)
Loan repayments		1,002	417	109
Interest received		32	-	-
Payments for licenses		(24,250)	-	-
Net cash used in investing activities		**(291,341)**	**(252,839)**	**(65,994)**
Cash flows from financing activities:				
Proceeds from share issuance		82,364	19,385	5,060
Cost of share issuance		(1,916)	(175)	(46)
Dividend paid to the Company's shareholders	20, 37	(38,710)	(50,323)	(13,135)
Repurchase of shares and warrants		(123,052)	-	-
Repayment of installment obligations		(5,511)	-	-
Finance lease payments		-	(199)	(52)
Repayment of borrowings		-	(2,500)	(653)
Interest repaid		-	(167)	(44)
Redemption of notes for warrants		(31)	(334)	(87)
Net cash used in financing activities		**(86,856)**	**(34,313)**	**(8,957)**
Exchange gains / (losses) on cash and cash equivalents		**1,310**	**(1,886)**	**(492)**
Net change in cash and cash equivalents		**(38,550)**	**(53,801)**	**(14,043)**
Cash and cash equivalents at beginning of period		235,937	197,387	51,521
Cash and cash equivalents at end of period		**197,387**	**143,586**	**37,478**

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

1. The Company and the Netia Group

Netia S.A. (the "Company" or "Netia") was formed in 1990 as a limited liability company under the laws of Poland and was transformed into a joint stock company in 1992. In 2003 a general meeting of shareholders adopted a resolution changing the Company's name from Netia Holdings S.A. to Netia S.A. The Company is incorporated and domiciled in Poland with its principal executive office located at ul. Poleczki 13, 02-822 Warsaw, Poland. The Company and its subsidiaries (together, the "Netia Group") is the largest alternative fixed-line telecommunication operator in Poland.

The consolidated financial statements of Netia S.A. for the year ended December 31, 2006 comprise the Company and its subsidiaries. A list of the Company's subsidiaries is set out in Note 2.

These consolidated financial statements were approved for issuance by the Company's Management Board on March 1, 2007.

The Netia Group provides various voice telephone and data transmission services. These services include switched, fixed-line voice telephone services (including domestic long distance, international long distance and fixed-to-mobile services), Integrated Services Digital Network ("ISDN"), Voice over Internet Protocol ("VoIP"), voice mail, dial-up and fixed-access Internet, leased lines and frame relay and MPLS services. The Netia Group also offers wholesale services (including the wholesale termination of in-bound traffic, ducts, dark fiber and co-location services), services based upon intelligent networks (free phone, split charge and premium rate services) and provides broadband Internet access with ADSL technology.

To further broaden Netia's product offer, including convergent services, Netia intends to offer mobile services. On May 9, 2005 the Company's current associate, P4 Sp. z o.o. ("P4") (until August 23, 2005 the Company's subsidiary, see also Notes 11 and 42), was announced the winner of the UMTS tender, organized by the Polish regulator.

In addition, on October 27, 2005 the Company's subsidiaries, Netia WiMax S.A. ("Netia WiMax") and Netia WiMax II S.A. (currently operating under the name "Netia WiMax S.A.", "Netia WiMax II"), received the reservation of the 3.6-3.8 GHz frequencies. During 2006, the Company began to use the frequencies to provide telecommunication services based on WiMAX technology. The WiMAX based access network will be used to provide high quality data and voice transmission. The new WiMAX network will interconnect with Netia's fiber-optic backbone infrastructure and integrate seamlessly with its existing access network.

The Netia Group is also engaged in the installation and supply of specialized mobile radio services (public trunking) in Poland through its 62.2% owned subsidiary (see Note 43), UNI-Net Sp. z o.o.

In March 2006 the Company sold 100 (not in thousands) shares of Netia Ventures Sp. z o.o., representing 100% of its share capital (see Note 11).

In May 2006 the Company's subsidiary, InterNetia Sp. z o.o., with its seat in Warsaw ("InterNetia"), was registered by the relevant Polish court. The shares in InterNetia were taken up solely by Netia. As at December 31, 2006 InterNetia has not commenced any business activities.

In June 2006 the Netia Group acquired Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o. (for further details see Note 8).

In July 2006 the Netia Group acquired Pro Futuro S.A. ("Pro Futuro"), a telecommunication services provider (see Note 8).

In July 2006 Netia merged with its three wholly-owned subsidiaries, which operated previously under the following names: Regionalne Sieci Telekomunikacyjne El-Net S.A. ("El-Net"), Netia WiMax S.A. and Polbox Sp. z o.o. In August 2006 Świat Internet S.A., the Company's subsidiary, merged with its wholly-owned subsidiary HFC Internet Sp. z o.o. In November 2006 Premium Internet S.A., Świat Internet S.A.'s subsidiary, merged with its wholly-owned subsidiary Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o.

The Company's ordinary shares have been listed on the Warsaw Stock Exchange since July 2000 and are part of the WIG-20 index. The Company is subject to periodic reporting requirements under the Polish regulations regarding reporting requirements for companies listed on the Warsaw Stock Exchange.

Current financial condition

As at December 31, 2006, the equity amounted to PLN 1,951,900 and the Netia Group had working capital of PLN 115,286. In 2006 the Company performed an impairment test for the telecommunications segment. The test has resulted in an impairment charge of PLN 354,672, which has been recognized in the consolidated statement of operations for the year ended December 31, 2006. For further details regarding the impairment test see Note 6. In 2004, 2005 and 2006 the Netia Group generated positive cash flows from operating activities and had PLN 143,586 of cash available and no outstanding financial debt. Based on this position, the Management does not believe that events or conditions exist which may cast significant doubt on the Company's ability to continue as a going concern.

2. Significant subsidiaries and associates of the Company

The consolidated financial statements include the accounts of the Company's directly or indirectly held subsidiaries:

Subsidiary	**Ownership Percentage**	
	December 31, 2005	**December 31, 2006**
Subsidiaries held directly:		
UNI-Net Sp. z o.o.	58	58
Netia WiMax S.A. (previously Netia WiMax II S.A.)	100	100
Świat Internet S.A.	100	100
Netia Mobile Sp. z o.o.	100	100
InterNetia Sp. z o.o.	-	100
Pro Futuro S.A.	-	100
Polbox Sp. z o.o.*	100	N/A
Netia WiMax S.A.*	100	N/A
RST El-Net S.A.*	100	N/A
Netia Ventures Sp. z o.o.	100	-
Subsidiaries held indirectly:		
Premium Internet S.A.	100	100
HFC Internet Sp. z o.o. **	100	N/A
Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o.***	-	N/A

* merged with Netia
** merged with Swiat Internet S.A.
*** merged with Premium Internet S.A.

The Company has one associate company, P4 Sp. z o.o., in which it held an indirect 30% interest via its 100% subsidiary Netia Mobile Sp. z o.o., throughout 2006.

All the Company's subsidiaries and associates are incorporated in Poland.

3. Summary of significant accounting policies

Basis of preparation

Following the European Union regulations, commencing January 1, 2005 Netia as a public company in Poland prepares consolidated financial statements, as required by the Accounting Act of 29 September 1994 (Journal of Laws of 2002, No. 76, item 694 with later amendments) in accordance with International Financial Reporting Standards as adopted by the European Union ("EU"). As of December 31, 2006 there are no differences as regards policies adopted by the Netia Group between these standards and International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board.

These consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU, issued and effective as at the time of preparing these consolidated financial statements. The accounting policies used in the preparation of the consolidated financial statements are consistent with those used in the annual consolidated financial statements for the year ended December 31, 2005, except for new accounting standards adopted as of January 1, 2006. These consolidated financial statements are supplement to the consolidated financial statements prepared in Polish and filed with the Warsaw Stock Exchange according to the relevant reporting regulations.

The consolidated financial statements are prepared under the historic cost convention as modified by the revaluation of financial assets at fair value through profit and loss. However, until December 31, 1996, Poland was considered to be a hyperinflationary economy. The consolidated financial statements for the periods through that date were prepared under the historical cost convention as adjusted for the effects of inflation in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies". The inflated values in PLN at December 31, 1996 for balance sheet items became the new historical basis for subsequent periods.

The preparation of financial statements in conformity with IFRS as adopted by the EU requires the use of certain critical accounting estimates. The areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 5.

All Euro amounts shown as supplementary information in the consolidated financial statements have been translated from PLN only as a matter of arithmetic computation using the official rate of the National Bank of Poland at December 31, 2006 of PLN 3.8312 to EUR 1.00. These amounts are included for the convenience of the reader only. Such translation should not be construed as a representation that the PLN amounts have been or could be converted into Euros at this or any other rate.

Reclassifications of comparatives

As at December 31, 2006 the Netia Group had funds of PLN 14,757 deposited in money market investment funds. Following detailed analysis of liquidity and risks connected with these financial assets, performed in the three-month period ended March 31, 2006, the Company's management decided to no longer classify these financial assets as cash equivalents. From March 31, 2006 these financial assets are presented as a separate balance sheet item – financial assets at fair value through profit and loss. The comparative amount of PLN 63,059 presented in these consolidated financial statements has been reclassified to conform to the presentation as at December 31, 2006. The relevant changes have also been made to the consolidated cash flow statement.

New standards, interpretations and amendments to existing standards

The following new standards, amendments to standards and interpretations are mandatory for the financial year ended December 31, 2006:

- Amendment to IAS 19, 'Actuarial gains and losses, group plans and disclosures', effective for annual periods beginning on or after January 1, 2006. The adoption of the amendment had an impact on the extent of disclosures presented in the accounts;

- Amendment to IAS 39, Amendment 'The fair value option', effective for annual periods beginning on or after January 1, 2006. The adoption of the amendment did not have a significant impact on these consolidated financial statements;

- Amendment to IAS 21, Amendment 'Net investment in a foreign operation', effective for annual periods beginning on or after January 1, 2006. This amendment is not relevant for the Netia Group;

- Amendment to IAS 39, Amendment 'Cash flow hedge accounting of forecast intragroup transactions', effective for annual periods beginning on or after January 1, 2006. The adoption of the amendment did not have a significant impact on these consolidated financial statements;

- Amendments to IAS 39 and IFRS 4, Amendments 'Financial guarantee contracts', effective for annual periods beginning on or after January 1, 2006. During the year ended December 31, 2006 the Company entered into a financial guarantee contract and its impact was recognized in the consolidated financial statements (see Note 23);

- IFRS 6, 'Exploration for and evaluation of mineral resources', effective for annual periods beginning on or after January 1, 2006. This standard is not relevant for the Netia Group;

- IFRIC 4, 'Determining whether an arrangement contains a lease', effective for annual periods beginning on or after January 1, 2006. The adoption of the interpretation did not have a significant impact on these consolidated financial statements;

- IFRIC 5, 'Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds', effective for annual periods beginning on or after January 1, 2006. This interpretation did not have a significant impact on these consolidated financial statements; and

- IFRIC 6, 'Liabilities arising from participating in a specific market – waste electrical and electronic equipment', effective for annual periods beginning on or after 1 December 2005. The adoption of the interpretation did not have a significant impact on these consolidated financial statements;

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2006 and have not been early adopted:

- IFRIC 7, 'Applying the Restatement Approach under IAS 29', effective for annual periods beginning on or after March 1, 2006. IFRIC 7 provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. Management do not expect the interpretation to be relevant for the Netia Group;

- IFRIC 8, 'Scope of IFRS 2', effective for annual periods beginning on or after May 1, 2006. IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. Management do not expect the interpretation to have a significant impact on the Netia Group's operations;

- IFRIC 9, 'Reassessment of Embedded Derivatives', effective for annual periods beginning on or after June 1, 2006. IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. Management do not expect the interpretation to have a significant impact on the Netia Group's operations;

- IFRIC 10, 'Interim Financial Reporting and Impairment', effective for annual periods beginning on or after November 1, 2006. IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Netia Group will follow the interpretation. The interpretation has not yet been endorsed by the EU;

- IFRIC 11, 'IFRS 2: Group and Treasury Share Transactions', effective for annual periods beginning on or after March 1, 2007. IFRIC 11 provides guidance on applying IFRS 2 in share-based payment involving an entity's own equity instruments in which the entity chooses or is required to buy its own equity instruments (treasury shares) to settle the share-based payment obligation, a parent grants rights to its equity instruments to employees of its subsidiary and when a subsidiary grants rights to equity instruments of its parent to its employees. Management do not expect the interpretation to be relevant for the Netia Group. The interpretation has not yet been endorsed by the EU;

- IFRIC 12, 'Service Concession Arrangements', effective for annual periods beginning on or after January 1, 2008. IFRIC 12 provides guidance on the accounting by operators in public-to-private service concession arrangements. Management is currently assessing the impact of IFRIC 12 on the Netia Group's operations. The interpretation has not yet been endorsed by the EU;

- IFRS 7, 'Financial instruments: Disclosures', effective for annual periods beginning on or after January 1, 2007 and the complementary Amendments to IAS 1, 'Amendments to capital disclosures', effective for annual periods beginning on or after January 1, 2007. IFRS 7 introduces new requirements to improve the information on financial instruments that is given in entities' financial statements. The amendment to IAS 1 complements the release of IFRS 7 "Financial Instruments: Disclosures" and introduces requirements for all entities to disclose: the entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. The Netia Group will follow the new disclosure requirements; and

- IFRS 8, 'Operating Segments', effective for annual periods beginning on or after January 1, 2009. IFRS 8 replaces IAS 14 'Segment Reporting' and adopts a management approach to segment reporting. Management is currently assessing the impact of IFRS 8 on the Netia Group's operations. IFRS 8 has not yet been endorsed by the EU.

Consolidation

(a) Subsidiaries

Subsidiaries, which are those entities in which the Company has a shareholding of more than one half of the voting rights or otherwise has the power to govern the financial and operating policies, are consolidated. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Company controls another entity.

Subsidiaries are consolidated from the date on which control is transferred to the Company. From the date that control ceases, subsidiaries are no longer consolidated and investment in such an entity is accounted for in accordance with IAS 39, provided that it does not become an associate.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments or liabilities incurred or assumed at the date of acquisition plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the assets, liabilities and contingent liabilities of the subsidiary acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the assets, liabilities and contingent liabilities of the subsidiary acquired, the difference is recognized directly in the income statement. Intercompany transactions, balances and unrealized gains on transactions between group companies are eliminated; unrealized losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Netia Group.

(b) Transactions with minority interests

The Netia Group applies a policy of treating transactions with minority interests as transactions with parties external to the Netia Group. Disposals to minority interests result in gains and losses for the Netia Group that are recorded in the income statement. Purchases from minority interest result in goodwill, being the difference between any considerations paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(c) Associates

Associates are all entities over which the Netia Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights or otherwise has power to participate in the financial and operating policy decisions.

Investments in associates are accounted for using the equity method and are initially recognized at cost. The Netia Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition. The Netia Group's share of its associates' post-acquisition profits or losses is recognized in the income statement. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Netia Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Netia Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Netia Group and its associates are eliminated to the extent of the Netia Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Segment reporting

The Netia Group has only one business segment – telecommunications and operates in one geographical area, which is the territory of Poland.

Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Netia Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Polish Złoty ("PLN"), which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency at the exchange rates prevailing at the date of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment in value, plus related inflation adjustment through December 31, 1996. Fixed assets under construction represent the accumulation of costs associated with the construction of the telecommunications and data transmission networks and other tangible fixed assets. The Netia Group includes in the construction cost of its networks all eligible borrowing costs (including interest costs, if applicable) and expenditures that are directly attributable to the acquisition or bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Costs relating to the fixed assets under construction are transferred to the related property, plant and equipment account and depreciation begins when they are available for use.

Subsequent costs are included in the carrying amount of the asset or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Netia Group and the cost can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Depreciation expense is recorded utilizing the straight-line method over the estimated useful lives of the assets. These lives are summarized as follows:

	Term
Buildings	10 to 40 years
Transmission network	15 to 40 years
Switching system	5 to 15 years
Machinery and equipment	5 to 12 years
Office machinery and equipment	3 to 10 years
Vehicles	6 to 8 years

Land and fixed assets under construction are not depreciated.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the income statement.

Non-current assets classified as held for sale

Non-current assets are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through continuing use.

Leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Leases where the Netia Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in other payables. The interest element of the finance cost is charged to the income statement over the lease period. The property, plant and equipment acquired under finance leases is depreciated over the useful life of the asset. If there is no reasonable certainty that the Netia Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life.

Intangible assets

(a) Licenses and license fee liabilities

Licenses are stated at cost less accumulated amortization and impairment losses. If payment for the license is deferred beyond normal credit terms, its cost is the net present value of the obligation. The present value of the obligation is calculated using the Netia Group's effective borrowing rates at the time the license was granted. Any differences between the nominal price of the license and its present value are treated as interest costs. Interest costs are capitalized until substantially all the activities to prepare the asset for its intended use are complete and are then recognized as interest expense over the period of the obligation. Amortization of the license also commences once the related network is capable of operating in the manner intended by management and is calculated on a straight-line basis until the end of the grant period. The amortization period is 12 to 15 years.

(b) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Netia Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Separately recognized goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The Netia Group allocates goodwill to the entire Netia Group.

(c) Computer software costs

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives (up to 5 years).

Costs associated with developing or maintaining computer software programmes are recognized as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Netia Group and that will probably generate economic benefits, exceeding costs, beyond one year, are recognized as intangible assets. Direct costs include staff costs of the software development team and an appropriate portion of relevant overheads. Computer software development costs recognized as assets are amortized using the straight-line method over their estimated useful lives, not exceeding a period of 5 years.

(d) Customer relationships

Customer relationships acquired separetly are measured on initial recognition at cost. The cost of customer relationship acquired in a business combination is recognized at fair value as at the date of acquisition. Customer relationships are amortized using the straight-line method over their estimated useful lives of 4 - 5 years.

Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses relating to non-financial assets other than goodwill may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset is increased to its recoverable amount. That increased carrying amount cannot exceed the lower of its recoverable amount and the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such a reversal is recognized in the income statement. After such a reversal the depreciation charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Financial assets

The Netia Group classifies its financial assets in the following categories: available-for-sale financial assets, financial assets at fair value through profit and loss and loans and receivables.

(a) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative assets that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless Management intends to dispose of the financial assets within 12 months of the balance sheet date.

(b) Financial assets at fair value through profit and loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term. Financial assets designated as at fair value through profit or loss at inception are those that are managed and their performance is evaluated on a fair value basis, in accordance with the Netia Group's documented investment strategy. Information about these financial assets is provided internally on a fair value basis to the Netia Group's key management personnel. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

(c) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as "trade and other receivables" in the balance sheet.

Purchase and sales of financial assets are recognized at the trade date on which the Group commits to purchase or sell the asset. Financial assets are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Netia Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit and loss are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method. Realized and unrealized gains and losses arising from changes in the fair value of the financial assets at fair value through profit and loss category are included in the income statement in the period in which they arise. Unrealized gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognized in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

The Netia Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement.

Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Netia Group designates certain derivatives as hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge).

The Netia Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Netia Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the hedged item is more than 12 months; it is classified as a current asset or liability when the remaining maturity of the hedged item is less than 12 months.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement within "Other gains/(losses), net".

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). When the forecast transaction that is hedged results in the recognition of non-financial asset (for example, investments in associates, inventory or fixed assets), the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset. The deferred amounts are ultimately recognised in cost of goods sold in the case of inventory, or in depreciation in case of fixed assets.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement within "Other gains/(losses), net".

Inventories

Inventories are stated at the lower of cost and net realizable value, generally determined on a first-in first-out (FIFO) basis. Net realizable value is the estimated selling price in the ordinary course of business less applicable variable selling expenses.

Trade receivables

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. If it is probable that the Netia Group will not be able to collect amounts due, according to the original terms of receivables, a provision for impairment is recognized in the income statement within "other expenses". The amount of the provision is measured as the difference between the carrying amount of receivables and the present value of expected future cash flows, discounted at the effective interest rate. Any amounts reversed during the period are presented net with the impairment provisions. The carrying amount of the asset is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, cash at bank, short-term deposits with an original maturity of three months or less and financial assets at fair value through profit and loss that meet the definition of cash equivalents.

Cash is carried in the balance sheet at nominal value. Financial assets at fair value through profit and loss classified as cash equivalents are measured at fair value. The fair value is based on dealer quotes obtained at each balance sheet date. Gains or losses arising from changes in the fair value are recognized in the income statement.

Share capital

All shares outstanding issued by the Company are classified as equity. External costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Treasury shares are shares issued by the Company for the purpose of the previous stock option plan and shares redeemed in relation to the buy-back program. The consideration paid for those shares is deducted from equity until they are cancelled, reissued or disposed.

Share-based compensation

The Netia Group operates an equity-settled, share-based compensation plan. Share options are granted to employees and board members of the managing bodies of the Company. Upon exercise of the options, the Company will issue to each exercising participant the number of shares representing such participant's gain resulting from the exercise of the options. No proceeds are received when the options are exercised. The vesting period for the options ranges up to three years from the date of grant or upon achieving certain specified conditions.

For options, which were granted after November 7, 2002 and had vested at January 1, 2005 only the nominal value of shares issued increased by costs of exercise are charged to the income statement as incurred upon exercise of the options. For options granted after November 7, 2002 and not vested at January 1, 2005 the fair value of the employee services received in exchange for the grant of options is recognized as an employee benefit expense with a corresponding increase in other reserves. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted. At each balance sheet date, the Company revises its estimate of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to other reserves.

Retirement benefits

The Netia Group makes contributions to the Government's retirement benefit scheme at the applicable rate during the period based on gross salary payments (the "State Plan").

The State Plan is funded on a pay-as-you-go basis, i.e. the Netia Group is only obliged to pay the contributions as they fall due based upon a percentage of salary and if the Netia Group ceases to employ members of the State Plan, it will have no obligation to pay any additional benefits. The State Plan is a defined contribution plan. The expense for the contributions is charged to the income statement in the same period as the related salary expense.

Employees are entitled to severance payments, which are paid on a one-off basis on retirement. The amount of retirement severance payments is defined in the Labour Code (an average monthly remuneration). The provision recognised in the Netia Group's balance sheet in respect of retirement severance payments is the present value of the future obligation. This provision is calculated annually by independent actuaries using the projected unit credit method. The present value of the retirement severance payments is determined by discounting the estimated future cash outflows using interest rates of long-term bonds that are denominated in the currency in which the benefits will be paid. Actuarial gains and losses are charged or credited to the income statement.

Provisions

Provisions are recognized when Netia Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Netia Group has recognized provisions for loss on rental contracts (onerous contracts), legal claims and tax assessments and restructuring. Costs related to the ongoing activities of Netia Group are not provided in advance. Provisions are not recognized for future operating losses.

Provisions for onerous contracts are recognized when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

Provisions for claims (legal and contractual) and tax assessments are recognized when, based on all available evidence, it is more likely than not that a present obligation exists at the balance sheet date, the outflow of benefits relating to the claim is probable and it is possible to estimate this reliably.

Provisions for claims and tax assessments are recorded at the estimated value of costs to be incurred. Provisions for onerous contracts are calculated based on the value of future net cash outflows by the termination of a contract. If a contract is concluded for a period exceeding the 12-month period from the balance sheet date, the provision is recorded based on the discounted value of net cash outflows.

Headcount restructuring and termination benefits provisions comprise employee termination payments and are recognized in the period in which Netia Group becomes legally or constructively committed to payment.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessment of the time value of money and the risk specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

Financial guarantee contract

Financial guarantee contracts are accounted for as financial instruments. Such contracts are recognized initially at fair value (equal to premium received or estimated using a valuation technique) and subsequently measured at the higher of: (i) the amount of provision determined based on the best estimate of the probable expenditure required to settle the obligation from the guarantee contract and (ii) the amount initially recognized less cumulative amortization.

The initially deferred revenue is recognized over the contract period by amortizing it to the income statement in the amounts assigned by the initial fair valuation model to each period (on a monthly basis).

At each reporting date, the Netia Group considers whether payment under the guarantee contract is probable and therefore requires a provision to be recognized. If a provision is recognized, and the provision amount is greater than the existing carrying amount (after amortization of revenue), an adjustment is made to reflect the provision and the difference is recognized in the income statement.

Revenue

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Netia Group's activities. Revenue is shown net of value added tax, rebates and discounts and after eliminated sales within the Group.

Telecommunications revenue includes direct voice products, such as monthly charges and calling charges. Calling charges include the following traffic fractions: local calls, domestic long-distance (DLD) calls, international long distance (ILD) calls, fixed-to-mobile calls and other services (incl. Internet dial-in, emergency calls and intelligent network services). Revenue from calling charges is recognized in the income statement at the time a call is made over the Netia Group's network. Telecommunications revenue includes also services other than traditional direct voice, such as indirect voice, data transmission, interconnection, wholesale, intelligent network services and other telecommunication services, as well as sales of goods. Other telecommunication revenue comprises the provision of Internet dial-in services for Netia's indirect customers, Internet callback services, payphones, as well as other non-core revenues. Other telecommunication revenues are recognized in the income statement in the period to which the services relate.

Interconnection revenues are derived from calls and other traffic that originate in other domestic or foreign operators' networks but use the Netia Group's network. The Netia Group receives interconnection fees based on agreements entered into with other telecommunication operators. These revenues are recognized in the income statement in the period to which the services relate.

Radio communications revenue includes revenue from specialized mobile radio service (public trunking), through the Company's subsidiary UNI-Net Sp. z o.o. Service revenues are recorded when the service is provided. Revenue from the sale of equipment is recorded when the equipment is delivered to the customer.

Deferred income

Deferred income is recognized when the income is invoiced during an accounting period, but for which the Netia Group has still to supply the related services. It includes deferred revenues from rental contracts and subscriptions relating to future periods. Deferred income is classified as current if the service is expected to be supplied within 12 months of the balance sheet date.

Interconnection charges

Interconnection with other telecommunication operators is required to complete calls that originate in but terminate outside of the Netia Group's network or originate outside the network and terminate within it, or are only transferred through the Netia Group's network. The Netia Group pays interconnection charges based on agreements entered into with other telecommunication operators.

Interest income

Interest income is recognized on a time-proportion basis using the effective interest method. Interest income on impaired loans is recognized either as cash is collected or on a cost-recovery basis as conditions warrant.

Deferred income taxes

Deferred income tax is provided, using the liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes and for tax losses. Currently enacted tax rates are used to determine deferred income tax. The principal temporary differences arise from different valuations of depreciable assets and accruals for tax and accounting purposes.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which temporary differences can be utilized. Deferred income tax assets are also recognized for unused tax losses carried forward and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilized.

Deferred income tax assets and deferred income tax liabilities are offset if, and only if, the Company or its subsidiaries have a legally enforceable right to set off current tax assets against current tax liabilities, and the deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable base.

Dividend distribution

Dividend distributions to the Company's shareholders are recognized as a liability in the Netia Group's consolidated financial statements in the period in which the dividends are approved by the Company's General Shareholders' Meeting.

4. Financial risk management

Financial risk factors

The Netia Group's activities expose it to a variety of financial risks. The Netia Group's overall risk management program focuses on minimizing potential adverse effects of those risks on the financial performance of the Netia Group. The Netia Group uses derivative financial instruments to hedge certain risk exposure. The Management Board provides written principles for overall risk management, as well as written policies covering specific areas, such as use of derivative financial instruments, credit risk and price risk.

Market risk

- Currency risk:

The Netia Group's revenues and costs are predominately denominated in Polish Zloty, other than some payments made under the equipment and construction contracts, which are linked to the U.S. Dollar and Euro. In order to mitigate the currency risk Netia Group holds deposits in Euro and U.S. Dollars for servicing those payments. Furthermore, the Netia Group has a commitment to make contributions to P4's capital, denominated in Euros. Therefore, to manage the currency risks, a certain part of planned payments was hedged.

- Interest rate risk:

The Netia Group's income and operating cash flows are substantially independent of changes in market interest rates. As a result, the Company is not exposed to the effect of future changes in the level of interest rates.

- Price risk:

The Netia Group does not participate in the market trading of securities. The investments held by the Netia Group and classified as short term deposits have an agreed redemption price and are regarded as having low market risk.

Credit risk

The Netia Group had no significant concentrations of credit risk throughout 2006. Cash transactions are limited to high credit quality financial institutions. The Netia Group has a large number of customers, nationally dispersed, and there are policies in place to ensure that sales of services to significant customers are preceded by appropriate verification of their credit history. On October 31, 2006 the Company granted to P4 a guarantee partially securing the repayment of the credit facility. The maximum exposure to a credit risk is limited to EUR 27,000 and may arise from a payment default by P4.

Liquidity risk

The Netia Group policy assumes maintaining sufficient cash and marketable securities to service the current payments. Surpluses are deposited in either bank deposits or treasury bills or low risk investment funds. Due to the dynamic nature of the underlying business, the Netia Group aims to maintain flexibility in funding by keeping borrowing facilities available.

Fair value estimation

The fair value of financial instruments traded in active markets (such as financial assets at fair value through profit or loss) is based on dealer quotes obtained at the balance sheet date.

The fair value of financial instruments that are not traded in an active market (for example available-for-sale financial assets) is determined by using valuation techniques.

The fair value of forward currency contracts is determined using quoted forward exchange rates at the balance sheet date.

The fair value of the financial guarantee contract is determined by using valuation techniques (probability-adjusted discounted cash flow analysis).

The nominal value less impairment provision of receivables and liabilities with a maturity of less than one year are assumed to approximate their fair values.

5. Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the current or next financial year are described below.

(a) Deferred income tax

As part of the process of preparing the consolidated financial statements, the Management is required to estimate the Netia Group's income taxes. This process involves estimating the Netia Group's actual current tax exposure together with assessing temporary differences resulting from different treatment for tax purposes compared to the accounting treatment, such as the valuation of tangible fixed assets, accruals and provisions. These differences result in deferred income tax assets and liabilities, which are recognized in the consolidated balance sheet.

The deferred income tax calculation is based on the probability that future taxable profit will be available against which temporary differences, the unused tax losses and unused tax credits can be utilized. That calculation is based upon Management's estimates, which contain a considerable amount of uncertainty.

The Management is required to assess the likelihood that deferred income tax assets will be recovered from future taxable income, and to the extent the recovery is probable the deferred income tax assets are recognized. Significant management estimates are required in the valuation of the Netia Group's deferred income tax assets. These estimates take into consideration future taxable income projections, potential volatility in those projections, historical results and ongoing tax planning strategies. Management's assessment also considered such factors as: the stability and trend of past earnings, the nature of the business and industry, the economic environment in which the Netia Group operates and the stability of local legislation.

Based on the above assumptions and Management's assessment of the Netia Group tax position as of December 31, 2006, including tax projections, the recognized deferred income tax assets as at December 31, 2006 amounted to PLN 3,875.

Because of the above and also due to results of final reviews of our tax returns by tax authorities actual results may differ and our estimates may be altered to reflect changes in the economic, technological and competitive environment in which the Netia Group operates. Consequently, we may need to adjust the valuation of our deferred income tax assets, which could potentially materially impact our financial position and results of operations.

(b) Impairment of investments in associates

As at December 31, 2006 the Netia Group assessed whether there are any indications that investments in associates may be impaired. The Netia Group's only investment in an associate is P4, the holder of a UMTS license. After assessing both the external and internal sources of information, the Management concluded that no such indication exists.

However, as P4 is a start-up phase enterprise, there is considerable uncertainty as to the recoverable amount of the Netia Group's investment in P4. The future success of P4's business model, based on its planned limited coverage UMTS network with national GSM coverage provided to its customers via a national roaming agreement with an incumbent GSM operator, is dependent on many factors. The overall level of competition in the market, including market prices for voice and data services, the future take-up of new mobile data services, access to sufficient distribution channels and the impact of possible mobile virtual network operators (MVNOs) that are entering the market, may all impact P4's ability to generate revenues. Observed delays in building and utilizing its own UMTS network and uncertainties over the market regulator's approach to new entrants relative to market incumbents, the rate of decrease in unit costs of UMTS handsets and market levels of handset subsidy generate uncertainties over achievable profit margins. Uncertainties as to the availability of additional sources of financing and the ability to attract the experienced employees necessary to implement P4's plans may also impact significantly on the success of P4's business. As a result of these and other uncertainties, including possible significant changes in mobile technology, the actual recoverable amount from Netia's investment in P4 may differ significantly in the future from Netia's current estimates.

(c) Impairment of goodwill and other long-lived assets

The Group tests annually whether goodwill has suffered any impairment and assesses at each balance sheet date whether there is any indication that an asset may be impaired, in accordance with the accounting policy stated in Note 3.

The total amount of goodwill is allocated to the cash-generating unit ("CGU") identified as the entire Netia Group besides the investments in P4 Sp. z o.o. and non-current assets of UNI-Net Sp. z o.o. which were excluded from the assets being tested as they represent different CGUs and no indications of impairment have been identified for them.

The recoverable amount of the cash-generating unit has been determined based on the fair value less cost to sell calculations. These calculations require the use of estimates and assumptions related to: determining cash generating units; identifying comparable transactions on the market for the purposes of fair value less cost to sell valuation; using most appropriate multiples and estimating the value of costs to sell. The key assumptions on which the Management has based its determination of fair value less costs to sell, including valuation methodologies used, can have a material impact on the fair value and ultimately the amount of any impairment. For the purposes of this valuation the Management was assisted by an internationally recognized external adviser.

The fair value determination using the market multiples method used by the Company assumed that companies with similar risk profile and development potential operating in the same industry had similar value. For the purposes of the valuation the Management with the assistance of the external adviser reviewed numerous purchase/sale transactions relating to companies in the telecommunications sector from 1 October 2005 to 31 December 2006. Based on the detailed analysis of the nature and type of activities, ten transactions were selected relating to companies with a similar risk profile which were considered as the most comparable to the Netia Group.

The Management considered that the multiple based on Enterprise Value / normalized earnings before interest, tax, depreciation and amortization ("normalized EBITDA") is the most appropriate, because normalized EBITDA is the most commonly used indicator for the performance of telecommunication companies. The multiple of an Enterprise Value / normalized EBITDA used in the fair value less cost to sell valuation amounted to 7.8. If the revised multiple decreases to 7.0, the impairment charge would be PLN 524,726. If the revised multiple increases to 9.0 the impairment charge would be PLN 90,622.

The Management also concluded that the costs of the process of potential transaction should primarily include the cost of legal and financial related services. Such costs are generally between 1 and 3 percent of the transaction value and primarily depend on a company's size. In the case of Netia, Management used 2 percent of the transaction value.

The determination of impairment of goodwill and long-lived assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in the current competitive conditions, expectations of growth in the telecommunications industry, cost of capital, technological obsolescence and other changes in circumstances that indicate an impairment exists. While the estimation of recoverable amount is based on current assessment of telecommunication market conditions and Management's best estimates and judgment, these estimates include a considerable amount of uncertainty. The actual outcome is uncertain and Management estimates may change in the future to reflect changes in the economic, technological and competitive environment, in which the Company operates.

(d) Useful lives of non-current assets

Non-current assets, consisting primarily of property, plant and epuipment and intangibles, comprise a significant portion of the Netia Group's total assets. Changes in the intended use of these assets, technological development and market conditions may cause the estimated period of use or the value of these assets to change. The Netia Group perform internal studies on an annual basis to confirm the appropriateness of its estimates of the economic useful lives for each category of current property, plant and equipment and other non-current assets. In determining the initial and remaining estimated useful life of a fixed asset, Management considers:

- the physical life of the asset;
- the technological life of the asset;
- the lives for similar productive assets; and
- the expected period that benefits will be derived from the asset.

The foregoing estimates and assumptions arę inherently uncertain and subject to change, including as a result of factors outside the Netia Group's control. If the estimated useful life is shortened, the Netia Group depreciate or amortize the remaining value of the asset over the revised remaining life of the asset. Likewise, if the anticipated technological or other changes occur morę slowly than expected, the life of the group could be extended based on the life assigned to new assets added to the group. This could result in a reduction of depreciation and amortization expense in future periods. Our estimates of useful lives affect the amount of gains or losses reported on the disposal or retirement of non-current assets.

(e) Financial guarantee

The valuation of fair value of the financial guarantee contract requires the Netia Group to make estimates about expected future cash flows, discount rates and probability of default, and hence they are subject to uncertainty.

The initial carrying amount of the financial guarantee contract would be an estimated PLN 949 lower or PLN 949 higher were the probability of default used in the discounted cash flow analysis to differ by 10% from management's estimates.

(f) Customer relationships

In July 2006 Netia Group acquired Pro Futuro (see Note 8). In the purchase price allocation process the Netia Group identified customer relationships as an intangible asset. The fair value of customer relationships was estimated using the excess earnings method. This method considers the present value of the future economic benefits that will flow to an owner of an intangible asset. This analysis requires certain assumptions including: the expected annual cash flows, the period in which the economic benefits will flow to the owner and the risk-adjusted discount rate.

6. Impairments of non-current assets

Impairment of goodwill and other long-lived assets

Under IAS 36 "Impairment of Assets" the Netia Group is obliged to assess at each balance sheet date whether there is any indication that an asset may be impaired or there is any indication that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. The Netia Group also tests annually whether goodwill recorded in the balance sheet has suffered any impairment. The goodwill recognized on the acquisition of HFC Internet Group and Pro Futuro is allocated to the cash generating unit ("CGU") identified as the entire Netia Group. If any such indication exists, the Netia Group must estimate the recoverable amount from the CGU. The recoverable amount of the CGU is determined based on higher of fair value less cost to sell ("FVLCS") and value-in-use.

As at December 31, 2006, Management has determined that indications exist that the CGU of the Netia Group may be impaired. Financial performance during 2006 has been below previously planned levels and the Netia Group has been unable to consistently record an operating profit. Faster erosion of voice tariffs and average revenues per subscriber than was previously planned, together with prospects for further significant price declines resulting from the expected impact of regulatory decisions announced during 2006 are being reflected in the Netia Group's new business plan. In addition, the amount and timing of revenues and margins previously planned to be generated from WiMAX connected customers and from cooperation with P4 are being revised in the context of regulatory changes and delays in P4's UMTS network roll-out respectively. While assessing potential indications of impairment, Management has considered the assumptions used for the new Netia Group's long term business plan to cover the period 2007-2011, which is now being completed by Management but is not yet approved by the Supervisory Board at the date of the consolidated financial statements.

The Company performed the impairment test in relation to the assets allocated to the CGU identified as the entire Netia Group besides the investments in P4 Sp. z o.o. and non-current assets of UNI-Net Sp. z o.o. Management determined that fair value less cost to sell of the Netia Group was higher than value in use of the Netia's existing business.

The FVLCS of Netia Group's CGU was determined based on the market method which used the analysis of multiples of values of the sales/purchase transactions of telecommunication companies which were considered comparable to Netia Group and took place during the last fifteen months prior to the balance sheet date. The Management used the valuation based on enterprise value to normalized EBITDA multiple as normalized EBITDA is considered to be the most commonly used performance measure in the telecommunication industry. The multiple of an Enterprise Value / normalized EBITDA used in the fair value less cost to sell valuation amounted to 7.8.

The recoverable amount of the Netia Group's CGU was based on an estimation of the FVLCS. As a result, the impairment charge amounted to PLN 354,672 and was calculated as a difference between the FVLCS and the carrying value of net assets of Netia Group's CGU. The impairment charge has been recognized in the consolidated statement of operations for the twelve-month period ended December 31, 2006 and has been allocated to the carrying amount of goodwill and then to the non-current assets of Netia Group's CGU on a pro rata basis.

The impact of the above charge on the particular groups of assets is as follows:

Goodwill	14,799
Tangible fixed assets (excluding cars)	270,638
Fixed assets under construction	22,747
Capital work in progress for software	1,472
Computer software	10,746
Customer relationship	207
Telecommunication licenses	34,063
	354,672

While the estimation of recoverable amount is based on current assessment of telecommunication market conditions and Management's best estimates and judgment, these estimates include considerable amount of uncertainty. The actual outcome is uncertain and Management estimates may change in the future to reflect changes in the economic, technological and competitive environment, in which the Company operates.

Impairments for specific individual assets

The impairment charge for specific individual assets recorded in the year ended December 31, 2006 amounting to PLN 5,163 relates mainly to telecommunication equipment and switching systems due to their replacement. The recoverable amounts of these assets are their value in use, which approximates to nil.

In addition, a plot of land owned by the Company's subsidiary Pro Futuro, was impaired to its fair value less costs to sell determined based on the valuation of the independent valuer. It resulted in an impairment provision of PLN 235.

The reversal of impairment of fixed assets under construction in the amount of PLN 359 (net of VAT) recorded in the year ended December 31, 2006, relates to those fixed assets, which the Company began to use in its operations. In addition, the impairment provision for specific individual assets (switching system) recorded in 2004 was partially reversed in the amount of PLN 2,513, due to the Management decision to continue their use in the Company's operations.

(All amounts in thousands, except as otherwise stated)

7. Property, plant and equipment

Current period:

	Buildings (PLN)	Land (PLN)	Transmission network (PLN)	Switching system (PLN)	Machinery and equipment (PLN)	Office furniture and equipment (PLN)	Vehicles (PLN)	Fixed assets under construction (PLN)	Total (PLN)
Gross book value as at December 31, 2005	73,272	17,684	1,855,368	1,488,393	82,439	138,948	17,369	72,855	3,746,328
Additions	207	-	157	1,543	614	2,151	3,175	144,618	152,465
Purchase of subsidiary	449	987	12,437	43,287	327	745	867	3,822	62,921
Transfers	386	-	24,609	52,291	2,190	5,644	44	(85,164)	-
Transfers to non-current assets held for sale	(1,079)	(1,363)	(2,464)	-	-	-	-	-	(4,906)
Disposals and other movements	(78)	-	(2,007)	(28,373)	212	(20,186)	(8,537)	(2,020)	(60,989)
Gross book value as at December 31, 2006	73,157	17,308	1,888,100	1,557,141	85,782	127,302	12,918	134,111	3,895,819
Accumulated depreciation as at December 31, 2005	17,645	-	511,946	473,690	49,268	110,087	8,420	-	1,171,056
Depreciation expense	3,087	-	76,783	123,089	5,046	10,470	2,033	-	220,508
Transfers to non-current assets held for sale	(141)	-	(583)	-	-	-	-	-	(724)
Disposals and other movements	(113)	-	(248)	(14,045)	(4,134)	(18,908)	(6,371)	-	(43,819)
Accumulated depreciation as at December 31, 2006	20,478	-	587,898	582,734	50,180	101,649	4,082	-	1,347,021
Accumulated impairment as at December 31, 2005	14,481	4,821	491,023	274,558	9,898	10,667	874	2,039	808,361
Impairment charge	2,006	431	139,556	121,931	4,031	2,671	12	22,747	293,385
Impairment charge for specific assets	50	235	1	4,861	10	-	88	153	5,398
Reversal of impairment	-	-	-	(2,513)	-	-	(15)	(359)	(2,887)
Transfers	-	-	-	-	10	18	-	(28)	-
Transfers to non-current assets held for sale	-	(379)	(501)	-	-	-	-	-	(880)
Disposals and other movements	(60)	-	(527)	(10,320)	1,131	(620)	(654)	(1,558)	(12,608)
Accumulated impairment as at December 31, 2006	16,477	5,108	629,552	388,517	15,080	12,736	305	22,994	1,090,769
Net book value as at December 31, 2005	41,146	12,863	852,399	740,145	23,273	18,194	8,075	70,816	1,766,911
Net book value as at December 31, 2006	**36,202**	**12,200**	**670,650**	**585,890**	**20,522**	**12,917**	**8,531**	**111,117**	**1,458,029**

7. Property, plant and equipment (cont'd)

Comparative period:

	Buildings (PLN)	Land (PLN)	Transmission network (PLN)	Switching system (PLN)	Machinery and equipment (PLN)	Office furniture and equipment (PLN)	Vehicles (PLN)	Fixed assets under construction (PLN)	Total (PLN)
Gross book value as at December 31, 2004	74,116	17,422	1,825,950	1,398,748	77,362	129,186	12,181	86,222	3,621,187
Additions	-	-	-	-	-	1	26	158,335	158,362
Purchase of subsidiary	40	-	-	6,499	16	163	5	1,537	8,260
Transfers	597	262	30,226	97,883	2,714	11,345	7,298	(168,207)	(17,882)
Disposals and other movements	(1,481)	-	(808)	(14,737)	2,347	(1,747)	(2,141)	(5,032)	(23,599)
Gross book value as at December 31, 2005	**73,272**	**17,684**	**1,855,368**	**1,488,393**	**82,439**	**138,948**	**17,369**	**72,855**	**3,746,328**
Accumulated depreciation as at December 31, 2004	15,006	-	437,711	378,345	43,498	97,401	8,834	-	980,795
Depreciation expense	2,998	-	75,040	101,960	5,123	13,464	1,400	-	199,985
Disposals and other movements	(359)	-	(805)	(6,615)	647	(778)	(1,814)	-	(9,724)
Accumulated depreciation as at December 31, 2005	**17,645**	**-**	**511,946**	**473,690**	**49,268**	**110,087**	**8,420**	**-**	**1,171,056**
Accumulated impairment as at December 31, 2004	14,633	4,821	490,220	283,680	9,445	11,621	1,095	7,721	823,236
Transfers	-	-	509	364	18	2	-	(952)	(59)
Disposals and other movements	(152)	-	294	(9,486)	435	(956)	(221)	(4,730)	(14,816)
Accumulated impairment as at December 31, 2005	**14,481**	**4,821**	**491,023**	**274,558**	**9,898**	**10,667**	**874**	**2,039**	**808,361**
Net book value as at December 31, 2004	44,477	12,601	898,019	736,723	24,419	20,164	2,252	78,501	1,817,156
Net book value as at December 31, 2005	41,146	12,863	852,399	740,145	23,273	18,194	8,075	70,816	1,766,911

In 2006 the Netia Group reassessed the useful lives of its fixed assets and in consequence, for certain fixed assets (narrowband radio equipment) the remaining period over which they would be depreciated was shortened until the end of 2008. Depreciation rates were changed accordingly resulting in an additional charge of PLN 7,912 recognized in the consolidated income statement during the year ended December 31, 2006. The relevant increase in the depreciation charge for the next year will amount to approximately PLN 10,518.

The transfers recorded in the year ended December 31, 2006 mainly relate to transfers from fixed assets under construction to fixed assets due to the completion of construction. Additionally, transfers between switching system and machinery and equipment were made due to reclassifications of selected computer based equipment.

In addition, during the year ended December 31, 2006 the Company reclassified certain non-current assets (land and buildings) at the total net book value of PLN 3,302, to assets held for sale (see Note 15).

Subsequent costs directly attributable to the acquisition or bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the Management amounting to PLN 11,054, and PLN 9,740 were capitalized to network under construction during the years ended December 31, 2006 and December 31, 2005, respectively.

Transmission network includes the net carrying amount of PLN 405 and PLN 460 relating to assets held under finance leases as at December 31, 2006 and December 31, 2005, respectively.

8. Acquisitions

Current period:

Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o.

On June 30, 2006 Premium Internet S.A. ("Premium Internet"), the Company's subsidiary, acquired 100% of the share capital of Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o. ("ZIT") for a total of PLN 15,541. The purchase price of ZIT's shares was ultimately set in January 2007. During the year ended December 31, 2006, the sellers received an advance payment in the total amount of PLN 5,324.

ZIT has been rendering managerial services for Premium Internet since July 2005. As the purchase price of ZIT's shares equals the amount due for those managerial services (and consequently the fair value of ZIT's net assets will equal the same amount), the Netia Group decided to reflect the economic substance of this transaction and not apply IFRS 3 "Business Combinations" for this acquisition. Therefore, during the year ended December 31, 2006 and the year ended December 31, 2005, the Netia Group recognized the cost of managerial services in the amount of PLN 10,241 and PLN 2,650, respectively and included it in "Professional services" in the consolidated income statement. The advance payment of PLN 5,324 was netted with the related accrual, which as at December 31, 2006 and December 31, 2005 amounted to PLN 10,217 and PLN 5,300, respectively.

Pro Futuro S.A.

On July 4, 2006, the Company purchased from Jupiter Narodowy Fundusz Inwestycyjny S.A. ("Jupiter") 75.87% of the share capital of Pro Futuro for a total of PLN 28,751.

On July 4, 2006, the Company purchased from Polskie Towarzystwo Ubezpieczeń S.A. ("PTU") 8.13% of the share capital of Pro Futuro for a total of PLN 3,079.

On July 5, 2006, the Company purchased from dataCOM S.A. ("dataCOM") 16.00% of the share capital of Pro Futuro for a total of PLN 6,063.

On July 5, 2006, Pro Futuro sold 456,166 (not in thousands) shares of dataCOM with a total nominal value of PLN 3,193, representing 18.6% of its share capital for a total price of PLN 2,007. The disposal of dataCOM's shares was agreed in advance and was directly related to the above transactions.

Following the above purchases of Pro Futuro's shares from Jupiter, dataCOM and PTU, Netia holds 100% of Pro Futuro's share capital and the corresponding number of votes at its shareholders' meeting.

Pro Futuro was an independent telecommunications operator providing data transmission, internet access, hosting and VoIP transmission services. It provided the services based on its own broadband telecommunications network (Infostrada Futuro) created based on modern LMDS technologies. The company provided services based on the Infostrada network in Poland's largest cities: Warsaw, Łódź, Katowice, Kraków, Kielce, Gdańsk, Gdynia, Szczecin, Wrocław, Poznań, Bielsko-Biała and Lublin.

The Netia Group accounted for the acquisition of Pro Futuro using the purchase method and started consolidating the financial statements of Pro Futuro as of July 1, 2006 adjusting the consolidated income statement and the consolidated balance sheet for material transactions, which took place between July 1, 2006 and July 4, 2006. The acquired business contributed revenue of PLN 22,433 and loss of PLN 11,243 in the six-month period ended December 31, 2006, after taking into account intercompany eliminations and impairment of goodwill. If the acquisition had occurred on January 1, 2006, the Netia Group's revenue would have amounted to PLN 885,103, and loss would have been PLN 387,187. These amounts have been calculated using the Netia Group's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment had applied from January 1, 2006, together with the consequential tax effects.

During the year ended December 31, 2006 the Netia Group performed a valuation of Pro Futuro's assets, liabilities and contingent liabilities. In particular, the Netia Group assessed fair values of identifiable assets, liabilities and contingent liabilities according to IFRS 3, including fixed asset items which have been adjusted on the basis of an independent valuation, and recorded a deferred income tax liability. Additionally, in the purchase price allocation process the Netia Group identified customer relationships as an intangible asset. The fair value of customer relationships was estimated using the excess earnings method. Further changes to the valuation may be introduced in 2007 if additional information in respect of acquired assets, liabilities and contingent liabilities is obtained. Such additional information may include information related to pre-acquisition contingencies and calculation of the related deferred income taxes. The Netia Group will continue evaluating fair values of these assets, liabilities and contingent liabilities, which may result in further adjustments to the carrying amounts of identifiable net assets.

Details of provisional fair value of net assets acquired and goodwill as at the date of the acquisition are as follows:

	(PLN)
Purchase consideration, including transaction costs of PLN 933	70,933
Sale of Pro Futuro's investment	(2,007)
Provisional fair value of net assets acquired	(67,970)
Goodwill (Note 9)	**956**

The goodwill is based on provisional fair value of net assets acquired and is attributable to the significant synergies expected to arise after the Netia Group's acquisition of Pro Futuro.

The purchase consideration made by the Company in exchange for control over the net assets of Pro Futuro encompassed: the price for 100% shares of PLN 37,893 (including a retention of PLN 2,500 to be paid in 2007 subject to all conditions being met by the seller), the amounts paid for Pro Futuro's convertible bonds issued to its previous shareholder of PLN 32,107 and transaction costs of PLN 933. The purchase consideration was decreased by PLN 2,007 received due to the disposal of Pro Futuro's investment in dataCOM shares.

The assets, liabilities and contingent liabilities recognized in the consolidated balance sheet arising from the acquisition, as at the acquisition date, are as follows:

	Acquiree's carrying amount	**Provisional fair value**
	(PLN)	**(PLN)**
Property, plant and equipment	65,189	62,921
Computer software	2,681	2,645
Customer relationships	-	18,827
Investments	2,002	-
Receivables	3,341	2,712
Prepayments	325	325
Cash and cash equivalents	638	638
Short-term loans	(2,500)	(2,500)
Trade liabilities	(4,028)	(4,026)
Other liabilities and accruals	(7,843)	(10,181)
Deferred income tax liabilities	(770)	(3,391)
Provisional net assets acquired	**59,035**	**67,970**

	(PLN)
Total purchase consideration settled in cash	(68,926)
Cash and cash equivalents in the subsidiary acquired	638
Cash outflow on acquisition	**(68,288)**

The investment in Pro Futuro shares is of a long-term nature.

<u>*Comparative period:*</u>

HFC Internet Sp. z o.o. Group

On September 30, 2005 Świat Internet S.A. ("Świat Internet"), one of the Company's subsidiaries, acquired 100% of the share capital of HFC Internet Sp. z o.o., a parent company of HFC Internet Sp. z o.o. Group ("HFC Internet Group"), a telecommunication services provider, for PLN 3,050. HFC Internet Sp. z o.o. controlled one operating subsidiary, Premium Internet S.A.

The Netia Group accounted for the acquisition of HFC Internet Group using the purchase method and started consolidating the financial statements of HFC Internet Group as of September 30, 2005. The Netia Group performed the valuation of the assets, liabilities and contingent liabilities of HFC Internet Group during the three-month period ended December 31, 2005. In particular, the Netia Group assessed fair values of identifiable assets and liabilities according to IFRS 3 and recorded a deferred income tax asset.

Details of the fair value of net assets acquired and goodwill as of the date of the acquisitions were as follows:

	(PLN)
Purchase consideration, including transaction costs of PLN 213	3,263
Negative fair value of net assets acquired	10,580
Goodwill	**13,843**

The goodwill is attributable to the significant synergies expected to arise after the Netia Group's acquisition of HFC Internet Group.

The assets, liabilities and contingent liabilities recognized in the consolidated balance sheet arising from the acquisition, as at the acquisition date, were as follows:

	Acquiree's carrying amount	Fair value
	(PLN)	(PLN)
Property, plant and equipment	7,557	8,260
Intangible assets	23	23
Deferred income tax assets	2,193	2,059
Inventories	274	274
Receivables	10,082	10,082
Prepayments	30	30
Cash and cash equivalents	8,367	8,367
Provisions	(1,071)	(1,071)
Short-term loans	(24,899)	(24,899)
Trade liabilities	(4,889)	(4,889)
Other liabilities and accruals	(8,816)	(8,816)
Negative net assets acquired	**(11,149)**	**(10,580)**

	(PLN)
Purchase consideration settled in cash	(3,263)
Cash and cash equivalents in the subsidiary acquired	8,367
Cash inflow on acquisition	**5,104**

The acquired business contributed revenue of PLN 15,946 and loss of PLN 784 in the year ended December 31, 2005, after taking into account intercompany transactions eliminations. If the acquisition had occurred on January 1, 2005, the Netia Group's telecommunication revenue would have amounted to PLN 932,849, and profit would have been PLN 60,143. These amounts have been calculated using the Netia Group's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment had applied from January 1, 2005, together with the consequential tax effects.

The investment in HFC Internet Group shares is of a long-term nature.

9. Intangible assets

Current period:

		Licences				Computer software costs			
	Goodwill (PLN)	Local telecommunication licenses / permits (PLN)	Data communications and internet licenses / permits (PLN)	Domestic long distance licenses / permits (PLN)	WiMAX licenses (PLN)	Computer software (PLN)	Capital work in progress (PLN)	Customer relationships (PLN)	Total (PLN)
Gross book value as at December 31, 2005	13,843	432,823	7,417	107,354	20,329	191,089	11,648	-	784,503
Additions	-	-	-	-	-	2,194	17,638	1,221	21,053
Purchase of subsidiary	956	-	-	-	-	2,646	-	18,827	22,429
Transfers	-	-	-	-	-	21,581	(21,581)	-	-
Disposals and other movements	-	-	-	-	-	(150)	18	-	(132)
Gross book value as at December 31, 2006	14,799	432,823	7,417	107,354	20,329	217,360	7,723	20,048	827,853
Accumulated amortization as at December 31, 2005	-	146,661	1,539	35,465	-	97,576	-	-	281,241
Amortization expense	-	17,482	-	4,967	547	27,060	-	1,901	51,957
Disposals and other movements	-	-	-	-	-	(59)	-	-	(59)
Accumulated amortization as at December 31, 2006	-	164,143	1,539	40,432	547	124,577	-	1,901	333,139
Accumulated impairment as at December 31, 2005	-	137,127	5,878	20,517	-	30,310	-	-	193,832
Impairment charge	14,799	22,661	-	7,994	3,408	10,746	1,472	207	61,287
Disposals and other movements	-	-	-	-	-	(2)	-	-	(2)
Accumulated impairment as at December 31, 2006	14,799	159,788	5,878	28,511	3,408	41,054	1,472	207	255,117
Net book value as at December 31, 2005	13,843	149,035	-	51,372	20,329	63,203	11,648	-	309,430
Net book value as at December 31, 2006	**-**	**108,892**	**-**	**38,411**	**16,374**	**51,729**	**6,251**	**17,940**	**239,597**

(All amounts in thousands, except as otherwise stated)

9. Intangible assets (cont'd)

Comparative period:

		Licences				Computer software costs		
	Goodwill (PLN)	Local telecommunication licenses / permits (PLN)	Data communications and internet licenses / permits (PLN)	Domestic long distance licenses / permits (PLN)	WiMAX licenses (PLN)	Computer software (PLN)	Capital work in progress (PLN)	Total (PLN)
Gross book value as at December 31, 2004	-	432,823	7,417	107,354	-	200,410	15,128	763,132
Additions	-	-	-	-	20,329	-	14	20,343
Purchase of subsidiary	13,843	-	-	-	-	23	-	13,866
Transfers	-	-	-	-	-	22,291	(4,409)	17,882
Disposals and other movements	-	-	-	-	-	(31,635)	915	(30,720)
Gross book value as at December 31, 2005	13,843	432,823	7,417	107,354	20,329	191,089	11,648	784,503
Accumulated amortization as at December 31, 2004	-	129,237	1,539	30,513	-	96,568	-	257,857
Amortization expense	-	17,424	-	4,952	-	26,096	-	48,472
Disposals and other movements	-	-	-	-	-	(25,088)	-	(25,088)
Accumulated amortization as at December 31, 2005	-	146,661	1,539	35,465	-	97,576	-	281,241
Accumulated impairment as at December 31, 2004	-	137,127	5,878	20,517	-	34,280	-	197,802
Transfers	-	-	-	-	-	59	-	59
Disposals and other movements	-	-	-	-	-	(4,029)	-	(4,029)
Accumulated impairment as at December 31, 2005	-	137,127	5,878	20,517	-	30,310	-	193,832
Net book value as at December 31, 2004	-	166,459	-	56,324	-	69,562	15,128	307,473
Net book value as at December 31, 2005	**13,843**	**149,035**	**-**	**51,372**	**20,329**	**63,203**	**11,648**	**309,430**

Telecommunication licenses / permits

Prior to the completion of the legal merger of the Company with its operating subsidiaries on December 31, 2003 its subsidiaries held fixed term permits for the operation of local telecommunication networks on a non-exclusive basis in specified areas throughout Poland. Those permits were obtained through their conversion from telecommunication licenses issued under the regulations of the previous Telecommunication Act. The conversion took place by virtue of the 2001 Act on January 1, 2001. Licenses for telecommunications services in Poland were issued for 15-year periods. The remaining amortization period of the permit ranges between 6 and 9 years.

Domestic long distance licenses / permits

In May 2000, one of the operating subsidiaries currently legally merged into Netia, was granted a domestic long distance license. The license, currently converted into a permit, covers the entire territory of Poland and enables the Company to provide inter-city telecommunication services. The remaining amortization period of the permit is 9 years.

Data communications and internet licenses / permits

In April 1999, one of the operating subsidiaries currently merged into Netia, obtained a data communications license covering the entire territory of Poland. This license was fully impaired in 2003.

WiMAX licenses

On October 27, 2005 the Company's subsidiaries, Netia WiMax (merged with Netia in July 2006) and Netia WiMax II (currently Netia WiMax), received the reservation of the 3.6-3.8 GHz frequencies, which will be used to provide telecommunication services based on the WiMAX technology. The license covers the entire territory of Poland and is valid for 15 years. The remaining amortization period of the permit is 14 years.

10. License fee liabilities

El-Net, the subsidiary acquired in 2004 and merged with Netia in July 2006, obtained licenses from the Ministry of Communications for the provision of local telephone services in areas including Warsaw, Bydgoszcz and smaller cities in the northern part of Poland. As of January 1, 2001, pursuant to the 2000 Act, all telephone licenses were converted by virtue of law into telecommunication permits. At that date the total nominal value of outstanding license fee obligations of El-Net was EUR 104,624 (PLN 400,835 at the exchange rate prevailing on December 31, 2006) increased by prolongation fees of PLN 37,733.

On December 30, 2002, El-Net submitted applications for cancellation of certain outstanding local license fee obligations in accordance with the applicable law enacted in 2002. Following its purchase by the Netia Group, El-Net filed an amendment to the previous application asking for cancellation of license fee obligations of EUR 75,690 (PLN 289,983 at the exchange rate prevailing on December 31, 2006) and related prolongation fees of PLN 37,733, based on capital expenditure incurred between 2001 and 2003 as well as future capital expenditure to be incurred until the end of 2006 within the Netia Group. On August 16, 2004 El-Net received a decision of the Minister of Infrastructure dated July 12, 2004 granting the promise to cancel the outstanding license fees obligations, amounting to EUR 75,690 and prolongation fees amounting to PLN 37,733. The above cancellation shall occur upon the verification of capital expenditure incurred in accordance with the applicable law. The Minister of Infrastructure also decided that this cancellation could apply to El-Net's capital expenditure incurred from January 1, 2001 until December 30, 2006, upon the assumption that capital expenditure already incurred by El-Net in 2001-2003 amounted to PLN 85,459. Pursuant to this decision all license fee payments and prolongation fees subject to the decision have been deferred until December 30, 2006.

On October 29, 2004, El-Net filed an application for cancellation of the remaining license fee installments payable in 2010 and 2011 amounting to a nominal value of EUR 28,934 (PLN 110,852 at the exchange rate prevailing on December 31, 2006). El-Net declared that it would cover these obligations by capital expenditure to be incurred in 2007-2008. On April 3, 2006 El-Net, received a decision of the Minister of Transport and Construction (a successor of the Minister of Infrastructure), dated March 28, 2006, granting the promise to cancel these obligations.

On March 22, 2006, El-Net received the decision of the Polish Minister of Transportation and Construction, dated March 21, 2006, canceling part of outstanding local license fee obligations and the prolongation fees owed in connection with the prior deferrals of the license fee installments, in exchange for El-Net's expenditure on telecommunications infrastructure incurred in years 2001, 2002 and 2003. The total nominal value of the local license fees cancelled was EUR 20,940 (PLN 81,597 at the exchange rate prevailing on March 21, 2006) and the total nominal value of prolongation fees cancelled was PLN 8,566.

On June 27, 2006, El-Net received the decision of the Polish Minister of Transportation, dated June 26, 2006, canceling part of outstanding local license fee obligations along with the prolongation fees owed in connection with prior deferrals of the license fee installments, in exchange for El-Net's expenditure on telecommunications infrastructure incurred in years 2004 and 2005. The total nominal value of the local license fees cancelled was EUR 9,174 (PLN 37,675 at the exchange rate prevailing on June 26, 2006) and the total nominal value of prolongation fees cancelled was PLN 3,561.

On September 20, 2006 the Company received the decisions of the Minister of Transportation, dated September 14, 2006, amending the previous decisions of the Minister of Infrastructure, dated July 12, 2004, and the Minister of Transportation and Construction, dated March 28, 2006, with regard to the deferral and promise to cancel the license fee obligations of El-Net, which merged with Netia on July 31, 2006 (see Note 1). The amendments to the above mentioned decisions followed Netia's motion and enabled the restructuring of license fee obligations based on capital investments incurred by Netia from January 1, 2003 to July 31, 2006.

On December 18, 2006 the Company received the decisions of the Minister of Transport, dated December 14, 2006, with regard to the cancellation of all outstanding license fee obligations, as well as the prolongation fees owed in connection with the prior deferrals of the license fee installments, in exchange for investments in telecommunications infrastructure made by the Company from January 1, 2003 to July 31, 2006. The nominal value of license fee obligations and prolongation fees cancelled based on the above decisions amounts to EUR 74,509 (PLN 283,239 at the exchange rate prevailing on December 14, 2006) and PLN 25,606, respectively.

The receipt of the above decisions completes the process of El-Net's license fee liabilities' restructuring. The total nominal value of license fee obligations and prolongation fees cancelled under this process amounted to EUR 104,624 and PLN 37,733, respectively.

Until the cancellation of all licence fee obligations the outstanding liabilities were recorded at amortized cost. At the acquisition of El-Net they were recorded at fair value based on the assessment performed in 2004 by the Management, which took into account the probability of future payments of license fee liabilities. During 2006 the Management, having analysed the progress of the cancellation process of the remaining liabilities, updated its assessment. Pursuant to the decisions obtained in March and June 2006, regarding cancellation of part of outstanding local license fee obligations and the prolongation fees in exchange for expenditure on the telecommunications infrastructure incurred in years 2001 – 2005 Management estimated that there was an 80% probability of cancellation in relation to the remaining licence fee liabilities and prolongation fees. In June 2006 the relevant adjustment was recorded as a gain in the income statement amounting to PLN 10,437. In addition, pursuant to the decisions obtained in September 2006, enabling conducting the restructuring of license fee obligations based on the capital investments incurred by Netia, the Management has changed its estimation and increased the probability of cancellation of the remaining licence fee liabilities and prolongation fees, up to 95%. This resulted in further reduction in license liabilities of PLN 40,713, and was accordingly recorded as a gain in the income statement. Upon receiving in December 2006 final decisions canceling all outstanding local license fee obligations along with the prolongation fees, the remaining liability of PLN 13,319 was reduced to nil and accordingly recorded as a gain in the income statement. Further changes in the value of licence fee liabilities as compared to December 31, 2005 relate to interest accrued and foreign exchange differences as presented below:

	(PLN)
Carrying value as at December 31, 2005	**57,413**
Interest accrued in the year 2006	5,247
Foreign exchange losses on the translation of EUR balances	1,809
Reassessment of the carrying value of license fee liabilities	(51,150)
Cancellation of the outstanding license fee liabilities	(13,319)
Carrying value as at December 31, 2006	**-**

11. Investments in associates

P4

As of December 31, 2006, the Netia Group had a 30% interest in P4 (until August 23, 2005 the Company's subsidiary), which was announced as the winner of the mobile telephony UMTS frequency tender in May 2005 (see also Note 43).

The following table summarizes financial information of the associate:

	December 31, 2005	December 31, 2006
	(PLN)	(PLN)
Assets	354,337	567,652
Liabilities	5,618	131,342

	Year ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
Revenue	-	17
Loss for the period	(10,326)	(102.412)

The following table summarizes changes in the investment in the associate (since the Netia Group started accounting for the investment in P4 using the equity method):

	Four-month period ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
At the beginning of the period	-	105,633
Investment in the associate	108,706	57,000
Unrealized profits on transaction with associate (see Note 12)	-	(8)
Financial guarantee contract (see Note 23)	-	9,493
Share of loss	(3,073)	(30,724)
At the end of the period	**105,633**	**141,394**

Following the provisions of P4's Shareholders' Agreement (see Note 41), during the year ended December 31, 2006 the Company and Novator Telecom Poland S.a.r.l. ("Novator") contributed share capital of PLN 57,000 and PLN 133,000, respectively. As a result, the Company is the holder of 10,830 (not in thousands) P4's shares constituting 30% of the shares in P4's share capital. Novator is the holder of 25,270 (not in thousands) P4's shares constituting 70% of the shares in P4's share capital.

P4 is not listed on any public stock exchange market and therefore there is no published quotation price for the fair value of this investment.

The distribution of P4's dividend may occure when certain conditions specified in the facility agreement (described in Note 42) are met.

12. Sale of investments

On March 30, 2006 Netia transferred to P4 ownership of 100 (not in thousands) shares of Netia Ventures Sp. z o.o. (currently operating under the name "3G Network Services Sp. z o.o.", "3GNS"), with a total nominal value of PLN 50, representing 100% of its share capital, for a total price of PLN 75 paid in cash. The profit on the disposal of 3GNS' shares, recognized in the consolidated financial statements, amounted to PLN 20. The unrealized profits on this transaction amounted to PLN 8.

Details of the cash and cash equivalents, assets and liabilities disposed of, were as follows:

	(PLN)
Receivables	2
Cash and cash equivalents	50
Trade liabilities	(5)
	47

On December 21, 2006 Netia's subsidiary Pro Futuro SA transferred ownership of 1,600 (not in thousands) shares of BiznesPartner.pl SA, with total nominal value of PLN 1,600, representing 30.77% of its share capital. The fair value of this investment was nil and it was sold for the total price of PLN 160 (not in thousands).

13. Inventories

	December 31, 2005	December 31, 2006
	(PLN)	(PLN)
Materials	1,752	1,053
Less provision for impairment charge	(1,075)	(865)
Materials, net	677	188
Goods for resale	1,750	1,572
Less provision for impairment charge	(165)	(176)
Goods for resale, net	1,585	1,396
Inventories, net	**2,262**	**1,584**

During the years ended December 31, 2006 and 2005 the Netia Group recognized PLN 4,868 and PLN 4,049, respectively as the cost of inventories included in "cost of goods sold". Moreover, the amount of PLN 210 of a previous inventory provision was utilized in 2006.

14. Trade and other receivables

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Trade receivables	227,639	163,639
Less provision for impairment of trade receivables	(82,582)	(68,597)
Trade receivables, net	145,057	95,042
Trade receivables from an associate	2,051	1,658
VAT and other government receivables	7,226	12,152
Other receivables	3,260	23,311
Less provision for impairment of other receivables	(670)	(608)
Other receivables, net	2,590	22,703
Loans*	13,070	13,421
Accrued interest *	42,909	51,267
Less provision for impairment of loans and accrued interest*	(55,979)	(63,926)
Loans, net	-	762
	156,924	**132,317**
Of which,		
Current	156,924	131,833
Non-current	-	484

* Loans include a short term loan of PLN 11,500 granted to Millennium Communications S.A. (described in Note 42). As at December 31, 2006 and 2005 an interest accrued on that loan amounted to PLN 51,214 and PLN 42,888, respectively. The loan and accrued interest were fully provided for.

The carrying amount of non-current receivables approximates their fair value.

The provision for impairment of the Netia Group's receivables recognized during the year ended December 31, 2006 and 2005 amounted to PLN 7,662 and PLN 17,514, respectively and was included in "other expenses" in the consolidated income statement.

15. Non-current assets classified as held for sale

	Year ended December 31, 2006 (PLN)
At the beginning of the period	-
Net book value of reclassified land	984
Net book value of reclassified buildings	2,318
Impairment charge (buildings)	(973)
At the end of the period	**2,329**

Due to the Management decision relating to the disposal of certain non-current assets (land and buildings), as at March 31, 2006, the Netia Group reclassified those assets to non-current assets held for sale.

An active program to locate potential buyers was initiated in the first quarter of 2006 and in most cases the interested parties have been found and negotiations are in progress. Sales transactions are expected to be completed within 12 months from the date of the reclassification.

16. Derivative financial instruments

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Forward currency contracts (cash flow hedges) - asset	-	600
	-	**600**

In December 2006 the Netia Group entered into several forward currency contracts designated as hedges of expected future contributions to P4's capital (see Note 41). The notional principal amount of the outstanding forward currency contracts at December 31, 2006 was EUR 22,700. The transactions mature within one year.

As at December 31, 2006, the cash flow hedges were assessed to be effective and an urealised gain of PLN 486, net of tax, was included in hedging reserve in in equity.

17. Financial assets at fair value through profit and loss

	December 31, 2005	December 31, 2006
	(PLN)	(PLN)
Financial assets at fair value through profit and loss..	63,059	14,757
	63,059	**14,757**

The above financial assets are classified as at fair value through profit or loss on initial recognition.

Financial assets designated as at fair value through profit or loss at inception are those that are managed and whose performance is evaluated on a fair value basis, in accordance with a documented investment strategy of the Netia Group. The Netia Group's investment strategy is to invest in money market investment funds, which invest in various short term, low risk debt instruments.

Changes in fair values of financial assets at fair value through profit and loss are recorded in "Finance income" in the income statement (Note 34).

18. Restricted cash

During the year ended December 31, 2006 the Netia Group established an escrow account in the amount of PLN 3,600 to secure contractual obligations in favor of another telecommunication operator. The agreement was concluded for an undefined period of time. Funds deposited on the escrow account were released in February 2007.

Furthermore, to secure the payment obligations arising pursuant to the provisions of the agreement relating to the acquisition of Pro Futuro (see Note 8), on May 19, 2006 the Company established an escrow account in the amount of PLN 60,967. During the year, payments of PLN 58,467 in total were made from this account. The escrow account will be closed in 2007, when the retention of PLN 2,500 (subject to all conditions being met by the seller) will be paid.

19. Cash and cash equivalents

	December 31, 2005	December 31, 2006
	(PLN)	(PLN)
Cash at bank and in hand..	120,146	143,586
Financial assets at fair value through profit and loss..	77,241	-
	197,387	**143,586**

The financial assets at fair value through profit or loss consisted of funds deposited in treasury bills.

The effective interest rate on short-term bank deposits was 3.78% and 4.85%, respectively for the years ended December 31, 2006 and 2005. The effective interest rate of treasury bills was 4.06% for the year 2005.

As at December 31, 2006 and 2005 the amounts of PLN 1,349 and PLN 1,581, respectively were restricted as they were placed as collateral securing payments to vendors. In addition as at December 31, 2005 the amount of PLN 276 was legally reserved for spending on social purposes.

20. Shareholders' equity

Shareholders' Rights (number of shares not in thousands)

At December 31, 2005, the Company's share capital consisted of 408,613,873 ordinary shares and of 1,000 series A1 shares with a par value of PLN 1 per share. Each ordinary share had one vote at shareholders' meetings. The holder of 1,000 series A1 shares had the right to nominate one member of the Supervisory Board. The majority of votes of the Supervisory Board elect the Management Board.

In May 2003, the Company issued 64,848,442 warrants to the pre-restructuring shareholders of the Company. On April 29, 2005, and April 29, 2006 1,361,947 two-year subscription warrants and 1,022,433 three-year subscription warrants, respectively, expired. In the year ended December 31, 2006 7,662,385 of the warrants were exercised and the Company's share capital was accordingly increased by 7,662,385 series J shares. The issue price was PLN 2.53 (not in thousands) per share. From the issuance date of warrants until their expiration dates, the total number of series J shares issued at the exercise of warrants was 62,464,062.

The Company also may issue up to 18,373,785 ordinary series K shares under a key employee share option plan (employee share option scheme) adopted by Netia's Supervisory Board in 2002 (the "Plan"). In the year ended December 31, 2006 the Company issued 1,052,691 ordinary series K shares due to the exercise by certain persons of their rights arising from the Plan. The total number of series K shares issued through December 31, 2006 was 4,945,065 and their nominal value was PLN 4,945.

In accordance with resolutions of the Company's General Shareholders' meeting (the "Shareholders Meeting") held on March 29, 2006 the Netia Group has redeemed 28,162,110 own treasury shares. The redemption was effective as of the day of the registration of the share capital decrease, i.e. as of April 19, 2006.

As a result, at December 31, 2006 the Company's share capital consisted of 389,166,839 ordinary shares and of 1,000 series A1 shares (par value of PLN 1 per share). All shares issued by the Company were fully paid and registered in the National Court Registry by the date of signing these consolidated financial statements.

Share Capital

	Number of shares authorized and issued (not in thousands)	Share capital (PLN)
At January 1, 2005	**366,956,325**	**366,956**
Exchange of warrants for series J shares	32,661,575	32,662
Issuance of series K shares	3,121,363	3,121
Issuance of series I shares	5,875,610	5,876
At December 31, 2005	**408,614,873**	**408,615**
Exchange of warrants for series J shares	7,662,385	7,662
Issuance of series K shares	1,052,691	1,053
Redemption of shares	(28,162,110)	(28,162)
At December 31, 2006	**389,167,839**	**389,168**

According to the information provided to the Company by its shareholders, as at December 31, 2006 the following shareholders held more than 5% of the votes in the General Shareholders Meeting:

	Number of shares (not in thousands)	% of share capital
Novator Telecom Poland II S.a.r.l.	98,243,602	25.24
SISU Capital Limited and related entities	23,743,225	6.10
Third Avenue Management LLC	63,770,278	16.39
Shares held by public and other shareholders	203,410,734	52.27
	389,167,839	**100.00**

Distributable reserves

In accordance with the Polish Code of Commercial Companies of 15 September 2000 (Journal of Laws of 2000, No. 94, item 1037 as amended) only those reserves, which relate to net profits of individual companies shown in their statutory financial statements, are available for distribution to shareholders. Due to Netia S.A.'s loss for the year 2006 of PLN 279,037, exceeding other supplementary capital of PLN 143,218 and the surplus relating to the merger of Netia S.A with its operating subsidiaries of PLN 82,697, the distributable reserve, as at December 31, 2006, amounted to PLN nil.

Other supplementary capital

As at December 31, 2005 other supplementary capital amounted to PLN 285,505. The Shareholders' Meeting held on March 29, 2006, resolved to transfer from other supplementary capital the amount of PLN 42,605 to cover the accumulated deficit of Netia S.A., which resulted from the adoption of IFRS as adopted by the EU, as of January 1, 2005. Furthermore, the Shareholders' Meeting resolved to distribute the net profit of Netia S.A. for the year ended December 31, 2005 amounting to PLN 73,447 as follows: transfer the amount of PLN 2,812 to the Company's special reserve capital (in connection with the purchase of own shares series C and E), approved the dividend of PLN 0.13 (not in thousands) per share and transfer the remaining 2005 profit, in the amount of PLN 20,312, to other supplementary capital. Additionally, in relation to the Shareholders Meeting's resolution regarding the decrease of share capital, the Company deducted from other supplementary capital the amount of PLN 120,463, representing the consideration paid for shares redeemed within the buy-back program and the nominal value of redeemed shares, which were issued by the Company for the purpose of the previous stock option plan.

Other reserves

	Employee share option scheme (PLN)	Separate reserve capital* (PLN)	Hedging reserve (PLN)	Total (PLN)
Balance as at January 1, 2005	**1,892**	-	-	**1,892**
Employee share option scheme:				
- value of services provided	904	-	-	904
- issuance of series K shares	(1,038)	-	-	(1,038)
Balance as at December 31, 2005	**1,758**	**-**	**-**	**1,758**
Employee share option scheme:				
- value of services provided	721	-	-	721
- issuance of series K shares	(1,483)	-	-	(1,483)
Appropriation of Netia's 2005 net profit:				
- transfer to reserve capital	-	2,812	-	2,812
Transfer related to repurchase of series C and E shares	-	(2,812)	-	(2,812)
Decrease of share capital	-	28,162	-	28,162
Cash flow hedges:				
- fair value gains, net of tax (see Note 16)	-	-	486	486
Balance as at December 31, 2006	**996**	**28,162**	**486**	**29,644**

* Pursuant to the resolution of the Shareholders' Meeting held on March 29, 2006 and in relation to the decrease of share capital, the Company has established "Separate reserve capital" and presented it within "Other reserves". This reserve capital does not constitute a distributable reserve, but may be used to cover future losses.

Stock options (number of options not in thousands)

In the year ended December 31, 2006 the following changes took place in the number of options granted under the Plan:

Options	**Year ended December 31, 2005** Average strike price	Options	**Year ended December 31, 2006** Average strike price	Options
At the beginning of the period	2.65	7,206,097	3.06	2,776,650
Granted	3.56	2,698,125	4.92	975,687
Forfeited	3.77	(1,389,272)	-	-
Exercised	2.60	(5,738,300)	2.59	(1,817,188)
At the end of the period	**3.06**	**2,776,650**	**4.44**	**1,935,149**

As at December 31, 2006 the total number of options approved for issue by the Supervisory Board was 15,271,220 as compared to 14,023,719 as at December 31, 2005. Out of these approved options 2,206,963 options were outstanding as at December 31, 2006 and 2,776,650 options were outstanding as as at December 31, 2005. As at December 31, 2006 and 2005, the total number of vested options was 687,648 and 1,817,188, respectively. The vesting period for the options is up to three years from the date of grant. As at December 31, 2006, the weighted average remaining contractual life of the outstanding options was 3 years. The options are exercisable until December 20, 2007 or December 20, 2012 (due to the change of Netia's statute in relation to the extention of the period during which series K shares may be offered to members of the Management Board and key employees to execute their rights resulting from the Plan, the Supervisory Board extended the period when options may be exercised). If an option holder ceases to be employed during the exercise period, options may be exercised only if they are granted and vested on the date of termination or expiration of the engagement with the Netia Group. If any of such engagements terminate during the course of any calendar year, the relevant proportion of the options which have not been vested, shall vest at the end of that calendar year. Upon exercise of the options, Netia will issue to each exercising participant the number of shares representing such participant's gain resulting from the exercise of the options, representing the difference between the exercise price of the Company's shares and strike price of the options. The participant will not be required to pay the strike price ranging from PLN 3.12 to PLN 5.30.

Due to the exercise of 1,817,188 options, in the year ended December 31, 2006, the Company issued 1,052,691 series K shares, at the nominal value of PLN 1 each. The share price at the date of exercise was PLN 6.15 per share.

The Company recognizes the cost of share-based awards to employees (including share options) over the vesting period and the fair value of options is determined using a binomial pricing model. The valuation model takes into account such factors as strike price (presented above), total expected life of the options (2 - 7 years), time to vest, expected volatility of the share price returns (21.32% - 54.98%), employee exit rate (5%), exercise multiple (1.5) and the risk free interest rate at the date of the grant (ranging from 4.13% to 6.83%). The expected volatility is based on historical volatility. The cost of options recorded in the years ended December 31, 2006 and 2005 amounted to PLN 721 and PLN 904, respectively.

21. Minority interest

	Year ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
At the beginning of the period	5,186	6,349
Share of net profit of subsidiaries	1,163	553
At the end of the period	**6,349**	**6,902**

22. Provisions

	December 31, 2005	December 31, 2006
	(PLN)	(PLN)
Loss on rental contract	2,564	1,099
Claims and tax assessments	1,636	3,189
Restructuring	-	508
	4,200	**4,796**
Of which,		
Current	2,969	4,166
Non-current	1,231	630
	4,200	**4,796**

	Loss on rental contracts	Claims and tax assessments	Restructuring	Total
	(PLN)	(PLN)	(PLN)	(PLN)
As at January 1, 2006	2,564	1,636	-	4,200
Reclassification	-	1,714	-	1,714
Charged to the income statement	-	133	1,377	1,510
Used during the period	(1,589)	(294)	(869)	(2,752)
Discount unwinding (charged to the income statement)	124	-	-	124
As at December 31, 2006	**1,099**	**3,189**	**508**	**4,796**

Loss on rental contracts

The provision was created for loss on rental contracts and relates to the excess of office space held in certain locations in Warsaw (rented by the Netia Group in connection with the acquisition of Świat Internet and El-Net) which have been sub-leased at a loss to the Netia Group. The loss on rental contracts is calculated as discounted committed rental costs less discounted revenues expected to be received from sub-contractors. The Netia Group expects that the cash outflows relating to this provision will be incurred through 2009.

Claims and tax assessments

The amounts represent a provision for a contractual penalty due to delays in the performance of a contract and a provision for a potential income tax liability of Premium Internet S.A. acquired in September 2005. In the opinion of the Management the outcome of the outstanding provisions will not give rise to any significant losses beyond the amounts provided. The Netia Group is unable to determine the timing of cash outflows related to the tax liability with reasonable accuracy.

Restructuring

As at December 31, 2006, the provision amounted to PLN 508 and was recorded in connection with the restructuring of headcount of Pro Futuro acquired in July 2006. The provision was created for those committed redundancies where the employment contract has not been yet terminated. The Netia Group expects that the cash outflows relating to this provision will be incurred through 2007.

23. Financial guarantee contract

On October 31, 2006 the Company concluded a number of agreements partially securing the repayment of the credit facility of EUR 150,000 granted to P4 by China Development Bank (see Note 42). Under the Guarantee and Share Retention Agreement, Netia provided a guarantee to a maximum amount of EUR 27,000. The guarantee covers the repayment of 30% of the outstanding amounts under one of the tranches of the credit facility (limited to a total of EUR 75,000) to be applied towards the acquisition of transmitter and core network construction sites, and the costs of related civil works investments in P4's UMTS network, increased by interest and costs (with a cap at EUR 90,000). The amount of guarantee will be reduced gradually as the network assets are put into commercial service.

The guarantee was measured initially at fair value. As the guarantee was issued without a premium, the fair value was estimated using a probability-adjusted discounted cash flow analysis. The probability of default by P4 (at 30.95%) was based on default rates amongst companies with a similar credit rating to that, which might be granted to P4, had P4 requested such a credit rating. The discount rate (of 10%) was based on the estimated risk adjusted cost of capital. The time horizon used in this analysis is directly related to the planned network build out (with the result that the guarantee is assumed to expire in 2008).

Changes in the value of the financial guarantee contract during the year ended December 31, 2006 are presented below:

	(PLN)
Initial fair value	9,493
Amortization (credited to other income)	(88)
Carrying value at December 31, 2006	**9,405**
Of which,	
Current	8,847
Non-current	558

Fair value of the financial guarantee contract as at December 31, 2006 amounted to PLN 9,457.

24. Undrawn borrowing facilities

On November 6, 2006, Netia entered into two one-year financing agreements with Bank Handlowy w Warszawie SA. Netia has secured an overdraft facility in the amount of PLN 40,000 and a term loan facility of PLN 160,000. On December 29, 2006 the PLN 160,000 loan facility was reduced to PLN 60,000. During the year ended December 31, 2006 there were no draw downs under these facilities.

25. Trade and other payables

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Trade payables	56,662	56,030
Investment payables	74,477	62,128
Accrued expenses (see Note 26)	49,728	41,489
VAT and other taxes	10,408	4,445
Retirement severance payments	-	530
Other payables	3,423	4,419
	194,698	**169,041**
Of which,		
Current	193,957	168,267
Non-current	741	774

Retirement severance payments

The provision for retirement severance payments was calculated by an independent actuary as at December 31, 2006, using the projected unit credit method. It represents the present value of the future obligation of the Company to make severance payments on its employee's retirement, required by the Polish Labour Code. A valuation was performed using a discount rate of 5% and a salary increase rate of 2%. Retirement severance payments will be paid on the Netia Group's employees' retirement.

26. Accrued expenses

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Construction costs	4,625	7,636
Uninvoiced services	11,968	14,263
Interconnection charges	12,674	942
Holidays accrual	4,780	4,003
Employees bonuses and accrued salaries	12,872	10,309
Other	2,809	4,336
	49,728	**41,489**

27. Corporate income tax

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Current income tax	(574)	(420)
Deferred income tax benefit / (charge), net	(34,720)	(6,802)
Income tax benefit / (charge)	**(35,294)**	**(7,222)**

Current income tax

The tax on the Netia Group's profit before tax differs from the theoretical amount that would arise using the tax rate applicable to profits of the consolidated companies as follows:

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Profit / (loss) before tax	95,484	(371,133)
Tax calculated at tax rates applicable to profit	(18,142)	70,515
Income not subject to tax	4,669	12,915
Expenses not deductible for tax purposes	(17,871)	(30,547)
Expenses deductible for tax purposes in previous periods	-	(739)
Deductible temporary differences arising during the year for which no deferred tax asset were recognized	-	(55,239)
Utilization of previously unrecognized tax losses	24,879	1,771
Tax losses for which no deferred income tax asset was recognized	(4,334)	(4,893)
Reassessment of tax bases of assets and liabilities	(28,009)	879
Recognition of previously unrecognized deferred income tax asset	3,514	418
Derecognition of previously recognized tax asset	-	(2,302)
Income tax benefit / (charge)	**(35,294)**	**(7,222)**

The corporate income tax rate applicable to the Company and its subsidiaries for 2005 and onwards is 19%.

The main titles of income not subject to tax and expenses not deductible for tax purposes are share of losses of an associate, amortization of license assets and interest and foreign exchange differences related to license fee liabilities.

Deferred income tax

The deferred income tax calculation is based upon the probability that future taxable profit will be available against which temporary differences, the unused tax losses and unused tax credits can be utilized. That calculation is based upon Management's estimates, which contain a considerable amount of uncertainty and the actual outcome may differ. These estimates may be altered to reflect changes in the economic, technological and competitive environment in which the Netia Group operates.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Deferred income tax assets:		
- Deferred income tax assets to be recovered after more than 12 months	20,098	6,606
- Deferred income tax assets to be recovered within 12 months	19,453	10,716
	39,551	17,322
Deferred income tax liabilities:		
- Deferred income tax liabilities to be recovered after more than 12 months	5,478	2,637
- Deferred income tax liabilities to be recovered within 12 months	19,891	10,810
	25,369	13,447
Deferred income tax assets, net	**14,182**	**3,875**
out of which:		
Deferred income tax assets	14,182	4,865
Deferred income tax liabilities	-	(990)

The movement in deferred income tax assets and liabilities during the period, without taking into consideration the offsetting of balances, is as follows:

Current period:

Deferred income tax liabilities	**Deferred revenue**	**Interest income and foreign exchange differences**	**Depreciation and impairment**	**Other receivables**	**Other**	**Total**
As at January 1, 2006	15,472	2,439	7,324	-	134	25,369
- Charged / (credited) to the income statement	(9,583)	(2,312)	(7,898)	3,781	(134)	(16,146)
- Deferred income tax on acquisition	-	-	4,110	-	-	4,110
- Credited / (charged) to the equity	-	-	-	-	114	114
As at December 31, 2006	**5,889**	**127**	**3,536**	**3,781**	**114**	**13,447**

Deferred income tax assets	**Depreciation and impairment**	**Impairment provisions for receivables**	**Tax losses**	**Accrued expenses**	**Other**	**Total**
As at January 1, 2006	14,323	7,576	11,011	6,036	605	39,551
- Credited / (charged) to the income statement	(11,264)	(2,982)	(6,902)	(2,098)	298	(22,948)
- Deferred income tax on acquisition	-	113	-	544	62	719
As at December 31, 2006	**3,059**	**4,707**	**4,109**	**4,482**	**965**	**17,322**

Comparative period:

Deferred income tax liabilities	**Deferred revenue**	**Interest income and foreign exchange differences**	**Depreciation and impairment**	**Other**	**Total**
As at January 1, 2005	12,655	2,919	8,319	-	23,893
- Charged / (credited) to the income statement	2,389	(410)	(995)	-	984
- Deferred income tax on acquisition	428	(70)	-	134	492
As at December 31, 2005	**15,472**	**2,439**	**7,324**	**134**	**25,369**

Deferred income tax assets	**Depreciation and impairment**	**Impairment provisions for receivables**	**Tax losses**	**Accrued expenses**	**Other**	**Total**
As at January 1, 2005	41,879	10,184	5,044	11,486	2,143	70,736
- Credited / (charged) to the income statement	(27,556)	(2,724)	3,514	(5,485)	(1,485)	(33,736)
- Deferred income tax on acquisition	-	116	2,453	35	(53)	2,551
As at December 31, 2005	**14,323**	**7,576**	**11,011**	**6,036**	**605**	**39,551**

The deferred income tax charged to equity regards movements in hedging reserve.

Deferred income tax assets are recognized for deductible temporary differences and tax loss carry-forwards to the extent that the realization of the related tax benefit through the future taxable profits is probable. As of December 31, 2006, the Netia Group had total deductible temporary differences of PLN 760,202 and unutilised tax loss carry-forwards of PLN 246,270 (total potential deferred income tax asset of PLN 191,229).

The Netia Group did not recognize deferred income tax assets of PLN 42,682 relating to tax losses of PLN 224,645 of Netia and the Company's subsidiaries, due to the likelihood of insufficient future taxable profits to realize these tax losses. These unrecognized tax losses of the Netia Group available for use as at December 31, 2006 will expire in the following years: PLN 109,802 in 2007, PLN 38,402 in 2008, PLN 36,563 in 2009, PLN 35,024 in 2010, and PLN 4,853 in 2011. Furthermore, due to the lack of conclusive evidence of future taxable profits, the Netia Group did not recognize deferred income tax assets of PLN 144,672, relating to deductible temporary differences of PLN 761,435.

The Polish tax system has restrictive provisions for grouping of tax losses for multiple legal entities under common control, such as those of the Netia Group. Thus, each of the Company's subsidiaries may only utilize its own tax losses to offset taxable income in subsequent years. Losses are not indexed to inflation. Tax losses are permitted to be utilized over five years with a 50% utilization restriction per annum.

28. Telecommunication revenue

	Year ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
Direct voice services	485,482	411,986
Monthly fees	142,824	133,954
Calling charges	342,658	278,032
Local calls	*108,548*	*80,760*
Domestic long distance calls	*65,658*	*49,121*
International long distance calls	*34,693*	*28,373*
Fixed-to-mobile	*114,692*	*105,337*
Other	*19,067*	*14,441*
Indirect voice	78,919	50,528
Data	128,258	171,486
Interconnection revenue	80,264	43,445
Wholesale services	97,867	150,327
Intelligent network services	19,960	15,349
Other telecommunication service revenue	7,804	7,492
Telecommunication services revenue	**898,554**	**850,613**
Sales of goods	629	2,735
Telecommunication revenue	**899,183**	**853,348**

29. Services purchased

	Year ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
Professional services	(14,244)	(26,120)
Advertising and promotion expenses	(27,422)	(28,769)
Cost of rented lines and network maintenance	(75,632)	(98,289)
Information technology services	(15,975)	(14,985)
Office and car maintenance	(10,929)	(10,799)
Insurance	(6,382)	(6,188)
Mailing services	(6,709)	(6,233)
Travel and accommodation	(4,977)	(4,573)
Other services	(15,703)	(22,136)
	(177,973)	**(218,092)**

(All amounts in thousands, except as otherwise stated)

30. Salaries and benefits

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Wages and salaries	(107,296)	(111,516)
Social security costs	(10,400)	(9,527)
Defined contribution plan (the State Plan)	(7,054)	(7,147)
Provision for retirement severance payment	-	(530)
Share-based compensation	(3,395)	(892)
Other employee costs	(4,519)	(4,404)
	(132,664)	**(134,016)**

The Netia Group is legally required to make contributions to the Government's retirement benefit scheme. During the years ended December 31, 2006 and 2005 the Group paid contributions at a rate of 9.76% of gross salaries up to certain limits and is not required to make any contributions in excess of this statutory rate.

31. Other gains / (losses), net

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Gain on sale of subsidiaries and other investments	11	20
Gain on sale of impaired receivables	-	1,280
Gain / (loss) on sale of fixed assets	345	2,574
Net foreign exchange gains / (losses)	2,769	(3,031)
	3,125	**843**

32. Other income

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Forgiveness of liabilities	4,357	621
Sale of services to associate	1,696	1,951
Reversal of accrued other income on sale of services to associate (see Note 40)	-	(303)
Fair value adjustments on other receivables	-	4,613
Other operating income	4,560	3,156
	10,613	**10,038**

33. Other expenses

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Taxes and fees	(47,727)	(53,453)
Provision for impaired receivables	(17,514)	(7,662)
Materials and energy	(8,699)	(9,704)
Other operating costs	(10,476)	(10,617)
	(84,416)	**(81,436)**

34. Finance income and finance costs

Finance income

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Interest income	12,527	5,983
Gain on fair value adjustment of financial assets	2,631	2,251
Net foreign exchange gains	295	-
	15,453	**8,234**

Finance costs

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Interest expense	(6,851)	(5,532)
Net foreign exchange losses	(354)	(1,727)
	(7,205)	**(7,259)**

35. Net foreign exchange gains / (losses)

The exchange differences credited/(charged) to the consolidated income statement are included as follows:

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Other gains / (losses), net	2,769	(3,031)
Finance income	295	-
Finance costs	(354)	(1,727)
	2,710	**(4,758)**

36. Earnings per share

Basic

Basic earnings per share have been calculated based on the net profit attributable to the equity holders of the Company for each period divided by the weighted average number of shares in issue during the year. The weighted average number of ordinary shares in issue excludes the weighted average number of treasury shares and own shares repurchased within the share and subscription warrant buy-back program completed in 2005, as presented below:

	Year ended December 31, 2005	Year ended December 31, 2006
Weighted average number of treasury shares (not in thousands)	468,648	139,952
Weighted average number of own shares repurchased within the program (not in thousands)	12,889,141	8,270,102

	Year ended December 31, 2005	Year ended December 31, 2006
Profit / (loss) attributable to the equity holders of the Company	59,027	(378,908)
Weighted average number of ordinary shares in issue (not in thousands)	377,405,104	387,809,730
Basic earnings per share (not in thousands)	0.16	(0.98)

Diluted

Diluted earnings per share for profit / (loss) attributable to the equity holders of the Company is calculated adjusting the weighted average number of ordinary shares outstanding to assume conversion of all potentially dilutive ordinary shares. The Company had two categories of potentially dilutive ordinary shares: warrants (which expired in April 2006 and which upon their exercise triggered the issue of the series J shares) and the employees' share options (which upon their exercise trigger the issue of the series K shares). For the share options and warrants a calculation was done to determine the number of shares that could have been acquired at fair value based on the monetary value of the subscription rights attached to the outstanding share options and warrants. The number of shares calculated as above was compared with the number of shares that would had been issued assuming the exercise of the share options and warrants.

	Year ended December 31, 2005	Year ended December 31, 2006
Profit / (loss) attributable to the equity holders of the Company	59,027	(378,908)
Weighted average number of ordinary shares in issue (not in thousands)	377,405,104	387,809,730
Adjustments for:		
- Share options	3,401,532	338,886
- Warrants	10,283,419	737,456
Weighted average number of ordinary shares for diluted earnings per share (not in thousands)	391,090,055	388,886,072
Diluted earnings per share (not in thousands)	0.15	(0.97)

37. Dividends per share

The Company's Shareholder's Meeting held on March 29, 2006, approved a dividend of PLN 0.13 (not in thousands) per share to be paid out of the net profit of Netia S.A. for the year ended December 31, 2005. Due to that resolution, PLN 50,323 of dividend was paid on May 16, 2006 to shareholders of record as at April 20, 2006.

The Company's Shareholder's Meeting held on March 17, 2005, approved a dividend of PLN 0.10 (not in thousands) per share to be paid out of the net profit of Netia S.A. for the year ended December 31, 2004. Due to that resolution, PLN 38,710 of dividend was paid on April 22, 2005 to shareholders of record as at April 7, 2005.

38. Supplemental disclosures to consolidated cash flow statement

Changes in working capital components:

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Trade receivables	(23,700)	39,289
Tax receivables	12	(4,889)
Other receivables	413	1,203
Inventories	290	678
Prepaid expenses	1,331	1,010
Restricted cash	-	(3,600)
Trade creditors	23,425	(10,381)
Provisions, accruals and other payables	(9,763)	(21,643)
Deferred income	145	8,131
	(7,847)	**9,798**

Supplemental disclosures to operating activities:

	Year ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Income taxes paid	592	327
Interest received	(12,503)	(6,324)

Non-cash transactions:

During the year ended December 31, 2006 the principal non-cash transactions were issuances of 1,052,691 (not in thousands) ordinary series K shares due to exercise of options granted under the Plan.

39. Changes in the Management Board and Supervisory Board

Changes in the Management Board

Effective March 1, 2006 Mr. Paweł Karłowski was appointed as a Member of the Management Board and Chief Commercial Officer.

Effective April 5, 2006 Mr. Jonathan Eastick was appointed as a Member of the Management Board and Chief Financial Officer. Since March 1, 2006 until October 23, 2006 Mr. Jonathan Eastick was also a Member of the Management Board and Chief Financial Officer of P4, the Netia's associate. Based on the Resolution of the Supervisory Board of Netia S.A. dated April 5, 2006 concerning issues connected with the appointment of a member of the Company's Management Board, in all business relations between the Company and P4, Mr. Jonathan Eastick; (i) did not act on behalf of the Company and (ii) abstained from conducting in any way, directly or indirectly, any businesses between the Company and P4, which could possibly lead to a conflict of interest.

Effective April 5, 2006 Mr. Tom Ruhan was appointed as Member of the Management Board and Chief Legal Officer.

Effective September 13, 2006 Mr. Wojciech Mądalski, President of the Company, resigned from his position.

Effective September 13, 2006 Mr. Paweł Karłowski was appointed as Acting President of the Management Board.

Changes in the Supervisory Board

Effective January 5, 2006 Mr. Nicholas Cournoyer, Chairman of the Company's Supervisory Board, resigned from the position of Member and Chairman of the Company's Supervisory Board.

On January 9, 2006 the Supervisory Board appointed Mr. Hubert Janiszewski, Netia's Supervisory Board member, for the position of Chairman of the Company's Supervisory Board. On March 29, 2006, the Company's Shareholder's Meeting dismissed Mr. Hubert Janiszewski as Chairman and member of Netia's Supervisory Board.

Effective January 15, 2006 Mr. Richard Moon, a Member of Netia's Supervisory Board, resigned from his position.

Effective March 29, 2006 Mr. Mark Holdsworth, a Member of Netia's Supervisory Board, resigned from his position.

On March 29, 2006, the Company's Shareholder's Meeting appointed Mr. Raimondo Eggink, Mr. Bruce McInroy, Mr. Constantine Gonticas and Mr. Pantelis Tzortzakis to Netia's Supervisory Board.

Appointment of Chairperson of Netia's Supervisory Board

On April 5, 2006 the Company's Supervisory Board unanimously appointed Ms. Alicja Kornasiewicz, Netia's Supervisory Board member, for the position of Chairperson of the Company's Supervisory Board, with immediate effect.

40. Related party transactions

Options granted to members of the Management Board (not in thousands)

As at December 31, 2006, the total number of options granted to members of the Company's Management Board under the Plan, was 1,721,489 of which 634,233 had vested as of that date. Strike prices for the options granted to the Management Board range between PLN 3.12 to 5.30 per share. The market price of the Company's shares at December 31, 2006 was PLN 5.05 per share.

The movements in the number of options held by Members of the Company's Management Board are presented below:

Options	**Year ended December 31, 2005**	**Year ended December 31, 2006**
At the beginning of the period	5,526,888	1,812,094
Granted	1,721,489	815,442
Status changed due to resignation from Management Board	(1,087,256)	-
Exercised	(4,349,027)	(906,047)
At the end of the period	**1,812,094**	**1,721.489**

As at December 31, 2005 Mr. Wojciech Mądalski – the Company's former President (see Note 39) – held 906,047 options, which were exercised during the year ended December 31, 2006.

As at December 31, 2006 and December 31, 2005 Mr. Paul Kearney – a member of the Company's Management Board – held 362,419 options.

As at December 31, 2006 and December 31, 2005 Mr. Piotr Czapski – a member of the Company's Management Board – held 543,628 options.

As at December 31, 2006 Mr. Paweł Karłowski – Acting President of the Company (see Note 39) – held 271,814 options.

As at December 31, 2006 Mr. Jonathan Eastick – a member of the Company's Management Board (see Note 39) – held 543,628 options.

The members of the Supervisory Board did not hold any options as at December 31, 2005 and December 31, 2006.

Number of shares held by members of the Management Board (not in thousands)

As at December 31, 2005 Mr. Wojciech Mądalski – the former Company's President (see Note 39) – held 2,043,292 series K shares of the Company. As at June 30, 2006 his holdings increased to 2,576,607 shares. Due to Mr. Wojciech Mądalski's resignation from the Company's President his shares are no longer recognized as shares held by members of the Company's Management Board.

As at December 31, 2006 Mr. Tom Ruhan – a member of the Company's Management Board (see Note 39) – held 253,593 series K shares of the Company.

Number of shares held by members of the Supervisory Board (not in thousands)

As at December 31, 2006, Mr. Andrzej Radzimiński – a member of the Company's Supervisory Board – held 10,000 ordinary shares and 1,000 series A1 shares. The number of the Company's shares has not changed since December 31, 2005.

As at December 31, 2006, Mr. Raimondo Eggink – a member of the Company's Supervisory Board (see Note 39) – held 20,000 shares of the Company.

As at December 31, 2006, Mr. Constantine Gonticas – a member of the Company's Supervisory Board (see Note 39) – held 43,000 shares of the Company.

As at December 31, 2005, Mr. Nicholas Cournoyer – the-then Chairman of the Supervisory Board – held 3,000 series A shares of the Company and 6,000 series J shares of the Company. Due to his resignation from the position of the member of the Supervisory Board his shares are no longer recognized as shares held by members of the Company's Supervisory Board.

Management Board remuneration

Compensation and related costs associated with members of the Company's Management Board during the years ended December 31, 2006 and December 31, 2005 amounted to PLN 6,656 and PLN 7,037, respectively. In addition, the cost of share-based payments in the amounts of PLN 638 and PLN 2,234, respectively, was recognized in 2006 and 2005. Furthermore, termination benefits for the former members of the Management Board of PLN 1,755 and PLN 783, respectively, were recognized as a cost in the the year ended December 31, 2006 and December 31, 2005.

Compensation and related costs associated with members of the Management Boards of the Company's subsidiaries during the years ended December 31, 2006 and December 31, 2005 amounted to PLN 696 and PLN 499, respectively. Furthermore, termination benefits for the former members of the Management Boards of the Company's subsidiaries of PLN 486 were recognized as a cost in the year ended December 31, 2006.

Supervisory Board remuneration

Compensation and related costs associated with current members of the Company's Supervisory Boards during the years ended December 31, 2006 and December 31, 2005 amounted to PLN 440 and PLN 482, respectively. Furthermore, the compensation and related costs for the former members of the Supervisory Board of PLN 44 were recognized as a cost in the year ended December 31, 2006.

Transactions with former members of the Supervisory Board and Management Board of the Company's subsidiary

Former members of the Supervisory Board and Management Board of one of the Company's subsidiaries were related parties to ZIT, a company, which rendered managerial services for Premium Internet and was aquired by the Netia Group in June 2006 (see Note 8). Due to that transaction, they received an advance payment of PLN 5,324 and as at December 31, 2006 the related outstanding liability amounted to PLN 10,217.

Transactions with the associate

The following transactions were carried out with P4 and 3GNS, P4's subsidiary (see also Notes 11, 12, 41 and 42):

	Four-month period ended December 31, 2005 (PLN)	Year ended December 31, 2006 (PLN)
Sale of services	1,696	1,951
Reversal of accrued other income on sale of services*	-	(303)
Other sales transactions	211	2,098
	1,907	**3,746**

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Trade receivables	2,051	1,658
	2,051	**1,658**

* Reversal of accrued other income on sale of services resulted from the adjustment of estimated prices for services provided to P4 during 2005 to contractual prices negotiated with P4 during the year ended December 31, 2006, but also applicable retrospectively to 2005.

41. Commitments

Capital commitments

Capital expenditures contracted for at the balance sheet date but not recognized in the consolidated financial statements amounted to PLN 27,317 as at December 31, 2006 and PLN 27,366 as at December 31, 2005 of which, PLN 1,945 and PLN 2,327, respectively, related to the planned acquisition of intangible assets.

Operating lease commitments – where the Netia Group is the lessee

As at December 31, 2005 and December 31, 2006 the future minimum payments payable under non-cancelable operating leases were as follows:

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Not later than 1 year	31,969	34,348
Later than 1 year and not later than 5 years	45,756	41,275
Later than 5 years	45,371	37,636
	123,096	**113,259**

Operating lease arrangements mainly relate to the rental of buildings, land, network and vehicles. The periods of administrative building and land rentals do not exceed 30 years, network rentals range up to 20 years and vehicles are leased for almost 4 years. Rental costs recognized in the income statement for year ended December 31, 2006 and the year ended December 31, 2005 amounted to PLN 68,069 and PLN 54,534, respectively. These rental costs are partially offset by income from sub-contractors (see also Note 22) in the amounts of PLN 3,105 and PLN 3,409, respectively.

Operating lease commitments – where the Netia Group is the lessor

The future minimum lease payments receivable under non-cancelable operating leases are as follows:

	December 31, 2005 (PLN)	December 31, 2006 (PLN)
Not later than 1 year	13,928	16,149
Later than 1 year and not later than 5 years	23,834	26,730
Later than 5 years	10,760	9,208
	48,522	**52,087**

The Netia Group has entered into several commercial leases on certain parts of the transmission network. The periods of network rentals range up to 20 years. The relevant rents recognized in the income statement for year ended December 31, 2006 and the year ended December 31, 2005 amounted to PLN 20,793 and PLN 19,381, respectively. The operating lease agreements do not relate to specific separate assets.

Finance lease commitments

Due to the acquisition of the HFC Internet Group on September 30, 2005, the Netia Group had finance leases for certain telecommunication equipment. The commitment expired during the year ended December 31, 2006.

P4 related commitments

In 2005 P4 - previously the Company's subsidiary, was announced a winner of the mobile telephony UMTS frequency tender. On August 23, 2005 Shareholders' Agreement ("Agreement") was concluded by the following entities: the Company, Netia Mobile Sp. z o.o. ("Netia Mobile", previously operating under the name "Netia Ventures Sp. z o.o."), P4, Novator One L.P., Novator and Novator Poland Pledge Sp. z o.o. (Novator and Netia Mobile both called "Shareholders"). Netia Mobile is a 100% subsidiary of the Company, and Novator is a 100% subsidiary of Novator One L.P.

As a result of that Agreement, Novator was the holder of 24,010 (not in thousands) of P4's shares ("Shares") constituting 70% of the Shares in P4's share capital and Netia Mobile was the holder of 10,290 (not in thousands) Shares constituting 30% of the Shares in P4's share capital. In total, based on the Agreement, the Shareholders are obligated to make contributions of up to the amount of EUR 300,000 in proportion to their share of P4's share capital. As a result, Netia Mobile is obligated to make contributions of up to EUR 90,000 (see also Note 43). Due to that obligation, as of December 31, 2006, Netia Mobile has made contributions to P4's equity in the amount of PLN 164,700 (of which PLN 57,000 was made in the year ended December 31, 2006) in order to cover the UMTS frequency reservation fee and initial operational expenses and capital investments in fixed assets.

Furthermore, during a 3-year period following execution of the Agreement (i.e. until August 23, 2008), the Shareholders may not dispose of their Shares without the consent of the other Shareholder, except for permitted transfers within their respective capital groups (the "3-year lock-up period"). In the event of a change of control of any Shareholder, the other Shareholder has the right to repurchase Shares held by the Shareholder which underwent the change of control.

The Agreement includes standard procedures which regulate the sale of Shares by the Shareholders following the 3-year lock up period. If a Shareholder wishes to dispose of its Shares, the other Shareholder is entitled to require the potential third party buyer to purchase its Shares on the same terms in the amounts commensurate with the percentages of Shares held by each Shareholder. Moreover, if Novator decides to sell all of its Shares, it is entitled to require the other Shareholder to sell all of its Shares on the same terms. These provisions are secured by contractual penalties in the maximum amount of EUR 25,000. The payment of the contractual penalties does not exclude the right of the parties to the Agreement to claim damages in an amount exceeding the amount of such penalties. Any transfer of shares in violation of these transfer restrictions will be ineffective against P4.

The Agreement includes a list of specific matters requiring unanimous approvals from both Shareholders regarding potential alterations to the share capital or articles of association, issuing securities, disposals and acquisitions of assets, certain business, trading and accounting matters, indebtedness and dividend levels. In the event at any time any shareholder who is a member of the Novator group transfers any shares in P4 to a person who is not a party to the Agreement, all resolutions of the shareholders' meeting will require the consent of Netia Mobile and all resolutions of the supervisory board will require the consent of all members of the supervisory board appointed by Netia Mobile.

If key issues regarding running P4's business cannot be agreed following the expiration of the 3-year lock up period, the Agreement includes an option for Novator to purchase Netia Mobile's Shares at market price plus 10% and an option for Netia Mobile to sell such Shares to Novator at market price with a 10% discount.

The Agreement includes material terms and conditions for commercial cooperation based on which the Company and P4 shall conclude a number of agreements: (i) framework commercial agreement, (ii) distribution agreement, (iii) co-development agreement, (iv) IT sharing agreement, (v) fixed telephony supply agreement, (vi) WiMax supply agreement, (vii) interconnection agreement, and (viii) intellectual property sharing agreement. The parties' obligations under the framework commercial agreement and the distribution agreement are secured by contractual penalties in the maximum amount of EUR 50,000.

The Agreement shall expire following a valid sale of all Shares by the Shareholders in accordance with its provisions. The Agreement includes limitations of competing activities, a non-disclosure clause and a ban on employee recruitment during an agreed period following the expiration of the Agreement. The Shareholders accept an option of P4's conversion into a joint stock company no earlier than after the 2-year period following the date of the Agreement, and an option to introduce P4's Shares to public trading following three years from the date of the Agreement.

42. Contingencies

Millennium (not in thousands)

In August and September 2000, the Company entered into certain agreements to acquire all of the outstanding equity of Millennium Communications S.A. ("Millennium"), a provider of telecommunications services in Warsaw. Certain advances were made to Millennium following the execution of the agreements, and currently a loan of EUR 2.9 million (PLN 11.1 million at the December 31, 2006 exchange rate) increased by the applicable interest is outstanding from Millennium. In December 2000, the Company brought a claim for the repayment of the loan against Millennium in the District Court in Warsaw. On October 16, 2006, the Regional Court granted the Company's claim and ordered Millennium to pay PLN 11.5 million with interest. The Court has also dismissed Millennium's counterclaim. The judgment is not final.

In 2001, a valuation allowance of PLN 17.0 million was recorded as other operating expense against the outstanding amount receivable from Millennium as a result of the events described above.

In September 2003, Newman Finance Corp. ("Newman"), Millennium's sole shareholder, filed a claim against the Company for damages of PLN 45.4 million, which is the equivalent of USD 11.5 million plus interest accrued since the date of filing the claim until the date of payment. This claim was filed for damages incurred when a security was placed over Millennium's shares between January 4, 2000 and November 1, 2002 in connection with litigation concerning Millennium's failure to perform the agreements entered in August and September 2002. On June 8, 2005 the District Court dismissed the claim. The District Court determined that Newman neither proved the damage occurrence nor its magnitude. On July 20, 2005, Newman filed an appeal. On February 13, 2007, the Appellate Court dismissed Newman's claim in its entirety. In the grounds given for its judgement the Court of Appeal noted that Newman failed to prove that it had incurred damage and that there was any causality between the loss of the value of Millennium shares, if any, and the existence of the security interest. The judgment is final and non-appelable.

On April 5, 2005, Millennium filed a claim against El-Net in connection with the alleged acts of unfair competition of El-Net against Millennium. El-Net filed an answer to the claim on June 6, 2005 in which it requested the District Court to dismiss the claim as wholly unsubstantiated. On December 23, 2006, the Court dismissed Millennium's claim in its entirety. The judgment is not final. The matter is still pending.

On August 21, 2005 Millennium filed a motion against Netia in connection with the alleged acts of unfair competition of Netia against Millennium. Netia filed an answer to the claim on September 7, 2005 in which it rejected the claim as wholly groundless and unsubstantiated. On October 6, 2006, the Court discontinued proceedings in their entirety, because of identity of claims of Millennium and the defendant (after merger of Netia and El-Net) with the matter indicated above (Millennium's claim dated April 5, against El-Net). The judgment is final and non-appelable.

In July 2005, Millennium filed a motion to secure the claim against El-Net for determination that an agreement between El-Net and Millennium concerning provisions of telephone services and the use of 30,000 telephone numbers by Millennium was not effectively terminated by El-Net. On August 21, 2005, Millennium filed a motion against El-Net in connection with the claim to which the injunction pertained to. El-Net filed an answer to the claim on October 19, 2005 in which it requested the District Court to dismiss the claim as wholly unsubstantiated. On October 11, 2006, the Court dismissed Millennium's claim in its entirety. Millennium filed an appeal. The matter is still pending.

Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

Minority shareholders

On August 1, 2002, the Company received a copy of a claim filed with the District Court in Warsaw by an individual shareholder demanding the cancellation of sections 10, 11 and 13 of Resolution No. 2 adopted by the Company's General Meeting on April 4, 2002. The individual shareholder claimed that the distribution of the Company's warrants under the financial restructuring was harmful to the minority shareholders and violated good custom. On August 14, 2002, the Company responded requesting the District Court to dismiss the claim as unsubstantiated. The matter is still pending.

In a second similar matter, a minority shareholder's claim was dismissed on merits by the Regional Court in Warsaw. On March 25, 2005, the minority shareholder filed an appeal. On December 8, 2005 the District Court examining the appeal overruled the judgment of the Regional Court and decided that the case has to be re-examined due to the fact that it should be the District Court not the Regional Court where the case should have been examined in the first resort. The matter is still pending.

Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

Pledge on shares in P4

On October 26, 2005 Netia Mobile entered into an agreement on registered pledge on shares regarding 10,260 (not in thusands) shares in P4. The pledge was established for the benefit of Novator Poland Pledge Sp. z o.o. in order to secure the performance by Netia Mobile of the claims that may arise due to failure by Netia Mobile to perform certain obligations under the Agreement. The maximum amount of collateral equals to EUR 25,000. Pursuant to the Agreement on October 26, 2005 Novator has also pledged all its shares in P4 to Netia Mobile on the same terms as indicated above in order to secure the performance by Novator of the claims that may arise if Novator fails to perform certain obligations under the Agreement. On October 31, 2006, under the Agreement for the Registered and Financial Pledges on Shares (described below) the pledges were subordinated to pledges established in favour of BPH SA.

The Company's Management is not aware of any circumstances, which may currently give rise to a utilization of the pledge.

Agreements partially securing the repayment of the vendor financing extended to P4

On October 31, 2006 the Company concluded a number of agreements partially securing the repayment of the credit facility of EUR 150,000 (the "Facility") granted to P4 by China Development Bank, acting as the Mandated Lead Arranger, and BPH SA, as the Facility Agent and Security Agent, under the Facility Agreement dated October 31, 2006. The Facility agreement provides for a ten year amortising term Facility with a three year availability period. The funds will be used by P4 for the purchase of core equipment for its UMTS network from Huawei Polska Sp. z o.o., including the acquisition of transmitter construction sites and related network construction costs. In order to facilitate the conclusion of part of the vendor financing package assumed in P4's original business plans, the Netia Group and Novator provided certain undertakings and separate guarantees in direct proportion to their shareholdings in P4. Accordingly, Netia concluded the following agreements:

- **Share Retention Agreement**. Under the Share Retention Agreement, Netia provided a guarantee to a maximum amount of EUR 27,000. The guarantee covers the repayment of 30% of the outstanding amounts under one of the tranches of the Facility (limited to a total of EUR 75,000) to be applied towards the acquisition of transmitter and core network construction sites, and the costs of related civil works investments in P4's UMTS network, increased by interest and costs (with a cap at EUR 90,000). Furthermore, Netia is obliged to ensure that the P4 equity stake currently held by the Netia Group shall not be disposed of before August 23, 2008. Thereafter, the current shareholders of P4 may not reduce their combined holdings below 50% of P4's share capital without the prior consent of China Development Bank.

- **Equity Contribution Agreement**. Under the Equity Contribution Agreement, Netia and Novator One L.P. agreed to ensure that during the scheduled Facility repayment period, P4's share capital will be increased or the shareholders will grant subordinated loans to P4 pro rata to their respective shareholdings in P4 to ensure that P4 can meet its obligations up to a maximum committed amount of EUR 300,000. The total outstanding amount of committed contributions still to be made by Netia will not exceed EUR 49,000 as at December 31, 2006 (see also Note 43).

- **The Subordination Agreement**. Under the Subordination Agreement, Netia agreed to subordinate all of its, and the Netia Group's, financial receivables due from P4, including any subordinated shareholders loans, by giving priority to the receivables due under the Facility granted to P4. The subordination does not affect commercial agreements concluded with P4 and other agreements, once accepted by the creditors on a case-by-case basis. Netia had no such receivables subject to subordination as at December 31, 2006.

- **The Agreement for the Registered and Financial Pledges on Shares** and the Agreement on Change of Priority of the Pledges. Under the Agreement for the Registered and Financial Pledges on Shares, Netia Mobile (P4's shareholder), established a registered and a financial pledge in favour of the Security Agent on its entire equity stake in P4 to secure P4's obligations under the Facility. At the same time, under a separate Agreement on Change of Priority of the Pledges, Netia Mobile agreed that the registered pledge established in its favour by Telecom Poland S.a.r.l. on P4's shares in connection with the conclusion of P4's Shareholders' Agreement be subordinated to the registered and financial pledges established by Telecom Poland S.a.r.l. on the same date in favour of the Security Agent to secure P4's obligations under the Facility.

The Company's Management is not aware of any payment default by P4. Should P4 default on its payment obligations in the future, Netia may be required to pay up to EUR 27,000 in respect to guarantees and may lose its shares in P4.

WiMAX license requirements

On October 27, 2005 Netia WiMax and Netia WiMax II received the reservations of the 3.6-3.8 GHz frequencies, which will be used to provide telecommunication services based on the WiMAX technology. The terms of licenses issued to the Company's subsidiaries require them to meet annual connected capacity milestones in the future, as measured at the end of each year, subject to demand in the territory and population of Poland (the milestones regarding population alloted for the year 2006 were met).

The Company's Management is not aware of any circumstances, which may currently give rise to a potential claim in this respect.

Tax contingent liability

Regulations relating to value-added tax, corporate income tax, and payroll (social) taxes have radically changed in comparison to the tax regulations, which existed prior to the economic and political transformation in Poland. The lack of reference to well-established practices and the relatively short period in which these new tax regulations have been in place often results in a lack of clarity and consistency in 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 areas of legal compliance are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems. The tax authorities may at any time inspect the books and records of the Company and may impose additional tax assessments with penalty interest and penalties within 5 years from the end of the year when a tax is due.

The Company's Management is not aware of any circumstances, which may currently give rise to a potential material liability in this respect.

43. Subsequent events

Increase of the Netia Group's share in UNI-Net

On January 9, 2007, the Company purchased from the minority shareholders 4% of the share capital of the Company's subsidiary UNI-Net Sp. z o.o. ("UNI-Net"), for a total of PLN 700. Following these transactions, the Netia Group holds 62,2% of UNI-Net's share capital and the corresponding number of votes at its shareholders' meeting.

Appointment of new President of the Management Board and CEO

On January 23, 2007, the Company's Supervisory Board appointed Mr. Mirosław Godlewski as Netia's President of the Management Board and Chief Executive Officer, effective February 15, 2007. Mr. Paweł Karłowski, the Acting President of the Company, continues to serve as Netia's Management Board member and Chief Commercial Officer.

Amendment of the P4 shareholders agreement

On January 31, 2007 the Company concluded an investment agreement (the "Investment Agreement"), which provides for the accession of a new shareholder, Tollerton Investments Limited ("Tollerton") to P4 and for the subscription by Tollerton for a 22% equity stake in the increased share capital of P4 in return for 100% of shares in Germanos Polska Sp. z o.o. together with its two subsidiaries Telecommunication Center Mobile Sp z o.o. and Mobile Phone Telecom Sp. z o.o. (the "Distribution Companies"), which will be contributed to P4 to pay for the new shares subscribed for by Tollerton. The Investment Agreement further provides for an amendment of the Shareholders Agreement of P4 dated August 23, 2005 after the transactions contemplated in the Investment Agreement have been completed (see Note 41).

Following the increase of P4's share capital, Netia Mobile will hold 23.4% of P4's share capital while Novator will hold 54.6% of P4's share capital. The above is conditional on obtaining the consent of the Chairman of the Polish Office for the Protection of Competition and Consumers and the consent of China Development Bank, as required under the terms of the facility of EUR 150,000 granted to P4 (see Note 42) to the transactions contemplated in the Investment Agreement, and on the Distribution Companies terminating certain existing exclusive distribution agreements to which they are the parties.

In the amended Shareholders Agreement, which will be concluded upon Tollerton subscribing for P4's shares, the Shareholders reiterate their earlier commitments to make contributions to P4 up to EUR 300.000, pro rata to their respective changed shareholdings in P4's share capital, whereby Tollerton has agreed to make contributions of EUR 35,000 and the investment commitment of Netia Mobile will be reduced to EUR 79,500 from EUR 90,000.

The Investment Agreement and the amended Shareholders Agreement specify the key principles of commercial cooperation of Netia and the Distribution Companies based on which the Company and P4 will conclude commercial contract providing for Netia's access to the Distribution Companies' sales network.

Key implications for the Company relating to the above agreements are as follows:

- the Company will have guaranteed long-term access to the distribution network for products from the fixed-line segment offered by the Company,
- Netia's associate company, P4, gains access to leading national distribution network of over 225 stores together with the continuing use of the Germanos brand name,
- the P4 joint venture is strengthened by the addition of a second strategic investor with proven know-how in mobile phone retailing, distribution, logistics and procurement.

Share options granted under the Plan (not in thousands)

On February 15, 2007 the President of the Company's Management Board was granted 10,000,000 options to subscribe for series K shares in accordance with the Plan. The grant is divided into three tranches: 4 million, 3 million and 3 million. The strike prices of the options for each tranche are: PLN 5.50, PLN 7.00 and PLN 8.25, respectively. The granted options shall expire on December 20, 2012.