NETIA S.A.
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2004

REPORT OF THE AUDITORS

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

We have audited the accompanying consolidated balance sheet of Netia S.A. (the "Company") and its subsidiaries (together, the "Netia Group") as at December 31, 2004 and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended, all of them expressed in Polish Złoty ("PLN"). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2004 and the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

The convenience translations are disclosed as part of the consolidated financial statements. The convenience translation for the year ended December 31, 2004 has been presented in US dollars, as a matter of arithmetic computation using the official rate of the National Bank of Poland at December 31, 2004 of PLN 2.9904 to US dollar 1.00. We have not audited these translations and accordingly we do not express an opinion thereon. The US dollar amounts presented in these consolidated financial statements should not be construed as a representation that the PLN amounts have been or could have been converted to US dollars at this rate or at any other rate.

PricewaterhouseCoopers Sp. z o.o.

Warsaw, Poland
March 1, 2005

NETIA S.A.
CONSOLIDATED BALANCE SHEET
(All amounts in thousands)

	Note	December 31, 2003 (PLN)	December 31, 2004 (PLN)	Convenience Translation $ (Note 3) December 31, 2004 (Unaudited)
ASSETS				
Current assets				
Cash and cash equivalents	5	228,001	301,863	100,944
Accounts receivable				
Trade, net of provision for impairment of PLN 55,381 and PLN 65,852 (USD 22,021)		95,023	116,732	39,036
Tax receivables		3,271	3,009	1,006
Other		2,249	3,022	1,011
Inventories		737	2,488	832
Prepaid expenses		10,042	10,432	3,488
Total current assets		**339,323**	**437,546**	**146,317**
Available for sale financial assets		9	51	17
Fixed assets, net	6, 9	1,583,277	1,817,156	607,663
Intangible assets				
Licenses, net	7, 9	252,732	222,783	74,499
Computer software, net	8, 9	91,429	84,690	28,321
Negative goodwill	13	(28,799)	(77,657)	(25,969)
Deferred income tax assets	16	-	46,843	15,664
Other long term assets		1,606	1,149	384
Total non-current assets		**1,900,254**	**2,095,015**	**700,579**
Total assets		**2,239,577**	**2,532,561**	**846,896**

Wojciech Madalski
President of the Company

Kent Holding
Chief Financial Officer

Warsaw, Poland
March 1, 2005

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

NETIA S.A.
CONSOLIDATED BALANCE SHEET
(All amounts in thousands)

	Note	December 31, 2003	December 31, 2004	Convenience Translation $ (Note 3) December 31, 2004
		(PLN)	**(PLN)**	**(Unaudited)**
LIABILITIES				
Current liabilities				
Short term liabilities for licenses	7	4,759	4,049	1,354
Short term installment obligations	15	-	11,872	3,970
Accounts payable and accruals				
Trade		64,751	90,269	30,185
Tax payables		4,325	10,955	3,663
Accruals and other	12	62,701	49,010	16,389
Deferred income		9,751	10,589	3,541
Total current liabilities		**146,287**	**176,744**	**59,102**
Provisions for liabilities and charges	11	**7,030**	**9,895**	**3,309**
Long term liabilities for licenses	7	4,361	54,088	18,087
Long term installment obligations	15	5,707	-	-
Other long term liabilities		508	1,216	407
Total non-current liabilities		**10,576**	**55,304**	**18,494**
Total liabilities and provisions		**163,893**	**241,943**	**80,905**
Minority interest	18	4,328	5,186	1,734
Shareholders' equity				
Share capital (nominal par value of PLN 1 per share)		344,487	366,956	122,711
Share premium		1,572,903	1,605,357	536,837
Treasury shares		(2,812)	(2,812)	(940)
Other reserves		3,816,325	-	-
Other supplementary capital		-	203,565	68,073
Retained earnings / (Accumulated deficit)		(3,659,547)	112,366	37,576
Total shareholders' equity	17	**2,071,356**	**2,285,432**	**764,257**
Total liabilities and shareholders' equity		**2,239,577**	**2,532,561**	**846,896**

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

NETIA S.A.
CONSOLIDATED INCOME STATEMENT
(All amounts in thousands)

	Note	Year ended December 31, 2003 (PLN)	Year ended December 31, 2004 (PLN)	Convenience Translation $ (Note 3) December 31, 2004 (Unaudited)
Revenue				
Telecommunication services revenue				
Direct voice services		489,453	546,989	182,916
Installation fees		847	640	214
Monthly fees		124,835	144,248	48,237
Calling charges		360,199	398,152	133,144
Local calls		*123,933*	*134,842*	*45,092*
Domestic long distance calls		*73,947*	*82,223*	*27,496*
International long distance calls		*30,384*	*35,685*	*11,933*
Fixed-to-mobile		*114,950*	*121,506*	*40,632*
Other		*16,985*	*23,896*	*7,991*
Payphones		3,572	3,949	1,321
Indirect voice		66,728	103,445	34,592
Data		61,495	90,288	30,193
Interconnection revenue		5,108	67,256	22,491
Wholesale services		41,409	41,921	14,019
Intelligent network services		15,891	28,869	9,654
Other telecommunication revenue		9,444	7,826	2,616
Radio communication services revenue		11,587	10,568	3,534
Total revenue		**701,115**	**897,162**	**300,015**
Other operating income		8,394	4,634	1,550
Costs				
Interconnection charges		(122,045)	(158,733)	(53,081)
Salaries and benefits	20	(114,943)	(113,952)	(38,106)
Social security costs	20	(18,097)	(20,261)	(6,775)
Professional services		(32,158)	(13,840)	(4,628)
Insurance		(5,897)	(6,505)	(2,175)
Taxes and fees		(37,422)	(44,239)	(14,794)
Advertising and promotion expenses		(28,281)	(24,523)	(8,201)
Cost of rented lines and network maintenance		(55,694)	(73,618)	(24,618)
Depreciation of fixed assets		(190,340)	(188,891)	(63,166)
Amortization of negative goodwill		25,828	21,420	7,163
Amortization of other intangible assets		(78,108)	(49,938)	(16,699)
Impairment and write-off charges for non-current assets	6, 9	(799,695)	(21,705)	(7,258)
Other operating expenses	21	(92,755)	(121,217)	(40,535)
Profit / (Loss) from operations		**(840,098)**	**85,794**	**28,692**
Financial income / (expense), net	22	(65,621)	27,874	9,321
Net effect of cancellation of license fee obligations	7	176,940	-	-
Profit / (Loss) before income tax		**(728,779)**	**113,668**	**38,013**
Income tax benefit	16	254	46,343	15,497
Profit / (Loss) before minority interest		**(728,525)**	**160,011**	**53,510**
Minority share in losses / (profits) of subsidiaries		(554)	(858)	(287)
Net profit / (loss)		**(729,079)**	**159,153**	**53,223**
Basic earnings per share (not in thousands)*	23	**(2.12)**	**0.44**	**0.15**
Diluted earnings per share (not in thousands)*	23	**(2.12)**	**0.42**	**0.14**

* The calculation was based on the following weighted average numbers of share: 343,849,029 and 358,096,167 for 2003 and 2004, respectively. The diluted weighted average number of shares for 2004 was 381,476,802.

NETIA S.A.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(All amounts in thousands)

	Share capital (PLN)	Share premium (PLN)	Other supplementary capital (PLN)	Treasury shares (PLN)	Other reserves (PLN)	Retained earnings / (Accumulated deficit) (PLN)	Total Shareholders' equity (PLN)
Balance as at January 1, 2003	**203,285**	**1,713,865**	**-**	**(2,812)**	**3,819,712**	**(2,931,759)**	**2,802,291**
Registration of series H shares	312,626	25,831	-	-	(338,457)	-	-
Transfer of shares issuance costs up to the amount of share premium	-	(25,831)	-	-	25,831	-	-
Decrease of nominal value of shares	(171,866)	171,866	-	-	-	-	-
Issuance of series J shares, net of related costs	442	-	-	-	-	-	442
Effect of full consolidation of certain subsidiaries	-	-	-	-	-	(2,297)	(2,297)
Coverage of losses from previous years in individual entities	-	(312,828)	-	-	309,239	3,589	-
Net loss	-	-	-	-	-	(729,079)	(729,079)
Balance as at December 31, 2003	**344,487**	**1,572,903**	**-**	**(2,812)**	**3,816,325**	**(3,659,547)**	**2,071,356**
Issuance of series J shares, net of related costs*	21,698	32,454	-	-	-	-	54,152
Issuance of series K shares, net of related costs	771	-	-	-	-	-	771
Transfers (see Note 17)	-	-	-	-	(3,816,325)	3,816,325	-
Transfer pursuant to resolution of shareholders' meeting of Netia S.A. (see Note 17)	-	-	203,565	-	-	(203,565)	-
Net profit	-	-	-	-	-	159,153	159,153
Balance as at December 31, 2004	**366,956**	**1,605,357**	**203,565**	**(2,812)**	**-**	**112,366**	**2,285,432**

* Transaction costs deducted from share premium amounted to total PLN 1,324 for series J shares and series K shares.

NETIA S.A.
CONSOLIDATED STATEMENT OF CASH FLOWS
(All amounts in thousands)

		Year ended		Convenience Translation $ (Note 3)
	Note	**December 31, 2003**	**December 31, 2004**	**December 31, 2004**
		(PLN)	**(PLN)**	**(Unaudited)**
Cash flows from operating activities:				
Net profit / (loss)		**(729,079)**	**159,153**	**53,223**
Adjustments to reconcile net profit / (loss) to net cash provided by operating activities:				
Depreciation of fixed assets and amortization of licenses and other intangible assets		268,448	238,829	79,865
Reversal of amortization and financial expenses related to cancellation of license fee obligations	7	(176,940)	-	-
Amortization of negative goodwill		(25,828)	(21,420)	(7,163)
Amortization of discount on notes and installment obligations		566	6,165	2,062
Impairment and write-off charges for non-current assets..............	6, 9	799,695	21,705	7,258
Deferred income tax benefit	16	-	(46,843)	(15,664)
Deferral of license fee obligations		-	(13,363)	(4,469)
Interest expense accrued on license liabilities		8,985	4,056	1,356
Minority share in profits / (losses) of subsidiaries		554	858	287
Other provisions		(715)	(149)	(50)
Increase in long term assets		(1,606)	457	153
Foreign exchange losses on translation of long term debt and restricted investments		18,638	(6,118)	(2,046)
Loss on sale of subsidiaries		-	(426)	(142)
Write-off of notes issuance costs		40,211	-	-
Amortization of notes issuance costs		1,265	-	-
Interest expense accrued on long term debt and restricted cash.....		3,030	-	-
Changes in working capital...		(4,766)	(27,213)	(9,099)
Net cash provided by operating activities		**202,458**	**315,691**	**105,571**
Cash flows used in investing activities:				
Purchase of fixed assets and computer software		(147,699)	(191,397)	(64,005)
Net cash received/ (paid) on acquisition of subsidiary..................	13	16,640	(95,608)	(31,972)
Sale of subsidiaries		-	(504)	(169)
Payments for licenses		(9,160)	(4,790)	(1,602)
Decrease / (increase) of restricted cash and cash equivalents		259,514	-	-
Purchase of minority shareholdings in subsidiary.........................		(577)	-	-
Increase of investments...		(291)	-	-
Net cash provided by / (used in) investing activities....................		**118,427**	**(292,299)**	**(97,748)**
Net cash used in financing activities:				
Proceeds from share issuance		1,118	55,667	18,615
Cost of share issuance...		(676)	(744)	(249)
Issuance / (redemption) of notes for warrants		508	(8)	(3)
Redemption of notes (excluding interest paid on redemption)		(198,988)	-	-
Payment of interest on long term debt		(5,205)	-	-
Payments related to financial restructuring...................................		(24,634)	-	-
Net cash provided by / (used in) financing activities		**(227,877)**	**54,915**	**18,363**
Effect of exchange rate change on cash and cash equivalents.....		**2,528**	**(4,445)**	**(1,486)**
Net change in cash and cash equivalents......................................		**95,536**	**73,862**	**24,700**
Cash and cash equivalents at beginning of year...............................		132,465	228,001	76,244
Cash and cash equivalents at end of year		**228,001**	**301,863**	**100,944**

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

NETIA S.A.
CONSOLIDATED STATEMENT OF CASH FLOWS
(All amounts in thousands)

Changes in working capital components:

	Year ended		Convenience Translation $ (Note 3)
	December 31, 2003	**December 31, 2004**	**December 31, 2004**
	(PLN)	**(PLN)**	**(Unaudited)**
Trade receivables	(4,286)	(10,867)	(3,634)
Tax receivables	3,217	1,220	408
Other receivables	6,838	(63)	(21)
Inventories	370	(360)	(120)
Prepaid expenses	329	217	73
Trade creditors	(27,391)	25,256	8,446
Provisions, accruals and other payables	13,362	(42,349)	(14,161)
Deferred income	2,795	(267)	(89)
	(4,766)	**(27,213)**	**(9,098)**

Supplemental disclosures:

	Year ended		Convenience Translation $ (Note 3)
	December 31, 2003	**December 31, 2004**	**December 31, 2003**
	(PLN)	**(PLN)**	**(Unaudited)**
Interest paid	5,205	-	-
Income taxes paid	723	529	177

Non-cash investing and financing activities:

The Netia Group incurred the following liabilities at the end of each year that were related to fixed assets or construction in progress additions:

Year ended		Convenience Translation $ (Note 3)
December 31, 2003	**December 31, 2004**	**December 31, 2004**
(PLN)	**(PLN)**	**(Unaudited)**
35,917	70,975	23,734

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

Index to the notes to the 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 in Poland with its principal executive office located at ul. Poleczki 13, 02-822 Warsaw, Poland. The Company and its subsidiaries (collectively, the "Netia Group") is the largest independent fixed-line telecommunication operator in Poland. The Netia Group is also engaged in the installation and supply of specialized mobile radio services (public trunking) in Poland through its 58.2% owned subsidiary, UNI-Net Sp. z o.o. ("UNI-Net").

The average number of persons employed by the Company was 1,279 and 1,254 during the years ended December 31, 2003 and 2004, respectively.

The consolidated financial statements of Netia S.A. for the year ended December 31, 2004 comprise the Company and its subsidiaries. A list of the Company's undertakings as at December 31, 2004 is set out in Note 19.

These consolidated financial statements were approved for issuance by the Company's Supervisory Board on March 1, 2005.

The Netia Group's backbone network, which connects the largest Polish cities as well as its local access networks currently allows for the provision of various voice telephone and data transmission services. These services include switched, fixed-line voice telephone service (including domestic long distance, international long distance and fixed-to-mobile services), Integrated Services Digital Network ("ISDN"), voice mail, dial-up and fixed-access Internet, leased lines, Voice over Internet Protocol ("VoIP") and co-location services. The Netia Group launched wholesale services, including the wholesale termination of in-bound traffic, in early 2001. In September 2001, the Netia Group began offering frame relay services. Since February 2002, the Netia Group has been offering Free Phone ("0800") and Split Charge ("0801"), services based upon an Intelligent Network. The Netia Group offers data transmission services utilizing its network. In the second half of 2002, the Netia Group started offering duct, dark fiber and capacity leasing and co-location services. In accordance with provisions of the Telecommunication Act introduced in 2001 ("2001 Act") liberalizing the market for international long-distance calls, as of January 1, 2003 the Netia Group started to offer international long distance services in selected zones, based on standard lines, in addition to alternative services based on VoIP technology, which were offered previously. The Netia Group commenced offering "0-708" premium rate services in April 2003. In April 2004 the Netia Group introduced a new service - "Net24" - a broadband Internet access in ADSL technology, addressed to Netia's subscribers using either analogue or ISDN lines.

The Company's ordinary shares have been listed on the Warsaw Stock Exchange since July 2000 and are part of the WIG-20 index. Between August 1999 and October 2002, the Company's American Depositary Shares ("ADSs") were also listed for trading on the NASDAQ stock market.

Until April 7, 2004 the Company was subject to the periodic reporting requirements in the United States under the American Securities Exchange Act of 1934 (the "Act"). On April 7, 2004, the Company filed a Form 15 with the U.S. Securities and Exchange Commission to deregister the Company from the Act. Upon filing of the Form 15 periodic reporting obligations under the Act were immediately suspended. Deregistration from the Act became effective on July 6, 2004. The Company continues to be subject to periodic reporting requirements under the Polish regulations on reporting requirements for companies listed on the Warsaw Stock Exchange.

In April 2003 the Netia Group acquired Świat Internet S.A. ("Świat Internet"), formerly TDC Internet Polska S.A., a Polish Internet service provider.

In January 2004 the Netia Group acquired Regionalne Sieci Telekomunikacyjne El-Net S.A., a fixed-line telecommunication operator (See also Note 13).

In September 2004 the Company's subsidiary, Netia Mobile Sp. z o.o., with its seat in Warsaw ("Netia Mobile"), was registered by the relevant Polish court. The shares in Netia Mobile were taken up solely by Netia's wholly owned subsidiaries.

2. Financial restructuring

Background of the restructuring

In 2002, the Netia Group went through a financial restructuring process. The restructuring process encompassed legal proceedings in three jurisdictions consisting of Dutch moratorium proceedings, Polish arrangement proceedings and proceedings in the United States of America under Section 304 of the U.S. Bankruptcy Code. Creditors of the Netia Group had an opportunity to subscribe with their reduced claims in the form of installment obligations for series H shares issued by the Company. On December 23, 2002, the Netia Group's creditors subscribed for 312,626,040 (not in thousands) series H shares offered by the Company in exchange for such installment obligations. The par value of the Company's ordinary shares was reduced on January 30, 2003 from PLN 6.00 (not in thousands) to PLN 1.00 (not in thousands).

On May 16, 2003, the Company issued 64,848,442 (not in thousands) warrants pursuant to the prospectus, dated April 17, 2002, as subsequently amended, prepared under Polish law and made available in Poland on December 2, 2002. The Company issued the warrants to holders of record of the Company's shares as of December 22, 2002 at the strike price of PLN 2.53 (not in thousands). The warrant strike price is the issue price for series J ordinary shares. The warrants began trading on the Warsaw Stock Exchange on May 27, 2003. The Company also plans to issue up to 18,373,785 (not in thousands) ordinary series K shares under a key employee stock option plan.

As at December 31, 2004, 22,140,102 (not in thousands) warrants have been exercised and the Company's share capital was accordingly increased by 22,140,102 (not in thousands) series J shares. Furthermore, as at December 31, 2004 the Company issued 771,011 (not in thousands) ordinary series K shares with a nominal value of PLN 1 each, due to the exercise by certain persons authorized thereto of their rights arising from the performance stock option plan adopted by Netia's Supervisory Board in 2002 (the "Plan") .

Current financial condition

The restructuring allowed the Netia Group to regain solvency. The restructuring did not lead to the elimination of all of the Netia Group's outstanding debt. The outstanding installment obligations at the nominal amount of PLN 11,872 represents indebtedness that was not exchanged for the ordinary series H shares offered by the Netia Group in December 2002. Payments of this debt were originally scheduled, according to court decisions, between 2007 and 2012. In 2004 Netia announced that it intended to repay all the outstanding installment obligations at the nominal amount of PLN 11,872 by the end of the second quarter of 2005. The restructuring creditors were offered to exchange their restructuring claim for new Company ordinary series I shares at the price of PLN 1.0826241 per share which shall be settled by the means of set-off with the installment obligations or settled in cash. The issue price of the series I shares is equal to the issue price of the series H shares which have been issued in relation to the Company's financial restructuring in 2002. The subscription for series I shares was closed on February 16, 2005 and 5,875,610 (not in thousands) shares were subscribed for. The value of installment obligations to be settled through exchange with subscribed shares is equal to PLN 6,361. Remaining creditors willing to receive cash for their installment obligation claims may submit their claims to the Company until April 29, 2005.

In 2003 the Company performed an impairment test for the telecommunications segment. The test resulted in an impairment charge of PLN 799,695, which was recognized in the consolidated income statement for the year ended December 31, 2003. For further details regarding the impairment test see Note 9.

As at December 31, 2004, the shareholders' equity amounted to PLN 2,285,432 and the Netia Group had working capital of PLN 260,802, including short-term license fee obligations. In 2003 the financial restructuring and the cancellation of local license fee obligations of Netia were completed. Management of the Company believes that the outstanding local license fee obligations of El-Net, measured at fair value as at acquisition date and subsequently at amortized cost of PLN 54,088 (PLN 463,628 in nominal terms, including prolongation fees) will also be cancelled in accordance with the applicable law. For further details on the current situation and the Company's plans in this respect, see Note 7. In 2003 and 2004 the Netia Group generated positive cash flows from operating activities. 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.

3. Basis of presentation and summary of significant accounting policies

The Netia Group maintains its accounting records and prepares statutory financial statements in accordance with Polish accounting and tax regulations. These consolidated financial statements have been prepared based upon the Netia Group's accounting records in order to present the consolidated financial position, results of operations and cash flows in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS") and Interpretations issued by the International Accounting Standards Board ("IASB").

New accounting pronouncements

In 2004 the IASB has published four standards and three amendments. In addition there have been several revisions to the existing standards. The Netia Group will adopt all relevant new standards and amendments from January 1, 2005. The nature of the future changes in the accounting policies and the estimate of potential impact of the change in relevant standards on the profit and loss and on the financial position of the Netia Group are presented below.

In February 2004, the IASB issued IFRS 2 "Share-based Payments". The new standard should be applied for annual periods beginning on or after January 1, 2005, with retrospective effect regarding instruments granted on or after November 7, 2002 and not vested as at January 1, 2005. At present, the Company does not recognize the employee stock options issued under the Plan until the date of exercise, when the nominal value of shares increased by the costs of exercise is charged to the income statement (see Note 17). Under the new standard the Company will have to recognize the cost of share-based awards to employees (including stock options) over the period from the grant date to the vesting date. The cost is assessed on a fair value basis with measurement at the grant date. The Company has performed the provisional valuation of the options in accordance with the requirements of IFRS 2 and the total cost of options to be recognized as at January 1, 2005 as an adjustment to retained earnings amounted to PLN 1,186, of which PLN 662 relates to the year ended December 31, 2004.

In March 2004, the IASB issued IFRS 3 "Business Combinations". The new standard should be applied for business combinations for which the agreement date is on or after 31 March 2004. For previously recognized goodwill or negative goodwill, it should be applied prospectively, from the beginning of the first annual period beginning on or after 31 March 2004. Pursuant to the application of IFRS 3 as at January 1, 2005 PLN 77,657 representing the unamortized part of the negative goodwill as of that date will be transferred to retained earnings.

In March 2004, the IASB issued IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations". The new standard should be applied for annual periods beginning on or after January 1, 2005. The Company estimates that application of IFRS 5 will not have any significant impact upon retained earnings upon its introduction.

The Company estimates that adoption of the standards listed below will not have any material effect on the Netia Group's retained earnings:

IAS 1 (revised 2003) Presentation of Financial Statements
IAS 2 (revised 2003) Inventories
IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003) Events after the Balance Sheet Date
IAS 16 (revised 2003) Property, Plant and Equipment
IAS 17 (revised 2003) Leases
IAS 21 (revised 2003) The Effects of Changes in Foreign Exchange RatesIAS 24 (revised 2003) Related Party Disclosures
IAS 27 (revised 2003) Consolidated and Separate Financial Statements
IAS 32 (revised 2003) Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003) Earnings per Share
IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement
IAS 36 (revised 2004) Impairment of Assets
IAS 38 (revised 2004) Intangible Assets.

Measurement basis

The consolidated financial statements are prepared in Polish Złoty ("PLN"), using the historic cost convention as modified by certain revaluations. 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 historical cost convention was also modified by the revaluation of available-for-sale investments at fair value through the income statements as well as fair value measurement of assets and liabilities, as at the acquisition date, acquired in business combinations.

US Dollar convenience translation (Unaudited)

These consolidated financial statements are presented in Polish Zloty, which is the measurement and reporting currency of the Netia Group as it reflects the economic substance of the underlying events and circumstances of the Company. The US Dollar amounts shown in the accompanying consolidated financial statements have been translated at December 31, 2003 and for the year ended December 31, 2004 from Polish Zloty only as a matter of arithmetic computation at the Polish Zloty exchange rate of PLN 2.9904 = USD 1.00, the rate published by the National Bank of Poland and effective on December 31, 2004. These amounts are unaudited and are included for the convenience of the reader only as supplementary information. Such translation should not be construed as a representation that the Polish Zloty amounts have been or could be converted into US Dollars at this or any other rate.

Group accounting

Subsidiaries, which are those entities in which the Company has an interest of more than one half of the voting rights or otherwise has 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 and are no longer consolidated from the date that control ceases. 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 up, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. The excess of the fair value of the net assets of the subsidiary acquired over the cost of acquisition is recorded as negative goodwill. See note below for the accounting policy on negative goodwill. Intercompany transactions, balances and unrealized gains on transactions between group companies are eliminated; unrealized losses are also eliminated unless cost cannot be recovered. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Netia Group. Separate disclosure is made of minority interest. Negative minority interest resulting from negative net assets of subsidiaries is not recognized unless there is a contractual commitment by the minority shareholders to cover the losses.

When an acquisition involves more than one transaction, each significant transaction is treated separately for the purpose of determining the fair values of the identifiable assets and liabilities acquired and for determining the amount of any goodwill or negative goodwill on that transaction. This results in a step-by-step comparison of the cost of the individual investments with the Company's percentage interest in the fair values of the identifiable assets and liabilities acquired at each significant step.

Accounting for merger with subsidiaries

The merger of the parent and its subsidiaries representing a business combination under common control is accounted for in a manner similar to a pooling of interests - that is the assets and liabilities transferred are recorded in the financial statements of the transferee at their carrying amounts of the transferor prior to the transaction. Any difference between the total carrying value of net assets transferred and the carrying value of shares in the transferee's books is accounted for as an adjustment to the shareholders equity of the transferee.

The consolidated financial statements of the Netia Group include the results of operations for the period in which the merger occurs as though the transfer of net assets had occurred at the beginning of the period. The effects of intercompany transactions on current assets, current liabilities, revenue, and cost of sales for all periods presented and on retained earnings at the beginning of the periods presented are eliminated to the extent possible.

In the case when a significant independent minority interest participates in the transaction, or exists just prior to the transaction, and their percentage interests changes as a result of the transaction, the transaction is treated as an acquisition of shares from the minority interest. As a result, the change in percentage shareholding is accounted for as an acquisition.

Use of estimates

The preparation of financial statements necessarily requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Although these estimates are based on the Management's best knowledge of current events, the actual results could differ from these estimates.

Reclassifications

Certain prior periods' amounts have been reclassified to conform to the presentation for the year ended December 31, 2004. The major reclassifications relate to the presentation of data transmission, wholesale services and intelligent network services revenue due to changes of product definitions used for the Company's management accounting as well as insurance costs and taxes and fees.

Segment reporting

Through December 31, 2003 the radiocommunication activities of the Netia Group were designated as a separate segment. In the current year the Management decided to discontinue this division mostly due to the fact that those activities are not significant to the Netia Group's operations and they are not considered different in nature to other operations of the Netia Group. In consequence, the Netia Group had only one business segment – telecommunications – as at December 31, 2004. The Group operates in one geographical area, which is the territory of Poland.

Cash and cash equivalents

Cash is carried in the balance sheet at nominal value. Available-for-sale financial assets and financial assets held for trading 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 are recognized in the income statement.

Investments

The Netia Group classifies its investments in the following categories: financial assets held for trading and available-for-sale financial assets.

Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets held for trading and included in current assets. During the years ended December 31, 2004 and December 31, 2003 the Netia Group did not hold any investments in this category.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available for sale; these are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

Purchases and sales of investments are recognized on trade-date – the date on which the Netia Group commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets held for trading and available-for-sale financial assets are subsequently carried at fair value. Realized and unrealized gains and losses arising from changes in the fair value these investments are included in the income statement in the period in which they arise.

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 as other operating expense. 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 imputed interest rate of interest for similar borrowers. Any amounts reversed during the period are presented net with the impairment provisions.

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. Where necessary, provision is made for obsolete, slow moving or defective inventory

(All amounts in thousands)

Impairment and write-offs of non-current assets

Tangible fixed assets and intangible assets, including goodwill, are reviewed for impairment losses 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 net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there is separately identifiable cash flows.

Individual items of tangible fixed assets and intangible assets are also periodically reviewed for their further use to the business. If they are no longer to be used due to technological, market or similar changes or decisions made by Management to discontinue investments in specific locations, their carrying value is decreased to reflect those changes.

Fixed assets and network under construction

Fixed assets are stated at cost less accumulated depreciation, plus related inflation through December 31, 1996. Network under construction represents 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 administration and other overhead costs directly attributable to the acquisition or construction of assets before operations commence. Costs relating to the network under construction are transferred to the related fixed asset account and depreciation begins when operations commence.

The costs of repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The costs of renovations are included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Netia Group. The renovations are depreciated over the remaining useful life of the related asset.

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

	Term
Buildings	10 to 40 years
Base stations (UNI-Net)	7 to 13 years
Transmission network	15 to 22 years
Switching system	10 to 15 years
Machinery and equipment	5 to 12 years
Office machinery and equipment	3 to 10 years
Vehicles	5 to 8 years

Land and land leasehold payments are not depreciated.

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 statements on a straight-line basis over the period of the lease.

Licenses and license fee liabilities

Licenses are stated at cost less accumulated amortization. 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 net present value are treated as interest costs. Interest costs are capitalized up until the time when the network in that license territory becomes operational and are then recognized as interest expense over the period of the obligation. Amortization of the license also commences once the related network is operational and is recorded on a straight-line basis until the end of the grant period. The amortization period is 12 to 15 years.

Computer software costs

Costs that are directly associated with identifiable and unique software products controlled by the Netia Group and which have probable economic benefits, exceeding the cost, 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.

Expenditure, which enhances or extends the performance of computer software programs beyond their original specifications, is recognized as a capital improvement and added to the original cost of the software. Computer software development costs recognized as assets are amortized using the straight-line method over their useful lives, not exceeding a period of 5 years.

Negative goodwill

Negative goodwill is recognized as any excess, as at the date of the exchange transaction, of the Netia Group's interest in the fair values of the identifiable assets and liabilities acquired over the cost of the acquisition. To the extent that negative goodwill does not relate to identifiable expected future losses and expenses that can be measured reliably at the date of acquisition, negative goodwill is recognized as income in the income statement as follows:

(a) the amount of negative goodwill not exceeding the fair values of acquired identifiable non-monetary assets is recognized as income on a systematic basis over the remaining weighted average useful life of the identifiable acquired depreciable/amortizable assets; and
(b) the amount of negative goodwill in excess of the fair values of acquired identifiable non-monetary assets is recognized as income immediately.

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 headcount restructuring and termination benefits, loss on rental contracts (onerous contracts) and legal claims. Costs related to the ongoing activities of Netia Group are not provided in advance. Provisions are not recognized for future operating losses.

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 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 legal claims 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 restructuring and legal claims are recorded at 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.

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 and if the Netia Group ceases to employ members of the State Plan, it will have no obligation to pay any additional e benefits other than those benefits already earned by its own employees in previous years. 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.

The Netia Group has no other employee retirement plans.

Equity compensation benefits

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. The Company provides the exercise price required to be paid by the participants in the form of cash bonuses granted to the exercising participants. The vesting period for the options ranges up to three years from the date of grant or upon achieving certain specified conditions. The Company does not recognize the options until the date of exercise. Upon the exercise of option the Company charges the nominal value of shares issued to 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. The consideration paid for those shares is deducted from the equity until they are cancelled, reissued or disposed.

Revenue

Revenue is stated net of discounts and value added tax.

Telecommunications revenue includes mainly direct voice products, such as installation fees, monthly charges and calling charges. The Netia Group records revenue from installation fees, which are not in excess of installation costs, when the customer is connected to the network. 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. Other telecommunication revenue comprises the provision of Internet dial-in services for Netia's indirect customers, Internet callback services, 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. Service revenues are recorded when the service is provided. Revenue from the sale of equipment is recorded when the customer takes delivery.

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.

Foreign exchange gains and losses

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translations of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Deferred income taxes

Deferred income tax is provided, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. 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 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 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.

The Company offsets deferred tax assets and deferred tax liabilities if, and only if, it has a legally enforceable right to set off current tax assets against current tax liabilities, and the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable base.

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 Management Board provides written principles for overall risk management, as well as written policies covering specific areas, such as credit risk and price risk.

Price risk

- Currency risk:

The Netia Group's revenues and costs are predominately denominated in Polish Zloty, other than some payments made under the construction contracts, which are linked to the U.S. Dollar and Euro. To mitigate the currency risk Netia Group holds deposits in Euro and U.S. Dollars for servicing of those payments. The Netia Group's outstanding domestic long distance license liabilities are also denominated in Euro.

- Interest rate risk:

The Netia Group's income and operating cash flows are substantially independent of changes in market interest rates.

- Market risk:

The Netia Group does not participate in the market trading of securities.

Credit risk

The Netia Group has no significant concentrations of credit risk. 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.

Liquidity risk

The Netia Group policy assumes maintaining sufficient cash and marketable securities to service the current payments . Surpluses are invested in either bank deposits or treasury

Fair value estimation

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values.

The fair value of financial assets available for sale is based on dealer quotes obtained at each balance sheet date. Gains or losses are recognized in the income statements.

(All amounts in thousands)

5. Cash and cash equivalents

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Cash at bank and in hand	158,060	203,938
Short term deposits	69,941	97,925
	228,001	**301,863**

The short term deposits consist primarily of funds deposited in treasury bills as well as money market investment funds and asset management institutions, which are invested in various short term, low risk debt instruments.

As at December 31, 2004 PLN 1,297 were restricted as they were put as collateral securing payments to vendors.

6. Fixed assets and network under construction

Assets at adjusted cost	December 31, 2003 (PLN)	Additions (PLN)	Purchase of subsidiary (PLN)	Transfers and reclassifications (PLN)	Disposals and other movements (PLN)	December 31, 2004 (PLN)
Buildings	62,056	-	3,442	8,895	(277)	74,116
Land	17,303	-	2	117	-	17,422
Transmission network	1,615,844	-	160,255	49,981	(130)	1,825,950
Switching system	1,198,522	-	108,874	87,253	4,099	1,398,748
Base stations	8,252	-	-	-	-	8,252
Machinery and equipment	63,003	-	3,181	3,683	(757)	69,110
Office furniture and equipment	107,469	-	6,768	22,664	(7,715)	129,186
Vehicles	14,120	-	1,036	110	(3,085)	12,181
	3,086,569	-	283,558	172,703	(7,865)	3,534,965
Network under construction	111,184	160,007	2,980	(172,672)	(15,277)	86,222
	3,197,753	**160,007**	**286,538**	**31**	**(23,142)**	**3,621,187**

Accumulated depreciation	December 31, 2003 (PLN)	Depreciation Expense (PLN)	Transfers and reclassifications (PLN)	Disposals and other movements (PLN)	December 31, 2004 (PLN)
Buildings	11,811	3,062	413	(280)	15,006
Transmission network	362,282	73,453	681	1,295	437,711
Switching system	296,611	85,230	(9,721)	6,225	378,345
Base stations	8,252	-	-	-	8,252
Machinery and equipment	29,688	5,993	33	(468)	35,246
Office furniture and equipment	76,633	19,372	8,594	(7,198)	97,401
Vehicles	10,520	1,781	-	(3,467)	8,834
	795,797	**188,891**	**-**	**(3,893)**	**980,795**

(All amounts in thousands)

Accumulated impairment and write-off provisions	December 31, 2003	Write-off charge	Transfers and reclassifications	Disposals and other movements	December 31, 2004
	(PLN)	(PLN)	(PLN)	(PLN)	(PLN)
Buildings	13,875	-	675	83	14,633
Land	4,814	-	7	-	4,821
Transmission network	485,409	28	4,824	(41)	490,220
Switching system	266,689	15,178	1,883	(70)	283,680
Machinery and equipment	9,081	-	488	(124)	9,445
Office furniture and equipment	9,358	-	2,515	(252)	11,621
Vehicles	1,302	-	-	(207)	1,095
	790,528	15,206	10,392	(611)	815,515
Network under construction	28,151	6,390	(11,543)	(15,277)	7,721
	818,679	**21,596**	**(1,151)**	**(15,888)**	**823,236**

The write-off charge recorded in 2004 includes PLN 6,390 of provision created for discontinued projects to be written off and PLN 15,206 for obsolete telecommunication equipment, which will not be used due to upgrade of the switching system and transmission network. For further details regarding the impairment charge see Note 9 “Impairment of non-current assets”.

The transfers recorded in the year ended December 31, 2004 mainly relate to transfers from network under construction to fixed assets due to the completion of construction. Additionally during the year ended December 31, 2004 transfers between switching system and transmission network and office equipment were made due to reclassifications of selected computer based equipment.

The transfer of PLN 1,151 from the accumulated impairment of network under construction to the accumulated impairment of software relates to the capital expenditures on software, which the Company started to use during 2004.

Net book value	December 31, 2003	December 31, 2004
	(PLN)	(PLN)
Buildings	36,370	44,477
Land	12,489	12,601
Transmission network	768,153	898,019
Switching system	635,222	736,723
Machinery and equipment	24,234	24,419
Office furniture and equipment	21,478	20,164
Vehicles	2,298	2,252
	1,500,244	1,738,655
Network under construction	83,033	78,501
	1,583,277	**1,817,156**

Overhead costs directly attributable to the acquisition or construction of assets amounting to PLN 19,414 and PLN 8,069 were capitalized to network under construction during the years ended December 31, 2003 and 2004, respectively. Financial costs of PLN 4,244 were capitalized to network under construction during the year ended December 31, 2003.

In connection with the purchase of El-Net the acquired fixed assets were valued as of January 31, 2004 by independent valuers. Valuations were made on the basis of replacement cost (see also Note 13).

The Netia Group has also concluded a general agreement regarding lease of cars pursuant to which 134 cars are subject to specific lease agreements. The Netia Group is also subject to a contract for the operating lease of office space in Warsaw.

(All amounts in thousands)

7. Licenses

License assets

Gross book value	December 31, 2003 (PLN)	Fair value adjustment (PLN)	December 31, 2004 (PLN)
Local telecommunication licenses/permits	432,823	-	432,823
Datacom and internet licenses/permits	7,417	-	7,417
Domestic long distance licenses/permits	114,854	(7,500)	107,354
	555,094	**(7,500)**	**547,594**

Accumulated amortization	December 31, 2003 (PLN)	Amortization expense (PLN)	December 31, 2004 (PLN)
Local telecommunication licenses/permits	111,725	17,512	129,237
Datacom and internet licenses/permits	1,539	-	1,539
Domestic long distance licenses/permits	25,576	4,937	30,513
	138,840	**22,449**	**161,289**

Accumulated impairment	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Local telecommunication licenses/permits	137,127	137,127
Datacom and internet licenses/permits	5,878	5,878
Domestic long distance licenses/permits	20,517	20,517
	163,522	**163,522**

Net book value	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Local telecommunication licenses/permits	183,971	166,459
Domestic long distance licenses/permits	68,761	56,324
	252,732	**222,783**

License fee liabilities

Prior to the completion of the 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, and all business plans of the Netia Group, were made on the assumption that for such 15-year period the operators would be able to operate in an environment that was limited to two operators. The Ministry of Infrastructure established license fees and the Netia Group accepted them under the same assumption. Because the Company’s subsidiaries obtained the licenses under the old regulatory regime, the Netia Group incurred license fee obligations of EUR 215,756 (in nominal value). In December 2002, a new law entered into force in Poland, which allowed the cancellation of outstanding local license fee obligations in exchange for telecommunication infrastructure capital expenditures or conversion of license fee obligations in exchange for shares or debt of companies that had outstanding license fees in connection with licenses for providing local services. Based on this law on December 23, 2003, the Ministry of Infrastructure issued decisions to the respective subsidiaries of the Company. In those decisions the Ministry cancelled all outstanding license fee obligations at nominal value amounting to EUR 91,385 (PLN 424,785 at the exchange rate prevailing at December 23, 2003) and the outstanding prolongation fees of PLN 15,799 (translated in the decision into EUR 3,601 using the exchange rate prevailing at July 31, 2003), based on applicable capital expenditure in telecommunication infrastructure incurred in 2001 and 2002 in the operating subsidiaries.

As a result of those decisions the Netia Group as at December 23, 2003 reduced the total local license fee liability to zero. At the same time a reduction of the gross book value of the license asset was recorded as PLN 234,970 being the historical cost of the obligations forgiven, and the accumulated amortization was decreased by PLN 63,412. The net effect of the cancellation of the local license fee liabilities of PLN 176,940, being the difference between the carrying value of the cancelled liability of EUR 74,973 (PLN 348,498 at the exchange rate prevailing on December 23, 2003) and the decrease in net book value of license assets of PLN 171,558 was recorded as a gain in the consolidated income statement for the year ended December 31, 2003.

On November 26, 2003 the President of the Office for Regulations of Telecommunications and Post granted to Netia S.A. a telecommunication permit. Based on that permit as of December 31, 2003 the Company performs the activities conducted previously by its operating subsidiaries. The permit is valid for 25 years with the possibility to extend this period before expiry date.

On September 3, 2004 the new Telecommunication Act (the "2004 Act") came into force. Under the 2004 Act provision of telecommunication activity is allowed after registration by the President of the Office for Regulations of Telecommunications and Post. All entities previously authorized to render telecommunication services in Poland retained their existing rights and have been automatically entered to the telecom entrepreneurs register. Therefore Netia and its subsidiaries continue to be entitled to provide telecommunication services and use fixed public telephony and data transmission networks in Poland. In 2004 Netia Mobile Sp. z o.o., a wholly owned subsidiary of Netia S.A., was registered in the telecom entrepreneurs register as a provider of mobile public telephony services.

El-Net license fee liabilities

El-Net, the subsidiary acquired in 2004, 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 2001 Act, all telephone licenses were converted by virtue of law into telecommunication permits. On December 31, 2004 the total nominal value of outstanding license fee obligations of El-Net was EUR 113,662 (PLN 463,628 at the exchange rate prevailing on December 31, 2004).

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 308,740 at the exchange rate prevailing on December 31, 2004) and related prolongation fees of PLN 37,733, based on capital expenditure incurred between 2001 and 2003 as well as future investments to be incurred within the Netia Group. Consequently, on October 29, 2004, El-Net has also filed an application for cancellation of remaining license fee installments payable in 2010 and 2011 amounting to nominal value of EUR 28,934 (PLN 118,022 at the exchange rate prevailing on December 31, 2004). 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 the prolongation fees amounting to EUR 9,039 (equivalent of PLN 37,733 translated using the exchange rate prevailing on November 29, 2002 and October 22, 2003). 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 El-Net's capital expenditure can be 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.

The total outstanding license fee obligations of El-Net have been subject to review as regards their fair value upon purchase of El-Net by Netia. The fair value has been established based on the Management's best estimate of the probability of future payments in connection with the commenced cancellation process as at the acquisition date. Management has estimated that there is a 100% probability of cancellation in relation to the capital expenditure already incurred and 80% probability of cancellation in relation to future capital expenditure. Based on these percentages as well as the estimation of capital expenditures planned beyond 2004 the nominal value of probable future payments as at January 29, 2004 has been established at EUR 17,452 increased by PLN 5,816 of prolongation fees.

(All amounts in thousands)

This nominal value has been further adjusted to reflect the present value of the probable future payments. As result of the above, the fair value allocated to license fee liabilities of El-Net as at January 29, 2004 was equal to EUR 14,260 (PLN 67,896) increased by PLN 5,816 of prolongation fees.

Pursuant to the decision on the deferral of payments extending them to December 30, 2006, the adjustment to the discounted fair value of future payments has been recorded as a gain in the income statements amounting to PLN 13,363.

The following table presents the fair value of the outstanding local license fee obligations of El-Net as at January 29, 2004 as well as subsequent changes to the value of liabilities through December 31, 2004:

	(EUR)	(PLN)
Nominal value of outstanding license fee obligations		
Overdue installments (excluding prolongation fees)	75,690	360,388
Prolongation fees (in PLN only)		37,733
Installments payable later than 5 years	28,934	137,766
	104,624	**535,887**
Less fair value adjustment to opening balances	(87,172)	(446,973)
Nominal value of probable future payments as at January 29, 2004	**17,452**	**88,914**
Less imputed interest on license fee liabilities	(3,192)	(15,202)
Fair value as at January 29, 2004,	**14,260**	**73,712**
of which:		
Short term license fee liabilities (including prolongation fees)	11,666	61,361
Long term license fee liabilities	2,594	12,351
Fair value as at January 29, 2004,	**14,260**	**73,712**
Effect of deferral of future payments (including translation of prolongation fees into EUR)	(1,725)	(13,363)
Interest accrued in the period ended December 31, 2004	725	3,647
Foreign exchange gains on the translation of EUR balances		(9,908)
Carrying value as at December 31, 2004	**13,260**	**54,088**

Long distance license fee liabilities

The long distance license fee liabilities were not the subject of the new law regarding the cancellation of outstanding local license fee liabilities. Therefore on April 18, 2003, Netia 1 paid the two outstanding license fee obligation installments in the amount of EUR 2,000 (PLN 8,526 at the exchange rate prevailing on that date) and the applicable prolongation fees of approximately PLN 320, and penalty interest amounting to approximately PLN 314. Furthermore, on February 18, 2004 the Company paid the installment due on January 31, 2004 of EUR 1,000 (PLN 4,761 at the exchange rate prevailing on that date) increased by penalty interest of PLN 29. On January 31, 2005 the Company paid the last installment of EUR 1,000 (PLN 4,050 at the exchange rate prevailing on that date).

The total license fee liability as at December 31, 2004 comprises the PLN 54,088 of El-Net's liabilities, which is long term and PLN 4,049 of domestic long distance license liability, which is short term.

(All amounts in thousands)

8. Computer software costs

	December 31, 2003 (PLN)	Increase (PLN)	Transfers and reclassifications (PLN)	Disposals (PLN)	Purchase of subsidiary (PLN)	December 31, 2004 (PLN)
Assets at adjusted cost						
Gross book value	188,017	-	12,524	(877)	746	200,410
Capital work in progress	4,462	22,485	(11,819)	-	-	15,128
	192,479	**22,485**	**705**	**(877)**	**746**	**215,538**

	December 31, 2003 (PLN)	Amortization expense (PLN)	Transfers and reclassifications (PLN)	Disposals (PLN)	December 31, 2004 (PLN)
Accumulated amortization	70,396	27,489	(467)	(850)	96,568

	December 31, 2003 (PLN)	Write-off charge (PLN)	Transfers and reclassifications (PLN)	Disposals (PLN)	December 31, 2004 (PLN)
Accumulated impairment and write-off provision	30,654	1,522	2,118	(14)	34,280

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Net book value	**91,429**	**84,690**

9. Impairment of non current assets

The significant changes in the current and expected market conditions, which followed the liberalization of the telecommunications market, resulted in the development of a new strategy and a revision of the Netia Group's previous business plans. The Supervisory Board approved the new business plan in 2003. The revised financial projections contained in the new business plan led the Netia Group to evaluate non-current assets for their possible impairment. As a result the Netia Group performed an impairment test.

In accordance with IAS 36 "Impairment of Assets", the carrying values of the Netia Group's non-current assets were compared with their recoverable amounts, represented by the higher of their net selling price and value in use. The entire telecommunications segment was identified as one cash-generating unit. The recoverable amount of the cash-generating unit was based on a calculation of the value in use. The value in use was derived from the financial projections of the new business plan, which covers the period to December 31, 2008. After that period, the projections, prepared for the purposes of the impairment test, make use of a long-term growth rate, which is compatible with the industry projections for the operations concerned. The discount rate used (of 10 %) represented the estimated risk adjusted cost of capital at the time the assessment was performed.

The test resulted in an impairment charge of PLN 799,695, which was recorded in the consolidated income statement for the year ended December 31, 2003 and was allocated to the non-current assets in the telecommunications segment on a pro rata basis. The impact of the said charge on the particular groups of assets is as follows:

Tangible fixed assets	581,007
Construction in progress	25,912
Computer software	29,254
Telecommunication licenses	163,522
	799,695

(All amounts in thousands)

As at December 31, 2004 the Netia Group assessed whether there was any indication that the impairment loss recognized for non-current assets in the prior year may no longer exist or may have decreased. After assessing both the external and internal sources of information, no indications were identified which could result in a new assessment of the impairment loss recorded in 2003.

While the calculation of the discounted future cash flows expected to arise from the use of assets is based upon Management's best estimates of such cash flows - and the appropriate discount rate - these estimates do include considerable additional 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 Netia Group operates.

10. Operating leases

As at December 31, 2004 the future minimum payments payable under non-cancelable operating leases were as follows:

	(PLN)
Not later than 1 year	24,147
Later than 1 year and not later than 5 years	41,805
Later than 5 years	56,144
	122,096

11. Provisions

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Headcount restructuring and termination benefits	1,175	2,622
Loss on rental contract	3,455	3,569
Legal claims	2,400	3,704
	7,030	**9,895**
Of which,		
Short term	4,892	7,758
Long term	2,138	2,137
	7,030	**9,895**

	Headcount restructuring and termination benefits (PLN)	Loss on rental contracts (PLN)	Legal claims (PLN)	Total (PLN)
As at January 1, 2004	1,175	3,455	2,400	7,030
Charged / (credited) to the income statements	2,285	(3,079)	(500)	(1,294)
Acquired at purchase of subsidiary	337	5,607	1,804	7,748
Used during the year	(1,175)	(2,414)	-	(3,589)
	2,622	**3,569**	**3,704**	**9,895**

Headcount restructuring and termination benefits

The provision, which was created in 2003, related to the headcount reduction program announced by the Netia Group, which assumed a decrease of the number of employees by the end of first quarter 2004. Furthermore a provision of PLN 474 was recorded in 2004 in connection with the restructuring of headcount of El-Net acquired in January 2004. The remaining balance as at December 31, 2004 comprises the provision 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 2005.

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) for which no sub-contractor has been found. The Netia Group expects that the cash outflows relating to this provision will be incurred through 2009.

Legal claims

The amounts represent a provision for certain legal cases brought against the Netia Group entities. In the opinion of the Management the outcome of those cases 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 those claims with reasonable accuracy.

12. Accruals and other

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Construction costs	8,330	2,811
Uninvoiced services	8,762	7,207
Interconnection charges	12,463	12,489
Holidays accrual	5,492	4,727
Employees bonuses and accrued salaries	15,433	12,539
Other	12,221	9,237
	62,701	**49,010**

13. Business combinations

El-Net acquisition

On January 29, 2004, Netia Ventures Sp. z o.o. ("Ventures"), one of the Company's subsidiaries, acquired 100% of the voting shares of Regionalne Sieci Telekomunikacyjne El-Net S.A. ("El-Net"), an alternative fixed-line telecommunication operator, having its main business activities in two big cities in Poland: Warsaw and Bydgoszcz. The purchase also included 100% of El-Net's debt to its previous shareholder and to a consortium of banks. This acquisition was effected in accordance with the Netia Group's business plan, which assumes the Netia Group's leading position in the consolidation of the Polish telecommunications market. On May 31, 2004 the Company entered into a share purchase agreement with Ventures as a result of which it acquired 3,970,000 (not in thousands) registered shares of nominal value of PLN 100 (not in thousands) each, constituting (together with 30,000 shares acquired in February 2004) 100% of the share capital of EL-Net and a right to 100% of the votes at the El-Net's general meetings of shareholders. The shares were transferred to the Company in order to settle the loans granted to Ventures in the total amount of PLN 100,834 (including interest). Along with El-Net's shares, the Company acquired also the El-Net's liabilities in the total nominal value of PLN 125,653 (including interest).

The Netia Group accounted for the acquisition of El-Net using the purchase method and started consolidating the financial statements of El-Net as of February 1, 2004, adjusting the consolidated income statements and the consolidated balance sheet for material transactions, which took place between January 29, 2004 and February 1, 2004. The acquired business contributed revenue of PLN 132,844 and profit from operations of PLN 28,259 in the year ended December 31, 2004, after taking into account negative goodwill amortization of PLN 5,798 and intercompany transactions eliminations, and the carrying values of its assets and liabilities at December 31, 2004 were PLN 325,514 and PLN 85,715, respectively. Cash and cash equivalents held by El-Net amounted to PLN 20,763 as at December 31, 2004.

Details of net assets acquired and goodwill as of the date of the acquisitions are as follows :

	(PLN)
Purchase consideration, including transaction costs of PLN 5,353 – cash paid	101,688
Less fair value of net assets acquired	(179,466)
Negative goodwill	**77,778**

(All amounts in thousands)

The purchase consideration made by the Netia Group in exchange for control over the net assets of El-Net encompassed: the price paid for 100% shares of PLN 3,100, the amounts paid for El-Net's liabilities to banks and the previous shareholder of PLN 93,235 and transaction costs of PLN 5,353.

The Netia Group performed the preliminary valuation of the assets and liabilities, including independent valuation of acquired fixed assets, during the three-month period ended March 31, 2004. This valuation has been up-dated during the period ended December 31, 2004 based on additional information obtained. Further changes to the valuation may be introduced in 2005 if additional information in respect of acquired assets and 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 and liabilities, which may result in further adjustments to the carrying amounts of identifiable net assets.

In particular, the Netia Group recorded El-Net's liabilities for telecommunication license fees, as at the acquisition date, based on the fair value of future payments taking into consideration estimates regarding the probability of positive outcome of the process of cancellation of license fee obligations (for details see Note 7). As a result, El-Net's license fee obligations had a significant impact on the estimated fair value of net assets acquired which resulted in negative goodwill as at the acquisition date of PLN 77,778 compared with the goodwill of PLN 317,300 provisionally accounted for before September 30, 2004.

The Netia Group amortized the negative goodwill over the weighted average remaining useful life of the non-current assets of El-Net (12 years) up to the date of adoption of IFRS 3, i.e., January 1, 2005. At the date of adoption of IFRS 3, the whole amount of unamortized negative goodwill will be transferred to retained earnings. The total amortization of negative goodwill from the date of the purchase of El-Net recorded in the year ended December 31, 2004 amounted to PLN 5,798.

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

	(PLN)
Cash and cash equivalents	6,080
Receivables	14,017
Inventories	670
Prepayments	607
Fixed assets	287,262
Intangible assets	746
Investments	43
License fee liabilities	(73,712)
Other liabilities	(56,247)
Fair value of net assets acquired	**179,466**

Netia 1

During the year ended December 31, 2004 the Netia Group adjusted the fair values of assets of Netia 1 acquired on May 21, 2003, at the purchase of the remaining 11% of share capital of Netia 1. The change in the fair value of PLN 7,500 concerned license assets and was recorded as an adjustment to negative goodwill. The remaining portion of negative goodwill was credited to the income statement in the year ended December 31, 2004.

(All amounts in thousands)

Movements in negative goodwill

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Gross book value:		
At the beginning of the year	-	54,627
Negative goodwill / (goodwill) provisionally recognized on transaction date	54,627	(317,300)
Subsequent change due to finalization of the fair value assessment of the acquired net assets	-	387,578
At the end of the year	**54,627**	**124,905**
Accumulated amortization		
At the beginning of the year	-	(25,828)
Negative goodwill amortization recognized as income during the year	(25,828)	(21,420)
At the end of the year	**(25,828)**	**(47,248)**
Net negative goodwill as at the beginning of the year	**-**	**28,799**
Net negative goodwill as at the end of the year	**28,799**	**77,657**

14. Sale of subsidiaries

On March 31, 2004, the Company sold to Fiducia Investment Sp. z o.o., with its seat in Warsaw ("Fiducia Investment"), the following holdings in its subsidiaries: 400 shares of Netia Holdings B.V., 400 shares of Netia Holdings II B.V. and 200 shares of Netia Holdings III B.V. The total sales price for the transaction amounted to PLN 3. A summary of financial information regarding the above sale is presented below:

Subsidiary	% of interest sold	Profit / (loss) on disposal (PLN)
Netia Holdings BV	100	(150)
Netia Holdings II BV	100	167
Netia Holdings III BV	100	63

Furthermore, on March 31, 2004, Świat Internet, sold to Fiducia Investment the following holdings in its subsidiaries: 835,130 shares of Multinet S.A., 435,660 shares of IDS S.A., 40 shares of Pik-Net Sieci Rozległe Sp. z o.o., 80,000 shares of Publiczny Dostęp do Internetu Sp. z o.o. and 1,368,420 shares of Polska OnLine Holding S.A. The total sales price for the transaction amounted to PLN 4. A summary of financial information regarding the above sale is presented below.

Furthermore, on March 31, 2004, the subsidiary of Świat Internet, Polska OnLine Holding S.A., sold to Fiducia Investment 7,649 shares of Polska OnLine Sp. z o.o. for a price of PLN 1. A summary of financial information regarding the above sale is presented below:

Subsidiary	% of interest sold	Profit / (loss) on disposal (PLN)
Multinet S.A.	100	(561)
IDS S.A.	100	622
Pik-Net Sieci Rozległe Sp. z o.o.	100	(173)
Publiczny Dostęp do Internetu Sp. z o.o.	100	(112)
Polska OnLine Holding S.A.	90	30
Polska OnLine Sp. z o.o.	100	542

The net results for the year ended December 31, 2004 and the year ended December 31, 2003 of all of the above subsidiaries had no material impact on the consolidated financial statements of the Netia Group in these periods. As a result the sale of above subsidiaries is not regarded as discontinued operation.

(All amounts in thousands)

15. Installment obligations

The outstanding installment obligations comprise those claims reduced in the Polish arrangement proceedings (including guarantees given by Netia S.A. to the holders of 1997 Notes, 1999 Notes and 2000 Notes and to swap counterparties), which were not exchanged into series H shares during the restructuring process (see Note 2). These obligations were originally scheduled for payment, according to court decisions, at their nominal reduced values between 2007 and 2012 and bear no interest. As at December 31, 2003 the installment obligations were recorded on the balance sheet at the present value of the future payment obligations using the discount rate of 11.02% being the effective interest rate of the 2002 Notes.

In connection with the decision made by the Netia Group in November 2004 on the early repayment of the outstanding installment obligations, the Netia Group reclassified them to current liabilities and as at December 31, 2004 recorded at nominal value of installment obligations of PLN 11,872. The difference between their previously recorded carrying value and nominal value of PLN 5,699 has been charged as financial expense to the income statement in addition to the discount charge recorded in 2004 of PLN 466. The restructuring creditors have been entitled to exchange their restructuring claim for the ordinary series I shares at the price of PLN 1.0826241 per share which shall be payable by the means of set-off with the installment obligations (see Note 2 for further details) or to receive cash payments in the amounts consistent with the nominal value of the outstanding installment obligations.

The carrying amounts of these obligations approximate their fair value.

16. Corporate income tax

	Year ended December 31, 2003 (PLN)	Year ended December 31, 2004 (PLN)
Provision for income taxes:		
Current	254	(500)
Deferred, net	-	46,843
Income tax benefit	**254**	**46,343**

Current 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, 2003 (PLN)	Year ended December 31, 2004 (PLN)
Profit / (loss) before tax	(728,779)	113,668
Tax calculated at tax rates applicable to profit	(196,770)	21,597
Income not subject to current tax	(2,815)	(21,512)
Expenses not deductible for current tax purposes	291,084	50,279
Utilization of previously unrecognized tax losses	(10,497)	(54,277)
Tax losses for which no deferred income tax asset was recognized	(82,083)	4,193
Recognition of previously unrecognized deferred tax asset (opening balances)	-	(46,623)
Previous periods' taxes returned	827	-
Income tax benefit	**(254)**	**(46,343)**

The corporate income tax rate applicable to the Company and its subsidiaries for 2003 was 27% and for 2004 and onwards – 19%. The change in rates is connected with the change of enacted tax legislation in Poland.

(All amounts in thousands)

Deferred tax

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

	December 31, 2004
	(PLN)
Deferred tax assets:	
- Deferred tax asset to be recovered after more than 12 months	(33,161)
- Deferred tax asset to be recovered within 12 months	(37,575)
	(70,736)
Deferred tax liabilities:	
- Deferred tax liabilities to be recovered after more than 12 months	16,264
- Deferred tax liabilities to be recovered within 12 months	7,629
	23,893
	(46,843)

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

Deferred tax liabilities	**Deferred revenue**	**Interest income and foreign exchange differences**	**Depreciation and impairment**	**Total**
As at January 1, 2004	-	-	-	-
- Charged to the Income Statement	12,655	2,919	8,319	23,893
As at December 31, 2004	**12,655**	**2,919**	**8,319**	**23,893**

Deferred tax assets	**Depreciation and impairment**	**Provisions for assets**	**Tax losses**	**Accrued expenses**	**Other**	**Total**
As at January 1, 2004	-	-	-	-	-	-
- Credited to the Income Statement	(41,879)	(10,184)	(5,044)	(11,486)	(2,143)	(70,736)
As at December 31, 2004	**(41,879)**	**(10,184)**	**(5,044)**	**(11,486)**	**(2,143)**	**(70,736)**

As of December 31, 2004 the Management updated its previous year's assessment regarding the recognition of deferred income tax. The new assessment considered that the Netia Group expects that future taxable profits will be generated based on the 2005 budget and 2005-2008 business plan. Management's assessment also considered factors such as: the stability and trend of past earnings; the nature of the business and industry; the economic environment in which the Netia Group is located; and the stability of the legislation to which the companies in the Netia Group are subject. Since the realization of the tax benefits through the projected 2005-2008 taxable profits became probable, Netia recognized a net deferred tax asset of PLN 46,843 as of December 31, 2004. The recognition of net the deferred tax asset resulted in an income tax benefit in the consolidated income statement of PLN 46,843, directly increasing the Netia Group's net result for the year ended December 31, 2004.

As of December 31, 2004, the Netia Group had total deductible temporary differences of PLN 828,788 and unutilized tax loss carry-forwards of PLN 671,780 (total potential deferred tax asset of PLN 285,108). 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.

The Netia Group did not recognize deferred tax assets of PLN 49,793 relating to tax losses of PLN 262,071 of the Company due to insufficient future taxable profits to realize these tax losses. These unrecognized tax losses of the Company available for use as at December 31, 2004 will expire in the following years: PLN 134,539 in 2005 and PLN 127,532 in 2006. In addition the Netia Group did not recognize deferred tax assets of PLN 73,835 relating to tax losses of PLN 388,604 of the Company's subsidiaries due to their expiry upon the expected merger of those subsidiaries with the Company.

Furthermore, due to the lack of strong evidence of future taxable profits, which may be generated beyond 2008, the Netia Group did not recognize the deferred income tax asset of PLN 114,637, relating to deductible temporary differences of PLN 603,353.

The deferred tax calculation is based upon Management's best 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, therefore the Management will continue analyzing the Netia Group's deferred tax position as at each balance sheet date in the future.

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. In addition, losses of subsidiaries, which are planned to be merged to Netia S.A. in 2005 cannot be utilized. Losses are not indexed to inflation. Tax losses are permitted to be utilized over five years with a 50% utilization restriction per annum.

17. Shareholders' equity

Shareholders' Rights (not in thousands)

At December 31, 2003, the Company's share capital consisted of 344,485,821 ordinary shares and of 1,000 of 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.

On May 16, 2003, the Company issued 64,848,442 warrants to holders of record of the Company's shares as of December 22, 2002, which began trading on the Warsaw Stock Exchange on May 27, 2003. Subsequently exercise of warrants into series J shares has commenced. As at December 31, 2004, 22,140,102 of warrants have been exercised and the Company's share capital was accordingly increased by 22,140,102 series J shares.

In addition during 2004 the Company issued 771,011 ordinary series K shares with a nominal value of PLN 1 each, due to the exercise by certain persons authorized thereto of their rights arising from the Plan.

As a result at December 31, 2004 the Company's share capital consisted of 366,955,325 ordinary shares and of 1,000 of series A1 shares (par value of PLN 1 per share). All shares issued by the Company were fully paid.

Share Capital

	Number of shares authorized and issued (not in thousands)	**Share capital (PLN)**
At December 31, 2002....................................	**31,419,172**	**203,285**
Registration of series H shares	312,626,040	312,626
Decrease of par value of shares	-	(171,866)
Exchange of warrants for series J shares	441,609	442
At December 31, 2003	**344,486,821**	**344,487**
Exchange of warrants for series J shares	21,698,493	21,698
Issuance of series K shares	771,011	771
At December 31, 2004	**366,956,325**	**366,956**

Other reserves

In the year ended December 31, 2004 the Company reclassified the reserves resulting from the financial restructuring, to the accumulated deficit from other reserves in the consolidated financial statements. The reclassification followed the resolution no. 2, of the Annual Shareholders' Meeting of Netia S.A. dated June 12, 2003.

Distributable reserves

The Company and its subsidiaries prepare their financial statements for statutory purposes according to Polish Accounting Act of 29 September 1994 (uniform text, Journal of Laws of 2002, No. 76, item 694 with further adjustments). 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.

Other supplementary capital

The amounts transferred to other supplementary capital relate to standalone net profit of PLN 42,517 of Netia S.A. for the year ended December 31, 2003 and the surplus relating to merger of Netia S.A with its operating subsidiaries of PLN 161,048 recorded in Netia S.A. 2003 standalone financial statements. They were transferred to other supplementary capital pursuant to resolution no. 2 of the Annual Shareholders' Meeting of Netia S.A. dated June 15, 2004. Of this supplementary capital only PLN 42,517 in addition to the net profit of Netia S.A. for the year ended December 31, 2004 of PLN 120,656 would potentially be available for distribution to shareholders in form of dividend or buy-back of the Company's shares. Following the meeting of the Company's Supervisory Board held on March 1, 2005 the details of the Management's proposals regarding the distribution will be announced.

Stock options (number of shares not in thousands)

The Company has in place an incentive plan under which senior executives, employees, co-operators, consultants and board members of the managing bodies of the Netia Group may be entitled to receive additional compensation in the form of the right to acquire the ordinary shares of the Company. Option holders will be entitled to receive series K shares. Up to 18,373,785 ordinary series K shares may be issued pursuant to the Plan, of which 771,011 were issued through December 31, 2004.

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 2.53 to PLN 4.23. The purchase prices of the series K shares (equal to their nominal value of PLN 1. per share) are paid from the cash bonuses, which are granted to the exercising option holders by the Company. In April and June 2003 as well as April and October 2004 the Supervisory Board approved the issue of 13,373,261 options under the Plan.

Movements in the number of share options outstanding under the Plan are as follows:

Options	Average strike price	Options	Average strike price	Options
	2003		2004	
At beginning of year	-	-	-	7,936,975
Granted	2.56	8,081,943	2.81	2,228,877
Forfeited/ expired	2.53	(144,968)	2.53	(1,087,257)
Exercised	-	-	3.27	(1,872,498)
At end of year	**2.56**	**7,936,975**	**2.65**	**7,206,097**

The total number of vested options was 4,759,770 and 4,131,577 as at December 31, 2004 and 2003, respectively. The vesting period for the options is up to three years from the date of grant or upon achieving certain specified conditions. The options are exercisable until December 20, 2007. Options exercised in 2004 resulted in 771,011 of shares being issued at PLN 1.00 each.

All options granted previously under the old stock option plan of the Company expired at January 1, 2004.

The Company does not recognize the options until the date of exercise. Upon the exercise of option the Company charges the nominal value of shares issued increased by the costs of exercise to the income statement as salaries and benefits. The current year expense relating to the Plan amounted to PLN 771 in 2004 and nil in 2003.

As of January 1, 2005 the Company has implemented IFRS 2. For further details see Note 3.

(All amounts in thousands)

18. Minority interest

	December 31, 2003 (PLN)	December 31, 2004 (PLN)
At beginning of the year	17,499	4,328
Share of net profit of subsidiaries	554	858
Acquisition of shares of Netia 1	(13,725)	-
At end of the year	**4,328**	**5,186**

On May 21, 2003 the Company purchased the remaining 11% of share capital of Netia 1 Sp. z o.o. for PLN 577 from TeliaSonera AB (publ.). Netia 1 was subsequently merged into the Company.

19. Significant subsidiaries of the company

The consolidated financial statements include the accounts of the Company's directly or indirectly held subsidiaries (after taking into account the merger of the operating subsidiaries into the Company, which took place on December 31, 2003):

	Ownership Percentage	
Subsidiary	**December 31, 2003**	**December 31, 2004**
Subsidiaries held directly:		
UNI-Net Sp. z o.o.	58	58
Netia Świat S.A.	100	100
Polbox Sp. z o.o.*,**	N/a	100
Netia Globe S.A.	100	100
Netia Ventures Sp. z o.o.	100	100
RST El-Net S.A.	-	100
Subsidiaries held indirectly:		
Netia Mobile Sp. z o.o.	-	100
Świat Internet S.A.*	100	100

* Subsidiaries consolidated since the acquisition of Świat Internet group that took place in April 2003.
** Polbox was sold from Świat Internet to Netia on May 31, 2004.

All subsidiaries are incorporated in Poland.

20. Salaries and benefits

	Year ended	
	December 31, 2003 (PLN)	December 31, 2004 (PLN)
Wages and salaries	112,046	109,925
Social security costs	11,404	13,444
Defined contribution plan (the State Plan)	6,683	6,817
Other employee benefits	2,907	4,027
	133,040	**134,213**

The Netia Group is legally required to make contributions to Government's retirement benefit scheme. During the years 2004 and 2003 the Group paid contributions at a rate of 9.76% of gross salaries and is not required to make any contributions in excess of this statutory rate.

21. Other operating expenses

	Year ended December 31, 2003 (PLN)	Year ended December 31, 2004 (PLN)
Cost of traffic termination	4,153	33,770
Information technology services	20,787	16,411
External services	10,683	17,014
Bad debt expense	14,402	10,251
Office and car maintenance	19,415	9,138
Materials and energy	7,683	9,092
Mailing services	5,008	7,069
Travel and accommodation	4,300	4,822
Other operating costs	6,324	13,650
	92,755	**121,217**

22. Financial income / (expense), net

	Year ended December 31, 2003 (PLN)	Year ended December 31, 2004 (PLN)
Interest income	6,578	9,516
Gain on deferral of license fee payments (see Note 7)	-	13,363
Gain on sale of subsidiaries	-	340
Gain on sale of available-for-sale financial assets	3,946	-
Gain on fair value adjustment of financial assets	2,437	3,278
Foreign exchange gains / (losses), net	(19,839)	4,805
Interest expense	(16,895)	(4,448)
Amortization of discount on installment obligations (see Note 15)	(566)	(6,165)
Amortization of notes issuance costs	(1,265)	-
Write-off of notes issuance costs due to early redemption of 2002 Notes	(40,211)	-
Other	194	7,185
	(65,621)	**27,874**

23. Earnings per share

Basic

Basic earnings per share have been calculated based on the net profit / (loss) for each period divided by the weighted average number of shares in issue during the year. The weighted average number of shares in issue (not in thousands) excludes 468,648 treasury shares in each of the periods presented.

	Year ended December 31, 2003	Year ended December 31, 2004
Net profit / (loss)	(729,079)	159,153
Weighted average number of shares in issue (not in thousands)	343,849,029	358,096,167
Basic earnings per share (not in thousands)	(2.12)	0.44

Diluted

Diluted earnings per share is calculated adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has three categories of dilutive potential ordinary shares: warrants (which upon their exercise trigger the issue of the series J shares), the employees' stock options (which upon their exercise trigger the issue of the series K shares), and the series I shares which were offered by the Company to its creditors in connection with the earlier repayment of outstanding installment obligations in February 2005. For the share options and warrants a calculation is 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 is compared with the number of shares that would have been issued assuming the exercise of the share options and warrants.

In calculation of the diluted earnings per share for the year ended December 31, 2003, the Group assumed no exercise of stock options and warrants since the exercise would have antidilutive effect.

	Year ended	
	December 31, 2003	**December 31, 2004**
Net profit / (loss)	(729,079)	159,153
Weighted average number of shares in issue (not in thousands)	343,849,029	358,096,167
Adjustments for:		
- Share options..	-	3,252,657
- Warrants...	-	20,127,978
Weighted average number of ordinary shares for diluted earnings per share (not in thousands)	343,849,029	381,476,802
Diluted earnings per share (not in thousands)..	(2.12)	0.42

24. Related party transactions

Changes in Management Board

Effective February 25, 2004 Mr. Zbigniew Łapiński resigned from his position in the Management Board.

Effective February 29, 2004 Ms. Elizabeth McElroy resigned from her position in the Management Board.

Effective May 1, 2004 Ms. Irene Cackett was appointed Member of the Management Board holding a position of Chief Commercial Officer.

Effective October 29, 2004 Mr. Kent Holding was appointed Member of the Management Board and Chief Financial Officer of the Company.

Changes in Supervisory Board

On January 23, 2004 the Company was informed about Mr. Andrzej Wierciński's resignation from his position as a member of the Company's Supervisory Board. His resignation was effective on March 2, 2004.

On March 11, 2004 the Extraordinary General Meeting of Shareholders of the Company adopted resolutions on changes in the composition of the Company's Supervisory Board; pursuant to which Mr. Jarosław Bauc, Mr. Morgan Ekberg and Ms. Ewa-Maria Robertson retired from their positions and Mr. Mark Holdsworth, Mr. Hubert Janiszewski, Mr. Bogusław Kasprzyk and Ms. Alicja Kornasiewicz were appointed members of the Company's Supervisory Board.

Options granted to members of the Management Board

As at December 31, 2004, the total number of options granted to members of the Company's Management Board under the Plan, was 5,526,888, of which 3,080,561 vested as of that date. Strike prices for the options granted to the Management Board range between PLN 2.53 to 4.23 per share. The market price of the Company's shares at December 31, 2004 was PLN 4.46 per share.

(All amounts in thousands)

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

Options	**December 31, 2003**	**December 31, 2004**
At beginning of year	-	6,342,331
Granted	6,342,331	1,359,071
Forfeited/ expired	-	(664,435)
Status changed due to resignation from Management Board	-	(362,419)
Exercised	-	(1,147,660)
At end of year	**6,342,331**	**5,526,888**

	Wojciech Madalski	**Paul Kearney**	**Irene Cackett**	**Former members of the Management Board**	**Total**
As at January 1, 2003	-	-	-	-	-
Granted	4,530,236	362,419	-	1,449,676	6,342,331
As at December 31, 2003	**4,530,236**	**362,419**	**-**	**1,449,676**	**6,342,331**
Granted	-	362,419	271,814	724,838	1,359,071
Forfeited/ expired	-	-	-	(664,435)	(664,435)
Status changed due to resignation from Management Board	-	-	-	(362,419)	(362,419)
Exercised	-			(1,147,660)	(1,147,660)
As at December 31, 2004	**4,530,236**	**724,838**	**271,814**	**-**	**5,526,888**

Management Board remuneration and Supervisory Board remuneration

Year ended December 31, 2003

Compensation and related costs associated with current members of the Company Management Boards and Supervisory Boards during the year ended December 31, 2003 amounted to PLN 5,897. Furthermore, the termination benefits for the former members of the Management Board pursuant to their resignations of PLN 7,501 were recognized as cost in the year ended December 31, 2003.

Year ended December 31, 2004

The compensation and related cost of remuneration of member of the Company’s Management and Supervisory Board are presented below:

Remuneration of current members of the Management Board (including bonus paid and accrued)	
Wojciech Madalski	1,978
Kent Holding	258
Irene Cackett	1,078
Paul Kearney	1,115
	4,429
Remuneration and termination benefits for the former members of the Management Board	2,161
Remuneration of current members of the Supervisory Board	
Nicolas Cournoyer	6
Richard Moon	111
Bogusław Kasprzyk	52
Mark Holdsworth	52
Alicja Kornasiewicz	52
Hubert Janiszewski	66
Andrzej Radzimiński	88
	427
Remuneration and termination benefits for the former members of the Supervisory Board	149
Remuneration of the members of management boards of subsidiaries	330
Total	**7,496**

25. Commitments and contingencies

Capital expenditures contracted for at the balance sheet date but not recognized in the consolidated financial statements amount to PLN 10,315 as at December 31, 2003 and PLN 24,743 (USD 8,274 at the December 31, 2004 exchange rate) as at December 31, 2004.

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 11,8 million at the December 31, 2004 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. The matter is still pending. 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.

On February 11, 2003, the District Court ruled in the Company's favor for the return of the principal amount of the loan and the related interest. That judgment was appealed by Millennium. Following a question on the matter of law to the Supreme Court, the Court of Appeal announced judgment on October 6, 2004 stating that the District Court made a procedural mistake, which caused the case to be returned for re-examination.

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 failure to perform the agreements entered into August and September 2002. The matter is pending, and the next hearing is scheduled for May 25, 2005.

On November 7, 2003 Millennium and Genesis Sp. z o.o. ("Genesis"), two shareholders of the Company, filed claims with the Regional Court in Warsaw for the suspension of the registration in the relevant registry of the Company's merger with certain of its subsidiaries pursuant to a resolution adopted by the Company's Extraordinary General Shareholders' Meeting on October 30, 2003. The Regional Court registered the merger in the register of entrepreneurs on December 31, 2003. Also, the court refused to allow Millennium and Genesis to participate in the registration proceedings, which Millennium and Genesis appealed with the District Court in Warsaw on January 12, 2004. On September 7, 2004 the District Court in Warsaw allowed Millennium and Genesis to participate in the registration proceedings. Separate claims were brought by Millennium and Genesis with the District Court in Warsaw requesting the invalidation of the resolution on the Company's merger adopted by the Company's Extraordinary General Shareholders' Meeting on October 30, 2003. The Company received the claims on June 3, 2004 and petitioned the court to dismiss them both as wholly unfounded and also requested that the shareholders make a payment equaling ten times the amount of Netia's court costs. A hearing is scheduled for March 30, 2005.

On June 1, 2004, the District Court in Warsaw dismissed at the first hearing the claim requesting the invalidation of a resolution adopted at Netia's Extraordinary General Meeting of Shareholders held on August 30, 2002 with regard to extending the mandates of certain members of Netia's Supervisory Board, deeming it wholly unfounded. The judgment is final and not appealable.

Millennium and Newman filed motions for the declaration of bankruptcy of the Company on July 16, 2004 and July 21, 2004. On December 14, 2004 the District Court for the Capital City of Warsaw, XVII Bankruptcy and Restructuring - Commercial Department in Warsaw (the "Court") dismissed both motions. The decision can be appealed.

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. At the court hearing held on February 4, 2004, the District Court in Warsaw decided to forward the claim to the Regional Court for the capital city of Warsaw for its determination. The hearing in this case was adjourned till April 21, 2005 before the Regional Court. In a second similar matter, a minority shareholder's claim was dismissed by the Regional Court in Warsaw on merits however the judgment can be appealed.

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.

Tax contingent liability

Regulations relating to value-added tax, corporate income tax, and payroll (social) taxes have been 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 regulations and the relatively short period in which these new tax regulations have been in place results in there being 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 (e.g., customs or foreign exchange law) 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 system. The tax authorities may at any time inspect the books and records 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 give rise to a potential material liability in this respect.

26. Subsequent events

Issuance of Series K shares (not in thousands)

On January 10, 2005 the Company issued 163,088 ordinary series K shares with a nominal value of PLN 1, which give the right to 163,088 votes at Netia's general meeting of shareholders, due to the exercise by certain persons authorized thereto of their rights arising from the Plan. On January 19, 2005 the issued shares were admitted to trading on the Warsaw Stock Exchange. As of March 1, 2005 the total number of series K shares issued amounted to 943,099.

Close of subscription of series I shares (not in thousands)

On February 16, 2005 the subscription of the Company's series "I" shares was completed. 5,875,610 series "I" shares were allocated out of a total of 18,373,785 series "I" shares offered in connection with the decision on early repayment of outstanding installment obligations resulting from Netia's arrangement proceedings approved in 2002. The price of the series "I" shares was PLN 1.0826241 per share.

Exercise of warrants (not in thousands)

As at February 28, 2005 27,803,472 of warrants have been exercised and the Company's share capital was accordingly increased by 27,803,472 series J shares. As a result at March 1, 2005 the Company's share capital consisted of 372,781,783 ordinary shares and of 1,000 of series A1 shares.