

FC 18106

Audited Financial Statements

Ukraine International Airlines

*Years ended December 31, 1996 and 1995  
with Report of Independent Auditors*



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Ukraine International Airlines  
Audited Financial Statements  
Years ended December 31, 1996 and 1995

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## Report of Independent Auditors

The Board of Directors and Shareholders  
Ukraine International Airlines

We have audited the accompanying balance sheets of Ukraine International Airlines (the "Company") as of December 31, 1996 and 1995, and the related statements of operations and accumulated deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 8 to the financial statements, the Company has recorded route acquisition costs at a value established by the Company's Board of Directors, and has elected not to amortize the capitalized amount. International Accounting Standard No. 4, "Depreciation Accounting", requires that such assets be amortized. Based on straight line amortization the route acquisition costs would be reduced by accumulated amortization of \$2.6 million, and the loss for the year and accumulated deficit would be increased by \$1.18 million and \$2.6 million, respectively (\$0.7 million, and \$1.42 million for 1995, respectively).

In our opinion, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the financial statements referred to above, present fairly, in all material respects, the financial position of Ukraine International Airlines as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

We have also audited the financial statements of the Company at December 31, 1996 and 1995 and for each of the two years then ended, not presented herein, prepared in compliance with the regulations for bookkeeping and accounting for income tax and statutory reporting purposes in Ukraine and we expect to report separately on the statutory financial statements. The significant differences between the accounting principles applied in preparing the statutory financial statements and those applied for International Accounting Standards purposes are summarized in Note 2 to the financial statements.

*Ernst & Young Ukraine*

June 5, 1997

# Ukraine International Airlines

## Balance Sheets

	December 31	
	1996	1995
	<i>(In Thousands of US Dollars)</i>	
<b>Assets</b>		
Current assets:		
Cash (Note 3)	\$ 1,245	\$ 2,345
Accounts receivable, net (Note 4)	1,880	2,632
Note receivable from UIAB (Note 5)	6,000	—
Inventory (Note 6)	2,817	2,828
Prepayments and other current assets	1,475	1,394
	<u>13,417</u>	<u>9,199</u>
Property and equipment, net of accumulated depreciation (Note 7)	838	936
Other assets:		
Route rights (Note 8)	32,829	28,340
Start-up costs, net of accumulated amortization (Notes 2 and 9)	374	749
	<u>33,203</u>	<u>29,089</u>
<b>Total assets</b>	<u><u>\$47,458</u></u>	<u><u>\$39,224</u></u>
<b>Liabilities and shareholders' equity</b>		
Current liabilities:		
Short-term borrowings	\$ —	\$ 1,450
Current portion of long-term debt (Note 10)	1,886	3,875
Accounts payable and accrued liabilities	5,617	6,331
Deferred revenue (Note 11)	1,986	1,612
	<u>9,489</u>	<u>13,268</u>
Long-term debt, net of current portion (Note 10)	1,560	2,221
Commitments and contingencies (Note 15)		
Shareholders' equity:		
Common stock (Note 13)	49,000	35,512
Accumulated deficit	(12,591)	(11,777)
<b>Total shareholders' equity</b>	<u>36,409</u>	<u>23,735</u>
<b>Total liabilities and shareholders' equity</b>	<u><u>\$ 47,458</u></u>	<u><u>\$ 39,224</u></u>

See accompanying notes.

# Ukraine International Airlines

## Statements of Operations and Accumulated Deficit

	December 31	
	1996	1995
	<i>(In Thousands of US Dollars)</i>	
Operating Revenues:		
Passenger	\$ 39,518	\$ 35,399
Charter	2,821	3,018
Cargo	3,707	2,746
Other revenue	1,228	654
	<u>47,274</u>	<u>41,817</u>
Operating Expenses:		
Passenger and aircraft handling	5,441	5,741
Fuel	5,324	3,384
Maintenance	5,584	3,869
Navigation	4,744	3,710
Landing fees	1,275	1,261
Salaries	3,242	2,525
Commissions	2,854	2,464
Catering	2,508	2,853
Sales and distribution costs	1,529	978
Block-Seat Costs	<u>319</u>	<u>—</u>
Aircraft lease costs	5,775	4,666
Insurance	1,766	1,892
Depreciation of inventory and fixed assets	386	333
Administration	3,135	2,856
Representative office expenditures	1,930	1,556
Amortization of start-up costs	374	374
Value-added tax	182	714
Bad debts provision	92	265
	<u>46,460</u>	<u>39,441</u>
Income (loss) from operations	814	2,376
Other expenses:		
Interest expense	694	595
Other local taxes	824	729
Other non-operating expense	—	63
Foreign currency translation loss	110	351
Net (loss) income	<u>\$ (814)</u>	<u>\$ 638</u>
Accumulated deficit - beginning of year	(11,777)	(12,415)
Accumulated deficit - end of year	<u>\$ (12,591)</u>	<u>\$ (11,777)</u>

*See accompanying notes.*

# Ukraine International Airlines

## Statements of Cash Flows

	December 31	
	1996	1995
	<i>(In Thousands of US Dollars)</i>	
<b>Cash Flows From Operating Activities</b>		
Net (loss) income	\$ (814)	\$ 638
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	760	707
Changes in operating assets and liabilities:		
Accounts receivable, net	752	(1,456)
Inventory	(120)	(277)
Prepayments and other current assets	(81)	(211)
Accounts payable and accrued liabilities	(714)	2,194
Deferred revenue	374	983
Net cash provided by operating activities	157	2,578
<b>Cash Flows From Investing Activities</b>		
Purchases of property and equipment	(157)	(715)
(Repayment of) proceeds from short-term borrowings	(1,450)	1,450
Net cash (used in) provided by investing activities	(1,607)	735
<b>Cash Flows From Financing Activities</b>		
Investment from UIAB	3,000	—
Proceeds from long-term debt	295	597
Payments of long-term debt	(2,945)	(2,524)
Net cash provided by (used in) financing activities	350	(1,927)
(Decrease) increase in cash	(1,100)	1,386
Cash at the beginning of the year	2,345	959
Cash at the end of the year	\$ 1,245	\$ 2,345

See accompanying notes.

# Ukraine International Airlines

## Notes to Financial Statements

(Balances in thousands of U.S. Dollars unless otherwise stated)

### 1. Organization and Basis of Presentation

#### Organization

Ukraine International Airlines (the "Company"), formerly named Air Ukraine International Airlines (renamed in the 1996 Charter Documents), was incorporated in Ukraine on October 29, 1992 as a joint venture between the Ukrainian Association of Civil Aviation ("UACA") and Guinness Peat Aviation ("GPA"). Pursuant to legislation enacted by the Ukrainian Government during 1994, the State Property Fund of Ukraine ("SPF") became the successor as shareholder to the Ukrainian Association of Civil Aviation. These changes came into effect in May 1996 upon re-registration of the Company's charter. In November 1996 the Company was again re-registered to reflect the investment made by U.I.A. Beteiligungsgesellschaft mbH ("UIAB"), a legal entity under the legislation of Austria, owned exclusively by Austrian Airlines and Swissair. The current shareholding is SPF 335,000 shares which is 68.37% of the total authorized capital, UIAB 90,000 shares which is 18.37% of the authorized capital and GPA 65,000 which is 13.26% of the authorized capital.

The Company provides commercial passenger and cargo transportation between selected destinations in Western Europe and Ukraine.

#### Basis of Presentation

In September 1996, the Ukrainian Government introduced a new currency, the Hryvnia ("UAH") to replace the Karbovanets as the national currency of Ukraine. All Ukrainian accounting records were converted to Hryvnia at the rate of 1 Hryvnia equal to 100,000 Karbovanets. The Company maintains its records and prepares its financial statements in Ukrainian Hryvnia in accordance with Ukrainian accounting and tax regulations. The currency used to report in these financial statements is the U.S. dollar as the majority of the Company's business and assets and liabilities are denominated in this currency. The accompanying financial statements differ from the financial statements issued for statutory purposes in Ukraine in that they reflect certain adjustments not recorded on the Company's books which are appropriate to present the financial position, results of operations and cash flows in accordance with International Accounting Standards ("IAS"). The principal adjustments relate to: (1) revenue recognition; (2) accounting for "low-value, short-life" inventory; (3) valuation and depreciation of property and equipment; (4) foreign currency translation; (5) interest charges, and (6) the allowance for bad debts.

## Ukraine International Airlines

### Notes to Financial Statements

#### 1. Organization and Basis of Presentation (continued)

IAS No. 29, "Financial Reporting in Hyper-inflationary Economies" has not been applied to the accompanying financial statements. However, by using the U.S. dollar as the reporting currency for these financial statements, and by applying the temporal method of translation, the effects of inflation have been taken into consideration in all material respects since movements in the exchange rate between the U.S. dollar and the Hryvnia are considered a reasonable approximation of the general price level index.

#### Reclassification

Certain of the 1995 comparative figures have been reclassified to conform to the presentation adopted in the current year.

#### 2. Significant Accounting Policies

##### Foreign Currency Translation

The temporal method has been used to translate the Hryvnia activities of the Company into U.S. dollars for these financial statements. Monetary assets and liabilities have been translated into U.S. dollars at the market rate in effect at the balance sheet date. At December 31, 1996, the rate was \$1 to UAH 1.889 and at December 31, 1995 the rate was \$1 to UAH 1.794. Non-monetary assets and liabilities have been translated at the estimated historical market rate prevailing on the date of the transaction. Income and expenses have been translated at the average monthly market rates. Translation gains and losses and exchange differences are included in the accompanying statements of operations.

The Hryvnia is not a convertible currency outside the territory of Ukraine. Within Ukraine, its convertibility is regulated by the National Bank of Ukraine ("NBU"). The translation of the Hryvnia denominated assets and liabilities into U.S. dollars for the purposes of these financial statements does not indicate that the Company could realize or settle in U.S. dollars the disclosed values of these assets and liabilities. At June 5, 1997 the market exchange rate was \$1 to UAH 1.850. The effect, if any, of this increase in value of the Hryvnia on the net monetary assets and liabilities as of December 31, 1996 has not been determined.

##### Use of Estimates

The preparation of financial statements in accordance with International Accounting Standards requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.



## Ukraine International Airlines

### Notes to Financial Statements

#### 2. Significant Accounting Policies (continued)

##### Cash Equivalents

The Company considers cash equivalents as all legally liquid investments with an original maturity of three months or less. At December 31, 1996 and 1995, cash accounts consisted of Hryvnia and foreign currency accounts.

##### Accounts Receivable

Accounts receivable are stated at their net realizable value. Accounts specifically identified as doubtful are written-off.

##### Inventory

Inventory is stated at cost and primarily consists of rotatable aircraft spare parts. Cost is based on the average unit invoice cost. Depreciation of rotatable parts is computed on a straight-line basis using an estimated useful life of sixteen years.

##### Property and Equipment

Office premises, equipment and vehicles are stated at historical cost, net of accumulated depreciation. Depreciation is computed on a straight-line basis using an estimated useful life of five years.

##### Start-up Costs

Expenditures incurred on the initial training of pilots, staff and other start-up costs were capitalized and are being amortized on a straight-line basis over five years.

##### Revenue Recognition

Revenues from passenger, charter, cargo operations and other airline services exclude taxes. Revenues from passenger and cargo operations are recognized when transportation is provided. The deferred passenger revenue represents the estimated value of sold but unused tickets as of the year end reporting date.

##### Leased Aircraft Maintenance

Lease payments, routine maintenance and airframe and engine overhauls for leased flight equipment are charged to operations as incurred.

Under the terms of the lease agreement, the Company is required to pay a supplemental per hour rent to General Electric Capital Aviation Services ("GECAS") for maintenance reserves. To the extent that the actual costs incurred associated with major engine and airframe overhauls exceed the cumulative supplemental rent charge, the Company pays the excess.

## Ukraine International Airlines

### Notes to Financial Statements

#### 2. Significant Accounting Policies (continued)

##### Income Taxes

Deferred taxes are accounted for under the liability method. The deferred taxes reflect the tax effect of all significant temporary differences between Ukrainian statutory tax accounting for assets and liabilities and their reported amounts in the accompanying financial statements which are reported in accordance with International Accounting Standards. A deferred tax asset does not appear on the accompanying financial statements because the environment encompassing the tax regime in Ukraine does not provide reasonable expectation of realization.

##### Borrowing and Interest Costs

Borrowing and interest costs are expensed as incurred.

##### Government Pension Funds

The Company contributes to the Ukrainian state pension fund, medical insurance fund and unemployment fund on behalf of all of its employees. The Company's contribution was 37% of its employees' salaries and is expensed as incurred. The total amount expensed in connection with contributions to the state pension fund for the year ended December 31, 1996 was \$564,000 (\$480,000 at December 31, 1995).

##### Non-monetary Transactions

As with many companies operating in Ukraine, a portion of the Company's business is conducted via non-monetary transactions. These transactions are accounted for at normal, arm's length selling prices of the items transferred. During the year ending December 31, 1996 the total value of these transactions as reported in the accompanying financial statements amounted to approximately \$220,000 (\$196,000 in 1995).

##### Concentration of Credit Risk

Financial instruments which potentially expose the Company to concentration of credit risk consist primarily of accounts receivable. The credit risk associated with accounts receivable is limited due to the Company's large customer base and ongoing procedures which monitor the credit worthiness of customers.

##### Fair Value of Financial Instruments

The fair value of financial instruments, consisting of cash, accounts receivable, obligations under accounts payable, short-term borrowings and long-term debt, are considered to be equal to their carrying values.

# Ukraine International Airlines

## Notes to Financial Statements

### 3. Cash

Cash includes deposit guarantees of \$745,000 (\$1,642,000 in 1995). During 1996 the Company was required to provide bank guarantees and refundable deposits to several trade creditors. These bank guarantees are secured by the Company's cash deposits maintained in financial institutions. Of those Bank Guarantees \$340,000 was for GPA in connection with an aircraft lease which has since expired (the bank guarantee expired on January 1, 1997).

### 4. Accounts Receivable

Accounts receivable consisted of the following as of December 31:

	1996	1995
Other airlines (through IATA)	\$ -	\$ 602
Agents	1,556	1,244
Cargo	503	814
Credit card companies	252	311
	<u>2,311</u>	<u>2,971</u>
Allowance for doubtful accounts	(431)	(339)
	<u>\$ 1,880</u>	<u>\$ 2,632</u>

### 5. Note Receivable from UIAB

The note receivable for \$6 million from UIAB was collected by UIA in the first quarter of 1997. The amount was non-interest bearing, and was due in connection with UIAB's charter contribution (see note 13).

### 6. Inventory

Inventory consisted of the following as of December 31:

	1996	1995
Spare parts	\$ 2,784	\$ 2,533
Other inventory	326	457
	<u>3,110</u>	<u>2,990</u>
Accumulated depreciation	(293)	(162)
	<u>\$ 2,817</u>	<u>\$ 2,828</u>

# Ukraine International Airlines

## Notes to Financial Statements

### 7. Property and Equipment

Property and equipment consisted of the following as of December 31:

	1996	1995
Office premises and improvements	\$ 293	\$ 232
Office equipment	638	585
Automobiles	428	414
	<u>1,359</u>	<u>1,231</u>
Accumulated depreciation	(521)	(295)
	<u>\$ 838</u>	<u>\$ 936</u>

### 8. Route Rights

~~UACA contributed rights to operate into and out of Ukraine ("route rights").~~ These route rights, initially established for thirty (30) international routes, were estimated by the founders (Ukraine Association of Civil Aviation and Guinness Peat Aviation) to be worth \$100 million when the Company was formed and included the rights to operate into and out of destinations which the Company did not operate from 1993 to 1995.

In January 1994, the Board of Directors issued a protocol whereby an agreement was reached to revalue the contributed capital of the Company. The purpose of this revaluation was to more accurately reflect the value of the route rights contributed by UACA for the destinations which the Company then served. The value recorded in the financial statements at December 31, 1995 at an amount of approximately \$28.3 million, is based on a proportionate amount of the initial \$100 million estimation to reflect the routes actively flown from inception.

# Ukraine International Airlines

## Notes to Financial Statements

### 8. Route Rights (continued)

In April 1996, at a general assembly shareholder meeting, several changes to the Company's authorized capital were agreed upon. The route rights contribution by the SPF was revalued at \$32.8 million. The increase in the value is attributed to eight new route rights which are not yet in use however management believes that the Company will have the capital necessary to operate these rights in the future. The SPF, through the State Department of Aviation Transport of Ukraine, guarantees exclusive rights to the Company for a period of fifteen (15) years to operate twenty air routes.

In connection with UIAB's charter contribution, the basis of the Route Rights was increased in the charter documents signed by all parties on July 25, 1996. The route rights are specifically given a value equal to that stated in the charter documents and as reported in these financial statements at December 31, 1996.

Management believes these rights have not suffered economic depreciation in value and, accordingly, no amortization has been reflected in the financial statements. International Accounting Standard No. 4, "Depreciation Accounting", requires that such assets be amortized. Based on straight line amortization the loss for the year would be increased by \$1.18 million, and the route rights would be reduced by accumulated amortization of \$2.6 million (\$ .7 million and \$1.42 million in 1995 respectively).

### 9. Start-up Costs

Start-up costs consisted of the following as of December 31:

	1996	1995
Guinness Peat Aviation	\$ 3,118	\$ 3,118
Ukrainian Association of Civil Aviation	671	671
	3,789	3,789
Accumulated amortization	(3,415)	(3,040)
	\$ 374	\$ 749

## Ukraine International Airlines

### Notes to Financial Statements

#### 10. Borrowings

Borrowings consisted of the following as of December 31:

	1996	1995
First Ukraine International Bank	\$ 1,560	\$ 1,399
Guinness Peat Aviation	1,392	2,821
Boeing	294	843
Austrian Airlines	-	833
Willis Corroon	200	200
	<u>\$ 3,446</u>	<u>\$ 6,096</u>
Non Current	<u>(1,560)</u>	<u>(2,221)</u>
	<u>\$ 1,886</u>	<u>\$ 3,875</u>

The Company has an agreement with First Ukraine International Bank ("FUIB") whereby FUIB has committed to provide up to \$1.56 million of credit with repayment due in January 1997. This line of credit bears an annual interest at the rate of 12%. According to the terms of this agreement, FUIB had the right to acquire a maximum of 5% of the outstanding common shares, however, this option was not exercised. The credit line was renewed in January 1997 and was secured by cash flows through the account. The renewed credit line will terminate in February 1999, and will be for \$2.5 million of which only \$1.56 million can be used as working capital and the balance can only be drawn down for a deposit for an aircraft purchase. Interest charged on this account is fixed at 18%, charged monthly in arrears on the actual amount outstanding.

In October 1994, GPA and the Company agreed upon a debt repayment schedule in order for the Company to repay its debt of approximately \$4 million. Interest accrues on the outstanding amount at the rate of six months LIBOR plus 3% as quoted on August 1, 1994 and adjusted on a semi-annual basis commencing February 1, 1995. The LIBOR rate in effect at December 31, 1996 was 5.5%. Monthly interest payments commenced on November 1, 1994 and continue through June 1997.

In October 1992, the Company entered into a loan agreement with Boeing Commercial Aeroplane Group in the principal amount of \$2.7 million in exchange for spare parts inventory. The note bears interest at the three month LIBOR rate plus 4%, and is secured by the related spare parts inventory and matured in December 1996. This loan was repaid in January 1997.

An interest free loan of \$200 thousand was received in 1994 from Willis Corroon, the Company's insurance carrier. It has been agreed that this loan will be repaid during 1997.

## Ukraine International Airlines

### Notes to Financial Statements

#### 11. Deferred Revenue

Deferred revenue consisted of the following as of December 31:

	1996	1995
Air traffic liability	\$ 1,467	\$ 1,101
Deferred pool revenue (Austrian Airlines)	500	500
Other	19	11
	<u>\$ 1,986</u>	<u>\$ 1,612</u>

The deferred pool revenue relates to prepayments received during 1996 in accordance with a revenue sharing agreement between the Company and Austrian Airlines.

#### 12. Income Taxes

The provision for income taxes is calculated based upon the Company's statutory profit (in Hryvnia) determined in accordance with Ukrainian accounting and tax legislation and is taxed at the rate of 30% (see note 16).

The Company has statutory losses in the amount of UAH 7.4 million from 1994 available for carryforward up to a maximum of five years, a portion of which has been applied to eliminate the 1995 and 1996 Ukrainian statutory profit. At December 31, 1996, UAH 0.6 million of losses are available for carryforward.

## Ukraine International Airlines

### Notes to Financial Statements

#### 13. Common Stock

The authorized capital of the Company consists of 490,000 shares of common stock with a par value of \$100. All 490,000 common shares were issued and outstanding at December 31, 1996.

Contributed common stock of the Company consisted of the following as of December 31:

	1996	1995
State Property Fund of Ukraine ("SPF")	\$ 33,500	\$ 29,012
UIA Beteiligungsgesellschaft mbH ("UIAB")	9,000	-
Guinness Peat Aviation ("GPA")	6,500	6,500
	<u>\$ 49,000</u>	<u>\$ 35,512</u>

In May 1996, the Company was reregistered to reflect the transfer of ownership from UACA to the SPF of Ukraine pursuant to legislation enacted by the Ukrainian government. It was again reregistered to reflect the investment in the Company by UIAB a wholly owned company belonging to Austrian Airlines and Swissair. At the end of December 31, 1996 only \$3 million of this has been paid as per an agreed schedule, the remaining \$6 million was paid in the first quarter of 1997.

#### 14. Related Party Transactions

The Company is indebted to GPA in the amount of \$1.39 million at December 31, 1996 (\$2.8 million at December 31, 1995).

Included in 1996 operations were payments to GPA in the amount of \$6.9 million (\$6.6 million in 1995) for aircraft rentals, maintenance reserves, political risk insurance and the lease of a spare engine.

At December 31, 1996 the Company was due \$6 million, in the form of a promissory note, from UIAB as part of their investment. This amount was subsequently paid as part of an agreed schedule in the first quarter of 1997.

UIA has a pool agreement with Austrian Airlines where there is sharing of revenue on the Vienna / Kyiv route.



# Ukraine International Airlines

## Notes to Financial Statements

### 15. Commitments and Contingencies

#### Lease Commitments

The future minimum lease payments required under operating leases that have an initial or remaining non-cancelable lease term after December 31, 1996, were as follows:

1997	<u>\$ 652</u>
	<u>\$ 652</u>

The future minimum lease payments required under operating leases that have an initial or remaining non-cancelable lease term in excess of one year and were entered into subsequent to December 31, 1996 are as follows:

1997	\$ 4,697
1998	2,798
1999	2,798
2000	<u>790</u>
	<u>\$ 11,083</u>

In addition to lease rental payments, the Company pays a per flight hour supplemental rent with respect to the heavy overhaul of the airframe, engines and landing gear to GPA. Rentals under operating leases are charged to operations as incurred over the lease term. Supplemental rent for maintenance accruals of \$242 and \$275 per flight hour for the 737-200 aircraft and 737-300 aircraft, respectively, is expensed as incurred.

## Ukraine International Airlines

### Notes to Financial Statements

#### 15. Commitments and Contingencies (continued)

##### Airplane Purchase Commitment

In March 1997 the Company signed an agreement to purchase a B737-300 Aircraft from Boeing. The delivery date has been set for 1999. The Boeing payment schedule has been agreed as follows although certain discounts have been negotiated which will reduce the total payment:

1997	\$ 3,898
1998	1,949
1999	<u>33,134</u>
	<u>\$ 38,981</u>

Austrian Airlines Lease and Finance Company ("ALFC") has agreed to finance progress payments to Boeing which the Company will reimburse to ALFC as per an agreed schedule prior to delivery of the aircraft. The progress payments being financed by ALFC have been agreed as follows:

1997	\$ 3,508
1998	<u>1,949</u>
	<u>\$ 5,457</u>

UIA plans to purchase and take possession of another aircraft in 2000, however at this time no agreement has been signed.

##### Contingencies

The taxation system in Ukraine is evolving as the central government transforms itself from a command to a market oriented economy. There were many Ukrainian tax laws and related regulations introduced in 1996 which were not always clearly written and their interpretation is subject to the opinions of the local tax inspectors, NBU officials and the Ministry of Finance. Instances of inconsistent opinions between local, regional and federal tax authorities and between the NBU and Ministry of Finance are not unusual. Management believes that it has paid or accrued for all tax liabilities that are applicable. Where uncertainty exists, the Company has accrued tax liabilities based upon management's best estimate.

## Ukraine International Airlines

### Notes to Financial Statements

#### 15. Commitments and Contingencies (continued)

As of December 31, 1996, the Company does not believe that any material matters exist relating to the developing markets and evolving fiscal and regulatory environment in Ukraine, including current pending or future governmental claims and demands, which would require adjustment to the accompanying financial statements in order for those statements not to be misleading.

The Company's operations and financial position will continue to be affected by Ukrainian economic developments including the application of existing and future legislation and tax regulations. The likelihood of such occurrences and their effect on the Company could have a significant impact on the Company's operations. The Company does not believe that these contingencies, as related to its operations, are any more significant than those of similar enterprises in Ukraine.

#### 16. Reconciliation of Ukrainian Financial Statements to International Accounting Standards Financial Statements

The following is a reconciliation of the Company's 1996 income as reported in the Ukrainian statutory financial statements to the 1996 results of operations reported in the accompanying financial statements prepared in accordance with International Accounting Standards ("IAS") for the year ended December 31, 1996:

Income reported in Ukrainian statutory financial statements	\$ 2,533
Net permanent differences related to revenues and expenses incurred in the ordinary course of business which are not assessable or deductible for Ukrainian tax purposes	(1,028)
Ukrainian income after deducting the Ukrainian non-tax deductible expenses	<u>1,505</u>
Adjustments to present financial statements in accordance with IAS	
Revenue reported in 1996 which related to 1995 for IAS purposes	(1,463)
Amortization of start-up costs	(374)
Depreciation of inventory spare parts	(131)
Additional depreciation of property and equipment	(155)
Additional bad debt provision	(92)
Foreign exchange loss, net	(110)
Other	<u>6</u>
Results of operations in accompanying IAS financial statements	<u>\$ (814)</u>

## Ukraine International Airlines

### Notes to Financial Statements

#### 17. Subsequent Events

The Company signed a letter of intent in 1997 for the lease of two B737-300 aircraft to satisfy growing market and schedule requirements. The leases will be at fixed lease rentals of \$263,500 per month for five year periods. The first lease will commence in November 1997, and the second will commence in March 1998.