

MER TELEMAGEMENT SOLUTIONS LTD

Form 20-F/A

October 07, 2005

SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 20-F/A

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b)  
OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-28950

MER TELEMAGEMENT SOLUTIONS LTD.  
(Exact name of Registrant as specified in its charter  
and translation of Registrant's name into English)  
Israel  
(Jurisdiction of incorporation or organization)  
22 Zarhin Street, Ra'anana 43662, Israel  
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:  
None

Securities registered or to be registered pursuant to Section 12(g) of the Act:  
Ordinary Shares, NIS 0.01 Par Value  
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d)  
of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of  
capital or common stock as of the close of the period covered by the annual  
report:

Ordinary Shares, par value NIS 0.01 per share ..... 4,638,004  
(as of December 31, 2004)

Indicate by check mark whether the registrant (1) has filed all reports required  
to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during  
the preceding 12 months (or for such shorter period that the registrant was  
required to file such reports), and (2) has been subject to such filing  
requirements for the past 90 days.

Yes X No  
---

Indicate by check mark which financial statement item the registrant has elected

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

to follow:

Item 17 Item 18 X  
---

This Report on Form 20-F/A is incorporated by reference into our Form S-8 Registration Statements File No. 333-12014 and 333-123321.

EXPLANATORY NOTE  
-----

This Amendment No. 1 on Form 20-F/A is being filed solely to correct an omission in Item 18 of Mer Telemanagement Solutions Ltd.'s Annual Report on Form 20-F for the fiscal year ended December 31, 2004, which was filed on June 30, 2005.

Item 18 has been corrected to include the audited financial statements of Jusan, S.A. ("Jusan"), the Registrant's 50% owned affiliate in Spain, as of December 31, 2002, 2003 and 2004 and for the three years ended December 31, 2004, which financial statements were not filed with the original Form 20-F.

This Amendment is not intended to revise other information presented in the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2004 as originally filed and all such other information in the original filing, which remains unchanged.

This Amendment does not reflect events occurring after the filing of the original Form 20-F and does not modify or update the disclosure therein in any way other than as required to reflect the amendments discussed above. As a result, this Amendment continues to speak as of June 30, 2005.

i

TABLE OF CONTENTS

	Page
	----
PART III.....	1
ITEM 17. FINANCIAL STATEMENTS.....	1
ITEM 18. FINANCIAL STATEMENTS.....	1
ITEM 19. EXHIBITS.....	1
S I G N A T U R E S.....	4

PART III

ITEM 17. FINANCIAL STATEMENTS  
-----

We have elected to furnish financial statements and related information specified in Item 18.

ITEM 18. FINANCIAL STATEMENTS  
-----

Consolidated Financial Statements of Mer Telemanagement Solutions Ltd.

Index to Consolidated Financial Statements .....	F-1
Report of Independent Registered Public Accounting Firm.....	F-2
Consolidated Balance Sheets.....	F-3-4
Consolidated Statements of Operations.....	F-5
Statements of Changes in Shareholders' Equity.....	F-6
Consolidated Statements of Cash Flows.....	F-7-8
Notes to Consolidated Financial Statements.....	F-9-38

Financial Statements of Jusan, S.A. as of December 31, 2002, 2003 and 2004 and for the three years than ended

Index to Financial Statements of Jusan, S.A.....	F-39
Report of Registered Public Accounting Firm.....	F-40
Report of Independent Auditors.....	F-41
Balance Sheets.....	F-42
Statements of Income.....	F-43

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Statements of Changes in Shareholders' Equity.....F-44  
Statements of Cash Flows.....F-44  
Notes to Financial Statements.....F-46-55

ITEM 19. EXHIBITS

-----

Index to Exhibits

1

Exhibit	Description
1.1	Memorandum of Association of the Registrant (1)
1.2	Articles of Association of the Registrant (1)
2.1	Specimen of Ordinary Share Certificate (1)
4.1	Asset Purchase Agreement dated December 30, 2004 among the Registrant and Teleknowledge Group Ltd. (5)
4.2	1996 Employee Stock Option Plan (1)
4.3	Section 102 Stock Option Plan (1)
4.4	2003 Israeli Share Option Plan (2)
4.5	Form of Consultant's Warrant (3)
8.1	List of Subsidiaries of the Registrant *
10.1	Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global (relating to Mer Telemanagement Ltd.)
10.2	Consent of BDO Audiberia Auditores, S.L.
10.3	Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global (relating to Jusan, S.A.)
14.1	Code of Ethics (4)
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
12.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
13.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

-----

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

- (1) Filed as an exhibit to our registration statement on Form F-1, registration number 333-05814, filed with the Securities and Exchange Commission, and incorporated herein by reference.

2

- (2) Filed as Exhibit 10.3 to our Annual Report on Form 20-F for the year ended December 31, 2003, and incorporated herein by reference.
- (3) Filed as Exhibit 10.5 to our Annual Report on Form 20-F for the year ended December 31, 2002, and incorporated herein by reference.
- (4) Filed as Exhibit 14.1 to our Annual Report on Form 20-F for the year ended December 31, 2003, and incorporated herein by reference.
- (5) Filed as Exhibit 4.1 to our Annual Report on Form 20-F for the year ended December 31, 2004, and incorporated herein by reference.

\*Previously filed.

3

### MER TELEMANAGEMENT SOLUTIONS LTD. AND ITS SUBSIDIARIES

#### CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2004

U.S. DOLLARS IN THOUSANDS

#### INDEX

	Page
	-----
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets	F-3 - F-4
Consolidated Statements of Operations	F-5
Statements of Changes in Shareholders' Equity	F-6
Consolidated Statements of Cash Flows	F-7 - F-8
Notes to Consolidated Financial Statements	F-9 - F-38

-----  
F-1

# Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

[ERNST & YOUNG LOGO]

Kost Forer Gabbay & Kasierer      Phone: 972-3-6232525  
3 Aminadav St.                      Fax: 972-3-5622555  
Tel-Aviv 67067, Israel

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of

Mer Telemanagement Solutions Ltd.

We have audited the accompanying consolidated balance sheets of Mer Telemanagement Solutions Ltd. ("the Company") and its subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. 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 did not audit the financial statements of Jusan SA, a 50% owned affiliate, for the year ended December 31, 2004, whose Company's investments constitute \$ 2,119 thousand as of December 31, 2004 and its equity in revenues constitute \$ 225 thousand. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of such investee companies, is based solely on the said reports of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2003 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
February 7, 2005

/s/Kost Forer Gabbay and Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

F-2

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

U.S. dollars in thousands

	December 31,	
	2003	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 8,684	\$ 3,684
Marketable securities (Note 3)	1,644	1,644
Trade receivables (net of allowance for doubtful accounts of \$350 and \$370 as of December 31, 2003 and 2004, respectively)	1,391	1,391
Other accounts receivable and prepaid expenses (Note 4)	566	566
Inventories (Note 5)	193	193
Total current assets	12,478	12,478
LONG-TERM INVESTMENTS:		
Investments in an affiliate (Note 6)	1,859	1,859
Long-term loans, net of current maturities (Note 7)	95	95
Severance pay fund	564	564
Other investments (Note 8)	368	368
Total long-term investments	2,886	2,886
PROPERTY AND EQUIPMENT, NET (Note 9)	482	482
OTHER ASSETS:		
Goodwill (Note 10a)	2,024	2,024
Other intangible assets, net (Note 10b)	206	206
Deferred income taxes (Note 13)	106	106
Total other assets	2,336	2,336
Total assets	\$ 18,182	\$ 18,182

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

F-3

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

	December 31,	
	*) 2003	2004
	-----	-----
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term loans	\$ 8	\$
Trade payables	393	
Accrued expenses and other liabilities (Note 11)	1,421	
Deferred revenues	1,219	
	-----	-----
Total current liabilities	3,041	
-----	-----	-----
LONG-TERM LIABILITIES:		
Accrued severance pay	677	
	-----	-----
Total long-term liabilities	677	
-----	-----	-----
COMMITMENTS AND CONTINGENT LIABILITIES (Note 12)		
SHAREHOLDERS' EQUITY (Note 15):		
Share capital -		
Ordinary shares of NIS 0.01 par value - Authorized: 12,000,000 shares as of December 31, 2003 and 2004; Issued: 4,631,471 and 4,648,804 shares as of December 31, 2003 and 2004, respectively; Outstanding: 4,624,471 and 4,638,004 shares as of December 31, 2003 and 2004, respectively	14	
Additional paid-in capital	12,877	1
Treasury shares (7,000 and 10,800 shares as of December 31, 2003 and 2004, respectively)	(20)	
Deferred stock compensation	(274)	
Accumulated other comprehensive income	87	
Retained earnings (accumulated deficit)	1,780	(
	-----	-----
Total shareholders' equity	14,464	1
-----	-----	-----
Total liabilities and shareholders' equity	\$ 18,182	\$ 1
-----	=====	=====

\*) Reclassification.

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

# Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

## CONSOLIDATED STATEMENTS OF OPERATIONS

-----  
 U.S. dollars in thousands (except share and per share data)

	Year ended December 31,		
	2002	2003	2004
	-----	-----	-----
Revenues (Note 16):			
Products sales	\$ 7,397	\$ 6,944	\$ 7,397
Services	2,390	2,286	2,390
	-----	-----	-----
Total revenues	9,787	9,230	9,787
-----	-----	-----	-----
Cost of revenues:			
Products sales	1,655	1,523	2,390
Services	241	326	241
	-----	-----	-----
Total cost of revenues	1,896	1,849	2,631
-----	-----	-----	-----
Gross profit	7,891	7,381	6,944
-----	-----	-----	-----
Operating expenses:			
Research and development	2,127	1,825	2,127
Selling and marketing	3,954	3,916	6,944
General and administrative	1,858	1,830	2,127
	-----	-----	-----
Total operating expenses	7,939	7,571	10,944
-----	-----	-----	-----
Operating loss	(48)	(190)	(4,000)
Financial income, net (Note 17a)	134	124	134
Other income (expenses), net (Note 17b)	(140)	6	(140)
	-----	-----	-----
Loss before taxes on income	(54)	(60)	(4,006)
Taxes on income (Note 13)	52	198	52
	-----	-----	-----
Loss before equity in earnings of affiliate	(106)	(258)	(4,058)
Equity in earnings of affiliate	236	345	236
	-----	-----	-----
Net income (loss)	\$ 130	\$ 87	\$ (4,022)
	=====	=====	=====
Net earnings (loss) per share:			
Basic net earnings (loss) per Ordinary share	\$ 0.03	\$ 0.02	\$ (0.03)
	=====	=====	=====
Diluted net earnings (loss) per Ordinary share	\$ 0.03	\$ 0.02	\$ (0.03)
	=====	=====	=====

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Weighted average number of Ordinary shares used in computing basic net earning (loss) per share	4,709,796 =====	4,617,099 =====	4,634, =====
Weighted average number of Ordinary shares used in computing diluted net earning (loss) per share	4,709,796 =====	4,628,249 =====	4,634, =====

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

F-5

MER T

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury shares
	-----	-----	-----
Balance as of January 1, 2002	\$ 15	\$ 12,846	\$ (158)
Purchase of treasury shares	--	--	(172)
Other comprehensive income:			
Unrealized losses on available-for-sale marketable securities, net	--	--	--
Foreign currency translation adjustments	--	--	--
Total other comprehensive income	--	--	--
Net income	--	--	--
	-----	-----	-----
Total comprehensive income			
Balance as of December 31, 2002	15	12,846	(330)
Exercise of options	*) --	--	--
Employee stock based compensation	--	**) 487	--
Amortization of deferred stock compensation	--	--	--
Retirement of treasury shares	(1)	(456)	457
Purchase of treasury shares	--	--	(147)
Other comprehensive income:			
Unrealized gains on available-for-sale marketable securities, net	--	--	--
Foreign currency translation adjustments	--	--	--
Loss from cash flows hedging transaction	--	--	--
Total other comprehensive income	--	--	--
Net income	--	--	--
	-----	-----	-----
Total comprehensive income			
Balance as of December 31, 2003	14	12,877	(20)
Exercise of options	*) --	2	--



Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Amortization of deferred stock compensation	--		66
Purchase of treasury shares	--		(9)
Other comprehensive income:			
Unrealized gains on available-for-sale marketable securities, net	--	\$ 83	83
Foreign currency translation adjustments	--	171	171
Gain from cash flows hedging transaction	--	7	7
		-----	
Total other comprehensive income		261	
Net loss	(4,127)	(4,127)	(4,127)
	-----	-----	-----
Total comprehensive loss		\$ (3,866)	
		=====	
Balance as of December 31, 2004	\$ (2,347)		\$ 10,657
	=====		=====

\*) Represents an amount lower than \$1.

\*\*) Reclassification.

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

F-6

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December	
	2002	2003
	-----	-----
Cash flows from operating activities:		
-----		
Net income (loss)	\$ 130	\$ 87
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Loss (gain) on sale of available-for-sale and trading marketable securities, net	140	(6)
Loss on sale of property and equipment	6	39
Equity in earnings of affiliate	(236)	(345)
Proceeds from trading securities, net	81	--
Depreciation and amortization	501	401
Deferred income taxes, net	29	23
Employee stock-based compensation	--	213
Accrued severance pay, net	(2)	(47)
Decrease (increase) in trade receivables	(87)	(132)
Decrease (increase) in other accounts receivable and prepaid expenses	215	(89)
Decrease in inventories	82	47
Increase (decrease) in trade payables	(149)	43
Increase (decrease) in accrued expenses and other liabilities	(419)	(99)
Increase (decrease) in deferred revenues	187	35
Others	11	(7)

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

	-----	-----
Net cash provided by (used in) operating activities	489	163
	-----	-----
Cash flows from investing activities:		
-----		
Changes in related parties account, net	108	--
Proceeds from sale of property and equipment	26	5
Purchase of property and equipment	(166)	(171)
Capitalization of research and development costs	--	--
Investment in leasing deposit	--	--
Proceeds from realization of short-term bank deposits	1,942	--
Investment in available for sale marketable securities	(1,512)	(969)
Investment in held-to-maturity marketable securities	(476)	--
Proceeds from sale of available-for-sale marketable securities	2,508	318
Proceeds from redemption of held-to-maturity marketable securities	201	275
Acquisition of certain assets and liabilities of Teleknowledge (a)	--	--
Dividend from an affiliate	190	100
Others	(12)	16
	-----	-----
Net cash provided by (used in) investing activities	2,809	(426)
	-----	-----

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

F-7

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2002	2003	2004
	-----	-----	-----
Cash flows from financing activities:			
-----			
Changes in related parties, net	4	51	--
Repayment of long-term loans	(55)	(8)	(1)
Proceeds from exercise of options and warrants	--	*)	--
Purchase of treasury shares	(172)	(147)	(1)
	-----	-----	-----
Net cash used in financing activities	(223)	(104)	(1)
	-----	-----	-----
Effect of exchange rate changes on cash and cash equivalents	--	(11)	(1)
	-----	-----	-----

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Increase (decrease) in cash and cash equivalents	3,075	(378)	(4,87)
Cash and cash equivalents at the beginning of the year	5,987	9,062	8,68
	-----	-----	-----
Cash and cash equivalents at the end of the year	\$ 9,062	\$ 8,684	\$ 3,81
	=====	=====	=====

Supplemental disclosure of cash flows activities:

Cash paid during the year for:			
Interest	\$ 10	\$ 1	\$
	=====	=====	=====
Income taxes	\$ 58	\$ 49	\$ 2
	=====	=====	=====

(a) In conjunction with acquisition, the fair values of assets acquired and liabilities assumed at the date of acquisition were as follow (see Note 1c):

Working capital (excluding cash and cash equivalents)			\$ 2
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Property and equipment			4
Goodwill			1,39
Developed technology			69
Customer relationship			30
			-----
			\$ 2,44
			=====

\*) Represents an amount lower than \$ 1.  
The accompanying notes are an integral part of the consolidated financial statements.

F-8

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 1:- GENERAL

a. Mer Telemanagement Solutions Ltd. (the "Company" or "MTS") was incorporated on December 27, 1995. MTS and its subsidiaries ("the Group") designs, develops, markets and supports a comprehensive line of telecommunication management and customer care & billing ("CC&B") solutions that enable business organizations and other enterprises to improve the efficiency and performance of all IP operations, and reduce associated costs. The Group products include call accounting and management products, fault management systems and web based management solutions for converged voice, voice over Internet

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Protocol, IP data and video and CC&B solutions. As for MTS's subsidiaries, see Note 18.

- b. MTS's products are designed to provide telecommunication and information technology managers with tools to reduce communication costs, recover charges payable by third parties, and to detect and prevent abuse and misuse of telephone networks including fault telecommunication usage.

The Group markets its products worldwide through distributors, business telephone switching systems manufacturers and vendors and its direct sales force. Several international private automatic branch exchange ("PBX") manufacturers market the Group's products as part of their PBX selling efforts or on an Original Equipment Manufacturer ("OEM") basis. The Group is highly dependent upon the active marketing and distribution of its OEM's. If the Group is unable to effectively manage and maintain a relationship with its OEM or any event negatively affecting such dealer's financial condition, could cause a material adverse effect on the Group's results of operations and financial position. In 2002, 2003 and 2004, one major customer generated 36%, 40% and 38% of the Group's revenues, respectively.

Certain components and subassemblies included in the Group's products are obtained from a single source or a limited group of suppliers and subcontractors. If such supplier fails to deliver the necessary components or subassemblies, the Company may be required to seek alternative sources of supply. A change in supplier could result in manufacturing delays, which could cause a possible loss of sales and, consequently, could adversely affect the Company's results of operations and financial position.

MTS's shares are listed for trade on the Nasdaq SmallCap Market.

- c. On December 30, 2004, the Company and Teleknowledge Group Ltd. ("Teleknowledge") consummated an Assets Purchase Agreement ("the Agreement"). TeleKnowledge is a leading provider of carrier-class billing and rating solutions. The integration of Teleknowledge's billing solution enables MTS to offer an end-to-end customer care and billing solution. Under the terms of the Agreement, the Company acquired certain assets and liabilities of Teleknowledge for the following consideration:

1. An initial consideration of \$2,374 in cash.
2. Additional contingent consideration of up to an amount of \$3,650 based on post acquisition revenue performance (calculated as 10% of renewal maintenance fees and 20% of all other revenues from sales which included Teleknowledge products), over a period of three years. Such payments will be recorded as additional goodwill, during the contingency period, when actual revenue performance will be evaluated.

F-9

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

NOTE 1:- GENERAL (Cont.)

3. In addition, the Company incurred transaction costs totaling \$71.

Prior to the acquisition, MTS and Teleknowledge had an OEM relationship. The commercial arrangements and transactions were settled before the date of the acquisition.

The acquisition was accounted for under the purchase method of accounting in accordance with SFAS 141, "Business Combination" ("SFAS 141"). Accordingly, the purchase price has been allocated to the assets acquired and the liabilities assumed based on the estimated fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired has been recorded as goodwill.

Based upon a valuation of the tangible and intangible assets acquired and the liabilities assumed, the Company has allocated the total cost of the acquisition to Teleknowledge's net assets at the date of acquisition, as follows:

Trade receivables	\$ 100
Property and equipment	40
Intangible assets:	
Developed technology (four-year useful life)	690
Customer relationship (six-year useful life)	300
Goodwill	1,391
	-----
Total assets acquired	2,521
	-----
Liabilities assumed:	
Deferred revenues	(76)
	-----
Total liabilities assumed	(76)
	-----
Net assets acquired	\$ 2,445
	=====

The valuation of the Company's developed technology was based on the income approach, which reflects the future economic benefits from Teleknowledge products. The value assigned to customer relationship was based on the cost approach. Under this approach, the customer relationship was valued by calculating the savings realized by the Company through obtaining a pre-existing customer relationship of Teleknowledge.

F-10

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 1:- GENERAL (Cont.)

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Pro forma results:

The following unaudited proforma information does not purport to represent what the Company's results of operations would have been had the acquisitions occurred on January 1, 2003 and 2004, nor does it purport to represent the results of operations of the Company for any future period.

	Year ended December 31,	
	2003	2004
	-----	-----
Revenues	\$ 10,128 =====	\$ 10,54 =====
Net loss from continuing operations	\$ (10,247) =====	\$ *) (4,93 =====
Basic and diluted net loss per share for continuing operations	\$ (2.22) =====	\$ (1.0 =====
Weighted average number of Ordinary shares in computation of basic and diluted net loss per share	4,617,099 =====	4,634,41 =====

\*) Net of capital gain from sale of Teleknowledge to MTS.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles 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.

b. Financial statements in U.S. dollars:

The majority of the revenues of the Company and certain of its subsidiaries are generated in U.S. dollars ("dollar") or linked to the dollar. In addition, a substantial portion of the Company's and certain of its subsidiaries' costs is incurred in dollars. Company's management believes that the dollar is the primary currency of the economic environment in which the Company and certain of its subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with SFAS No. 52, "Foreign Currency Translation". All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The financial statements of foreign subsidiaries and affiliates, whose functional currency has been determined to be their local currency, have been translated into dollars. Assets and liabilities have been translated using the exchange rates in effect at the balance sheet date. Statements of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

c. Principles of consolidation:

The consolidated financial statements include the accounts of MTS and its wholly-owned subsidiaries. Intercompany transactions and balances, including profits from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

d. Cash equivalents:

The Company considers all short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less to be cash equivalents.

e. Marketable securities:

The Company accounts for investments in debt and equity securities (other than those accounted for under the equity method of accounting) in accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115").

Management determines the classification of investments in marketable debt and equity securities at the time of purchase and reevaluates such designations as of each balance sheet date.

As of December 31, 2004 and 2003, all marketable securities were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity, net of taxes. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated Statement of Operations.

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventories write-offs are provided to cover risks arising from slow moving items or technological obsolescence. Cost is determined as follows: Raw materials - using the "first in, first out" method with

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

the addition of allocable indirect manufacturing costs. Finished products are recorded on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

F-12

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. Investments in an affiliate:

In these financial statements, affiliated company is company held 50% (which is not a subsidiary), where the Company can exercise significant influence over operating and financial policy of the affiliate.

The investment in affiliated company is accounted for by the equity method, in accordance with Accounting Principle Board Opinion No.18, "The Equity Method of Accounting for Investments in Common Stock", ("APB No.18"). Profits on intercompany sales, not realized through sales to third parties, were eliminated. The excess of the purchase price over the fair value of net tangible assets acquired has been attributed to goodwill.

Goodwill is no longer amortized, but is reviewed annually (or more frequently if circumstances indicate impairment has occurred) for impairment in accordance with the provisions of Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). Before the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over 10 years, in accordance with APB Opinion No.17, "Intangible Assets".

Under APB 18, a loss in value of an investment accounted for under the equity method, which is other than a temporary decline, should be recognized as a realized loss, establishing a new carrying value for the investment. Factors the Company considers in making this evaluation include: the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer, including cash flows of the investee and any specific events which may influence the operations of the issuer and the intent and ability of the Company to retain its investments for a period of time sufficient to allow for any anticipated recovery in market value. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. No impairment losses were recorded during 2004.

h. Investment in other companies:

The investment in these companies is stated at cost, since the Group does not have the ability to exercise significant influence over operating and financial policies of those investments. The Company's investments in other companies are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an investment may not be recoverable, in accordance with APB

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

No.18. As of December 31, 2004, based on management's most recent analyses, no impairment losses have been identified.

F-13

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method, over the estimated useful lives of the assets, at the following annual depreciation rates:

	%
Computers and peripheral equipment	33
Office furniture and equipment	6 - 20
Motor vehicles	15
Leasehold improvements	Over the shorter term of the lease agreement or the life of the asset

j. Impairment of long-lived assets:

The Company's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2004, no impairment losses have been identified.

k. Goodwill and other intangible assets:

Goodwill represents excess of the costs over the net assets of business acquired. Under SFAS No. 142, goodwill acquired in a business combination on or after July 1, 2001, will not be amortized. Goodwill that arose from acquisitions prior to July 1, 2001 was amortized until December 31, 2001, by the straight-line method, over 10 years.

SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of the

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

reporting unit with its carrying value. Fair value is determined using discounted cash flows. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, and weighted average cost of capital. As of December 31, 2004, no impairment losses have been identified. As for application of SFAS No. 142, see Note 10a.

Developed technology is amortized over a weighted average of four years and customer relationship is amortized over a weighted average of six years .

F-14

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

1. Revenue recognition:

The Company generates revenues from licensing the rights to use its software products directly to end-users and indirectly through resellers and OEM's (who are considered end users). The Company also generates revenues from rendering maintenance, service bureau and support.

Revenues from software license agreements are recognized when all criteria outlined in Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP No. 97-2") as amended are met. Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable. The Company generally does not grant a right of return to its customers.

Where software arrangements involve multiple elements, revenue is allocated to each undelivered element based on vendor specific objective evidence ("VSOE") of the fair values of each undelivered element in the arrangement, in accordance with the "residual method" prescribed by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition With Respect to Certain Transactions". The VSOE used by the Company to allocate the sales price to support services and maintenance is based on the renewal rate charged when these elements are sold separately. License revenues are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements, and (2) all revenue recognition criteria of SOP No. 97-2, as amended, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered element.

Revenues from maintenance and support services are recognized over the life of the maintenance agreement or at the time that support services are rendered.

Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

m. Research and development costs:

Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"), requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's and its subsidiaries product development process, technological feasibility is established upon completion of a working model.

F-15

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred, net of participation of the Office of the Chief Scientist of Israel's Ministry of Industry and Trade.

Significant costs incurred by the Company and its subsidiaries between completion of the working model and the point at which the product is ready for general release, have been capitalized.

Capitalized software costs are amortized by the greater of the amount computed using the: 1) ratio of the current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or 2) the straight-line method over the estimated useful life of the product (three years). The Company assesses the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2004.

n. Government grants:

Royalty-bearing grants from the Government of Israel for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred and recorded as a deduction of research and development costs.

o. Income taxes:

The Company accounts for income taxes, in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the

## Edgar Filing: MER TELEMAGEMENT SOLUTIONS LTD - Form 20-F/A

differences are expected to reverse. Valuation allowances are provided to reduce deferred tax assets to their estimated realizable value.

p. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock option plans. Under APB No. 25, when the exercise price of the Company's stock options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized.

F-16

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"), which amended certain provisions of SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning 2003. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Company's net income (loss) and net earnings (loss) per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value for options granted in 2002, 2003 and 2004 is amortized over their vesting period and estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	Year ended December 31,		
	2002	2003	2004
Dividend	0%	0%	0
Average risk-free interest rates	2%	2%	2.79
Average expected life (in years)	4	2.5	4.71
Volatility	66.8%	71.8%	53.37

Pro forma information under SFAS No. 123, is as follows:

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

	Year ended December 31,		
	2002	2003	2004
Net income (loss), available to ordinary shares as reported	\$ 130	\$ 87	\$ (4,127)
Add: Stock-based employee compensation - intrinsic value	--	213	66
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effect	(177)	(346)	(274)
Pro forma net loss	\$ (47)	\$ (46)	\$ (4,335)
Basic and diluted net earnings (loss) per share, as reported	\$ 0.03	\$ 0.02	\$ (0.89)
Basic and diluted net loss per share, pro forma	\$ (0.01)	\$ --	\$ (0.94)

F-17

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company applies Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and Emerging Issues Task Force No. 96-18 ("EITF No. 96-18"), "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" with respect to options issued to non-employees. SFAS No. 123 requires use of an option valuation model to measure the fair value of the options at the measurement date.

q. Warranty costs:

The Company provides free warranty for up to one year for end-users and up to 15 months for the "OEM" distributors. A provision is recorded for probable costs in connection with these services based on the Company's experience.

The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of sold units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. No changes in the Company's product liability were recorded during

## Edgar Filing: MER TELEMAGEMENT SOLUTIONS LTD - Form 20-F/A

the period and the provision for the year ending December 31, 2004 amounted to \$ 22.

r. Fair value of financial instruments:

The following methods and assumptions were used by the Group in estimating its fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable and trade payables approximate their fair value, due to the short-term maturity of such instruments.

The fair value for marketable securities is based on quoted market prices (see Note 3).

Long-term loans - The carrying amounts of the Company's borrowings under its long-term agreements, both as a lender and as a borrower, approximate their fair value.

s. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

F-18

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expenses for the years ended December 31, 2002, 2003 and 2004 amounted to approximately \$ 104, \$ 13 and \$ 164, respectively.

t. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables, marketable securities and long-term loans.

Cash and cash equivalents are deposited with major banks in Israel and major banks in United States. Such deposits in the U.S. may be

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

in excess of insured limit and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers in the U.S. and Europe (see Note 16). The Company performs ongoing credit evaluations of its customers. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection according to management estimates. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

The Company's marketable securities include mainly investments in corporate debts and mutual funds. Management believes that the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

u. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS No. 128").

The total number of shares related to the outstanding options excluded from the calculation of diluted net earnings (loss) per share was 757,580 766,141 and 667,101 for the years ended December 31, 2002, 2003 and 2004, respectively.

F-19

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

v. Derivatives and hedging:

To protect against the reduction in value of forecasted foreign currency cash flows resulting from export sales over the next year, the Company hedged portions of its forecasted revenue denominated in foreign currencies with forward contracts. During 2004, the Company realized all its forward derivatives.

Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial

position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in other income/expense in current earnings during the period of change.

During 2004 and 2003, there were no significant gains or losses recognized in earning for hedge ineffectiveness.

w. Impact of recently issued accounting standards:

On December 16, 2004, the FASB issued FASB Statement No. 123 (revised 2004), "Share Based Payment", which is a revision of FASB Statement No. 123, "Accounting for Stock Based Compensation". SFAS 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flow". Generally, the approach adopted by SFAS 123(R) is similar to the approach described in Statement 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair value. Pro forma disclosure is no longer an alternative.

SFAS 123(R) must be adopted by no later than July 1, 2005. Early adoption is permitted in periods in which financial statements have not yet been issued. The Company expects to adopt SFAS 123(R) on July 1, 2005.

F-20

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

SFAS 123(R) permits companies to adopt its requirement using one of the two methods:

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the

requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123(R) for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date.

2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123(R) for purposes of pro forma disclosures either: (a) all prior periods presented or (b) prior interim period of the year of adoption.

As permitted by SFAS 123, the Company currently accounts for share based payments to employees using the APB 25 intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS 123(R) fair value method will have a significant impact on the Company's result of operations, although it will have no impact on the Company's overall financial position. The impact of the adoption of SFAS 123(R) cannot be predicted at this time because it will depend on levels of share based payments granted in the future. However, had the Company adopted SFAS 123(R) in prior periods, the impact of that Standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income and earnings (loss) per share in above.

In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4" ("SFAS151"). SFAS 151 amends Accounting Research Bulletin ("ARB") No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect that the adoption of SFAS 151 will have a material effect on its financial position or results of operations.

Reclassification:

Certain amounts from prior years referring to the employee stock based compensation have been reclassified to conform current periods representation.

F-21

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 3:- MARKETABLE SECURITIES

The following is a summary of the Company's investment in marketable

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

securities:

	December 31, 2003					
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair market value	Amortized cost	unrealized gains
Available-for-sale:						
Mutual funds	\$ 623	\$ 5	\$ --	\$ 628	\$ 506	\$ --
Equity securities	51	12	--	63	25	--
Corporate bonds	702	--	(8)	694	368	--
Israeli Government debts	265	--	(6)	259	72	--
	<u>\$ 1,641</u>	<u>\$ 17</u>	<u>\$ (14)</u>	<u>\$ 1,644</u>	<u>\$ 971</u>	<u>\$ --</u>

The gross realized gains (losses) on sales of available-for-sale securities totaled \$ 6 and \$ 0 in 2003 and 2004, respectively. The net adjustment to unrealized holding gains (losses) on available-for-sale securities included as a separate component of shareholders' equity, "Accumulated other comprehensive gains (losses)" amounted to \$ 109 and \$ 83 in 2003 and 2004, respectively.

The amortized cost and fair value of debt and marketable equity securities as of December 31, 2004, by contractual maturity, are shown below.

	December 31, 2004	
	Amortized cost	Fair market value
Matures in one year	\$ 368	\$ 376
Matures after one year through nine years	72	82
Equity securities and mutual funds	531	599
	<u>\$ 971</u>	<u>\$ 1,057</u>

F-22

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

December 31,	
2003	2004

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

	-----	-----
Government authorities	\$ 232	\$ 117
Prepaid expenses	103	149
Deferred income taxes (1)	66	66
Others	165	59
	-----	-----
	\$ 566	\$ 391
	=====	=====

(1) See Note 13f

NOTE 5:- INVENTORIES

Raw materials	\$ 73	\$ 76
Finished products	120	102
	-----	-----
	\$ 193	\$ 178
	=====	=====

The Company periodically assesses its inventory valuation in accordance with its revenues forecasts, technological obsolescence, and the market conditions. Marked down inventory that is expected to be sold at a price lower than the carrying value is not material.

NOTE 6:- INVESTMENTS IN AFFILIATE

a. Composed as follows:

	December 31,	
	2003	2004
	-----	-----
Investment in Jusan S.A. (50% owned)		
Equity, net (1)	\$ 1,824	\$ 2,084
Goodwill	35	35
	-----	-----
	\$ 1,859	\$ 2,119
	=====	=====
(1) Investment as of purchase date	\$ 1,171	\$ 1,171
Foreign currency translation adjustments	143	316
Accumulated net earnings	510	597
	-----	-----
	\$ 1,824	\$ 2,084
	=====	=====
Dividend received from Jusan S.A. during the year	\$ 100	\$ 136
	=====	=====

F-23

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

U.S. dollars in thousands (except share data)

NOTE 6:- INVESTMENTS IN AFFILIATE (Cont.)

b. Summarized financial information of Jusan S.A. (50% owned):

	December 31,	
	2003	2004
Current assets	\$ 5,266	\$ 5,552
Non-current assets	\$ 99	\$ 68
Current liabilities	\$ (1,861)	\$ (1,438)

	Year ended December 31,		
	2002	2003	2004
Revenues	\$ 6,848	\$ 6,049	\$ 6,892
Gross profit	\$ 3,260	\$ 3,079	\$ 3,158
Net income	\$ 708	\$ 594	\$ 444

NOTE 7:- LONG-TERM LOANS

a. Composed as follows:

	December 31,	
	2003	2004
Loans to others in NIS - unlinked (1)	\$ 131	\$ 84
Less - current maturities (2)	36	39
	\$ 95	\$ 45

(1) The weighted average interest rate for the year ended December 31, 2004 and 2003 is 6.375%.

(2) Included in other accounts receivable.

b. As of December 31, 2004, the aggregate annual maturities of long-term loans are as follows:

	December 31,
2005 (current maturities)	\$ 39
2006	36
2007	9
	\$ 84

# Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

NOTE 8:- OTHER INVESTMENTS

	December 31,	
	2003	2004
Long-term leasing deposits (1)	\$ 21	\$ 26
Investment in other companies	347	347
	\$ 368	\$ 373
	=====	=====

(1) Linked to the Israeli CPI.

NOTE 9:- PROPERTY AND EQUIPMENT, NET

Cost:		
Computers and peripheral equipment	\$ 2,528	\$ 2,838
Office furniture and equipment	536	558
Motor vehicles	96	62
Leasehold improvements	100	112
	3,260	3,570
	-----	-----
Accumulated depreciation:		
Computers and peripheral equipment	2,300	2,454
Office furniture and equipment	358	407
Motor vehicles	64	55
Leasehold improvements	56	73
	2,778	2,989
	-----	-----
Depreciated cost	\$ 482	\$ 581
	=====	=====

The depreciation expense for the years ended December 31, 2002, 2003 and 2004 was \$ 347, \$ 247 and \$ 211, respectively.

F-25

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

NOTE 10:- GOODWILL AND OTHER ASSETS

a. Goodwill:

The changes in the carrying amount of goodwill for the year ended December 31, 2004 are as follows:

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Balance as of December 31, 2003	\$ 2,024
Goodwill acquired during year (see Note 1c)	1,391
Impairment losses	--
	-----
Balance as of December 31, 2004	\$ 3,415
	=====

b. Other intangibles consist of the following:

	December 31,	
	2003	2004
	-----	-----
Cost:		
Development technology	\$ 750	\$ 1,440
Capitalized software developed costs	--	386
Customer relationship	--	300
	-----	-----
	750	2,126
	-----	-----
Accumulated amortization:		
Development technology	544	700
Capitalized software developed costs	--	32
Customer relationship	--	--
	-----	-----
	544	732
	-----	-----
	\$ 206	\$ 1,394
	=====	=====

c. Amortization expenses amounted to \$ 154, \$ 154 and \$ 188 for each of the years ended December 31, 2002, 2003 and 2004.

d. Estimated amortization expenses for the years ended:

December 31,  
-----

2005	273
2006	223
2007	222
2008	222
2009 and further	100

F-26

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 11:- ACCRUED EXPENSES AND OTHER LIABILITIES

December 31,	
2003	2004
-----	-----

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Employees and payroll accruals	\$	473	\$	799
Income tax payable		242		330
Accrued expenses		456		646
Customer advances		203		204
Related parties		47		63
		-----		-----
	\$	1,421	\$	2,042
		=====		=====

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The facilities of the Company are rented under operating leases for periods ending in 2006.

Future minimum lease commitments under non-cancelable operating leases as of December 31 are as follows:

2005	\$	399
2006		130
		-----
	\$	529
		=====

Lease expenses for the years ended December 31, 2002, 2003 and 2004, were approximately \$ 446, \$ 372 and \$ 334, respectively.

b. Royalty commitments:

1. The Company is committed to pay royalties to the Office of the Chief Scientist of the Ministry of Trade ("OCS") of the Government of Israel on proceeds from sales of products resulting from the research and development projects in which the Government participated. In the event that development of a specific product in which the OCS participated is successful, the Company will be obligated to repay the grants through royalty payments at the rate of 3% to 5% based on the sales of the Company, up to 100%-150% of the grants received linked to the dollar. As of December 31, 2004, the Company has a contingent liability to pay royalties in the amount of \$ 7,429. The obligation to pay these royalties is contingent upon actual sales of the products and, in the absence of such sales, no payment is required.

The Company has paid or accrued royalties in its cost of revenues relating to the repayment of such grants in the amount of \$ 132, \$ 146 and \$ 181 for the years ended December 31, 2002, 2003 and 2004, respectively.

F-27

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

2. The Israeli Government, through the Fund for Encouragement of Marketing Activities, awarded the Company grants for participation in foreign marketing expenses. The Company is committed to pay royalties at the rate of 3% of the increase in export sales, up to the amount of the grants received linked to the U.S. dollar. As of December 31, 2004, the Company has a contingent obligation to pay royalties in the amount of \$ 259. During the three years ending on December 31, 2004, the Company accrued royalties in the amount of \$129.

c. Claim and demand:

In April 2000, the tax authorities in Israel issued to the Company a demand for a tax payment, for the period of 1997-1999, in the amount of approximately NIS 6 million (\$ 1,350).

The Company has appealed to the Israeli district court in respect of the abovementioned tax demand. Based on the opinion of its legal counsel, the Company believes that certain defenses can be raised against the demand of the tax authorities. The Company believes that the outcome of this matter will not have a material adverse effect on its financial position or results of operations and, the Company provided a provision in the amount of \$464, based on the current evidence and on the basis of the said opinion of its legal counsel that, in the opinion of Company, is an adequate provision.

### NOTE 13:- TAXES ON INCOME

- a. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

MTS was granted the status of an "Approved Enterprise" under the Law in respect of expansion projects. According to the provisions of the Law, MTS elected to enjoy the "alternative benefits" - the waiver of grants in return for a tax exemption and, accordingly, income derived from the "Approved Enterprise" is tax-exempt for a period of two years, commencing with the year it first earns taxable income, and subject to corporate tax at the rate of 10%- 25%, for additional periods of five to eight years.

The expansion programs which are assigned to MTS are as follows:

1. One program entitled MTS to tax-exemption for a two-year period ended December 31, 1999, and is subject to a reduced tax rate of 10%-25% for a five to eight years period ending December 31, 2004.
2. The current program entitles MTS to tax exemption for a two year period and it is subject to a tax rate of 10%-25% for an additional period of five to eight years. The benefits in respect of this program have not yet commenced.
3. During 2004 the Company received an additional expansion program which entitles MTS to tax exemption for a two year period and to a reduced tax rate of 10%-25% for a five year period. The benefits in respect of this program have not yet commenced.

# Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

U.S. dollars in thousands (except share data)

### NOTE 13:- TAXES ON INCOME (Cont.)

The period of tax benefits detailed above is subject to a limit of the earlier of 12 years from the commencement of production or 14 years from receiving the approval.

The entitlement to the above benefits is conditional upon MTS's fulfilling the conditions stipulated by the above Law, regulations published thereunder and the letters of approval for the specific investment in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and MTS may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2004, management believes that MTS is meeting all of the aforementioned conditions.

The tax-exempt income attributable to the "Approved Enterprise", amounting to \$2,250 as of December 31, 2004, can be distributed to shareholders without subjecting MTS to taxes only upon the complete liquidation of MTS. MTS has determined that such tax-exempt income will not be distributed as dividends and permanently re-invested these profits. Accordingly, no deferred taxes have been nor will be provided on income attributable to MTS's "Approved Enterprise".

Should the retained tax-exempt income be distributed in a manner other than in the complete liquidation of MTS, it would be taxed at the corporate tax rate applicable to such profits as if MTS had not elected the alternative tax benefits (currently - 10%-25% for an "Approved Enterprise").

Should MTS and its Israeli subsidiary derive income from sources other than an "Approved Enterprise", they will be subject to tax at the regular rate of 35%.

Since MTS is operating more than one "Approved Enterprise" and since part of its taxable income is not entitled to tax benefits under the abovementioned law and is taxed at the regular corporate tax rate, its effective tax rate is the result of a weighted combination of the various applicable rate and tax exemptions, and the computation is made for income derived from each program on the basis of formulas specified in the law and in the approvals.

- b. Measurement of results for tax purposes under the Income Tax Law (Inflationary Adjustments), 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are presented in dollars. The difference between the annual change in the CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes presented in the financial statements. In accordance with paragraph 9(f) of SFAS 109, MTS and its Israeli subsidiary have not provided for deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities.

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 13:- TAXES ON INCOME (Cont.)

- c. Tax benefits under the Law for the Encouragement of Industry (Taxation), 1969:

MTS is currently qualified as an "industrial company" under the above law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation of machinery and equipment, as prescribed by regulations published under the Inflationary Adjustments Law, the right to claim public issuance expenses and amortization of intangible property rights as a deduction for tax purposes.

- d. Net operating losses carryforwards:

As of December 31, 2004, the Company and its subsidiaries in Israel, Asia, U.S. and Holland have an estimated total amount of available carryforward tax losses of \$5,717, \$ 290, \$210 and \$ 0, respectively to offset against future taxable profits.

The tax loss carryforward in Israel may be offset indefinitely against operating income. The operating loss carryforwards of MTS and its Israeli subsidiary, which can be used indefinitely, amounted to approximately \$5,717.

- e. Tax assessments:

Regarding the claim from the tax authorities in Israel, see Note 12c. The Company has received final tax assessments until the 1996 tax year.

- f. Deferred income taxes:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

	December 31,	
	2003	2004
Tax loss carryforwards of the Company	\$ 845	\$ 1,291
Allowances for doubtful accounts and accruals for employee benefits	121	122
In respect of marketable securities	84	76
Capitalized software and other intangible assets	134	93
Other	5	190

	-----	-----
Net deferred tax asset before valuation allowance	1,189	1,772
Valuation allowance	(1,017)	(1,633)
	-----	-----
Net deferred income taxes	\$ 172	\$ 139
	=====	=====
Presented as follows:		
Current assets - foreign	\$ 66	\$ 66
	=====	=====
Other assets - foreign	\$ 73	\$ 73
	=====	=====
Other assets - domestic	\$ 33	\$ --
	=====	=====

F-30

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 13:- TAXES ON INCOME (Cont.)

MTS and certain of its subsidiaries have provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforward and other temporary differences, since they have a history of losses over the past years. Management currently believes that it is more likely than not that part of the deferred tax regarding the loss carryforward in the Company and other temporary differences will not be realized in the foreseeable future.

- g. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statements of operations, is as follows:

	Year ended December 31,		
	2002	2003	2004
	-----	-----	-----
Loss before taxes as reported in the statements of operations	\$ (54)	\$ (60)	\$ --
	=====	=====	=====
Tax rates	36%	36%	36%
	=====	=====	=====
Theoretical tax benefit	\$ (19)	\$ (22)	\$ --
Increase in taxes resulting from:			
Effect of different tax rates and "Approved Enterprise" benefit	200	--	--

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Tax adjustment in respect of inflation in Israel and others	(61)	(22)	
Utilization of carryforward tax losses for which valuation allowance was provided	(246)	(86)	
Non-deductible expenses and tax exempt income	(24)	9	
Taxes in respect of previous years	--	175	
Deferred taxes for which valuation allowance was provided	202	144	
	-----	-----	-----
Taxes on income as reported in the statements of operations	\$ 52	\$ 198	\$
	=====	=====	=====

h. Loss before income taxes is comprised as follows:

Domestic	\$ (841)	\$ (312)	\$
Foreign	787	252	
	-----	-----	-----
	\$ (54)	\$ (60)	\$
	=====	=====	=====

F-31

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 13:- TAXES ON INCOME (Cont.)

i. Taxes on income are comprised as follows:

	Year ended December 31,		
	2002	2003	2004
	-----	-----	-----
Current taxes	\$ 23	\$ --	\$ 10
Deferred taxes	29	23	33
Taxes in respect of previous years	--	175	223
	-----	-----	-----
	\$ 52	\$ 198	\$ 266
	=====	=====	=====
Domestic	\$ 29	\$ 322	\$ 256
Foreign	23	(124)	10
	-----	-----	-----
	\$ 52	\$ 198	\$ 266
	=====	=====	=====

NOTE 14:- RELATED PARTIES TRANSACTIONS

a. On November 8, 1999, the board of directors and the audit committee approved, subject to shareholders' approval, an increase in the monthly salary of the Chairman of the Board of Directors from \$ 5 to

Edgar Filing: MER TELEMAGEMENT SOLUTIONS LTD - Form 20-F/A

\$ 7 per month and the grant of options to purchase 98,824 ordinary shares. The options were granted to him at his request in lieu of salary for the twelve month period ending December 31, 2000. The exercise price of the options is \$ 6 per share, expected dividend yield is 0%, and the risk free interest rate is 6%. The options will vest ratably over an eight-month period beginning January 1, 2000 and will terminate five years from the date of grant. The options were forfeited by the end of the year 2004.

The wife of the Chairman of the Board of Directors provides ongoing legal services to the Company and receives a monthly retainer of \$ 5. The conditions for retaining her services were approved by the Company's Board of Directors and audit committee.

MTS's subsidiaries, MTS Asia Ltd. and MTS IntegraTRAK, entered into an agreement with C. Mer, pursuant to which they distribute and support certain of C. Mer's (company under common control) products and provide certain services on behalf of C. Mer. Generally, C. Mer compensates MTS Asia Ltd. for these activities at cost plus 10% and compensates MTS IntegraTRAK at cost plus 5%.

F-32

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 14:- RELATED PARTIES TRANSACTIONS (Cont.)

b. In 2003 and 2004, the balance with C. Mer reflects short-term debt and other receivable. Due to the short-term nature, no interest was charged by or paid to C. Mer through December 31, 2003 and 2004.

c. Transactions with related parties were as follows:

	Year ended December 31,		
	2002	2003	2004
Sales through related parties	\$ 65	\$ 28	\$ 15
Amounts charged by related parties:			
Cost of revenues	\$ 239	\$ 34	\$ 32
Research and development	8	--	--
Selling and marketing	2	--	--
General and administrative	4	5	7
	\$ 253	\$ 39	\$ 39
Amounts charged by MTS Integra TRAK and MTS Asia to related parties:			
Selling and marketing	\$ 2	\$ --	\$ 18

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Payments from (repayments to) the related parties, net	\$ (172)	\$ (48)	\$ 20
	=====	=====	=====

d. Amounts due from an affiliate:

	December 31,	
	2003	2004
	-----	-----
Jusan S.A	\$ (2)	\$ (21)
	=====	=====

NOTE 15:- SHAREHOLDERS' EQUITY

a. Share capital:

The Ordinary shares entitle their holders the right to receive notice to participate and vote in general meetings of MTS and the right to receive cash dividends, if declared.

b. Share Option Plan:

MTS has authorized, through its 1996 Incentive Share Option plan, the grant of options to officers, management, employees and directors of MTS or any subsidiary of up to 1,900,000 of MTS's Ordinary shares. Up to 1,500,000 options shall be granted under the option plan pursuant to section 102 of the Israel Income Tax Ordinance. Any option, which is canceled or forfeited before expiration, will become available for future grants.

F-33

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 15:- SHAREHOLDERS' EQUITY (Cont.)

Each option granted under the Plan is exercisable until the earlier of four years from the date of the grant of the option or the expiration dates of the option plan. The exercise price of the options granted under the plans may not be less than the nominal value of the shares into which such options were exercised. The options vest primarily gradually over three or four years of employment.

In 2003, Section 102 of the Israeli Income Tax Ordinance was amended effective as of January 1, 2003. Therefore MTS has rolled-over the remaining options available, at that time for grant into a new plan that conforms with the newly amended provisions of Section 102 of the Israel Income Tax Ordinance. The Incentive Share Option Plan will terminate in 2013, unless cancelled earlier by MTS's board of directors.

As of December 31, 2004, 672,025 options are available for future

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

grant.

Summary of MTS's stock options activity and related information for the three years ended December 31 is as follows:

	Options available for grant	Number of options outstanding	Options exercisable
	-----	-----	-----
Options exercisable at January 1, 2002			800,887 =====
Balance on January 1, 2002	531,609	1,227,141	
Options granted	(35,000)	35,000	
Options forfeited	504,561	(504,561)	
	-----	-----	
Options exercisable at December 31, 2002			502,644 =====
Balance on December 31, 2002	1,001,170	757,580	
Options granted	(434,500)	434,500	
Options exercised	--	(133,333)	
Options forfeited	260,106	(260,106)	
	-----	-----	
Options exercisable at December 31, 2003			355,413 =====
Balance on December 31, 2003	826,776	798,641	
Options granted	(226,000)	226,000	
Options exercised	--	(17,333)	
Options forfeited	251,708	(251,708)	
Options forfeited from old plan	(180,459)	--	
	-----	-----	
Options exercisable at December 31, 2004			301,812 =====
Balance on December 31, 2004	672,025 =====	755,600 =====	

F-34

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

NOTE 15:- SHAREHOLDERS' EQUITY (Cont.)

The options outstanding as of December 31, 2004 have been separated into ranges of exercise prices, as follows:

Options                      Weighted

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Exercise price	outstanding as of December 31, 2004	average remaining contractual life (in years)	Weighted average exercise price	Options exercisable
\$ 0.93-1.3	31,500	1.08	\$ 1.18	20,998
\$ 1.844	250,000	3.92	\$ 1.844	62,500
\$ 1.9-2.05	186,300	0.39	\$ 1.95	186,300
\$ 2.2-2.35	184,000	4.71	\$ 2.27	-
\$ 2.9-2.95	98,800	3.92	\$ 2.9	27,014
\$ 4.5	2,000	0.08	\$ 4.5	2,000
\$ 5.9375	3,000	0.75	\$ 5.9375	3,000
	755,600		\$ 2.11	301,812

- c. The weighted average fair value of options granted during 2003 and 2004, whose exercise price equals the fair value of the stock on the date of grant, was \$ 1.20 and \$ 0.781 per option, respectively.

During 2004, the Company granted 226,000 options at a weighted average exercise price of \$ 2.29 per share (the fair market value of the shares on the date of grant).

The Company has recorded deferred stock compensation expense for options issued in 2003 with an exercise price below the fair market value of the shares; the deferred stock compensation expense has been amortized and recorded as compensation expense ratably over the vesting period of the options. Compensation expense of approximately \$ 60 and \$ 66 was recognized during 2003 and 2004, respectively.

During 2003 the Company reduced the exercise price of 83,000 options to zero resulting in a compensation expense of approximately \$ 153.

- d. In January 2000, MTS granted 98,824 options to Mr. Chaim Mer, chairman of the Company, having an exercise price of \$ 6.00 per share. These options were granted in lieu of Mr. Mer's salary (\$ 7 per month) in 2000. The options were exercisable for five years commencing January 1, 2000 and forfeited by the end of year 2004 (see Note 14a).
- e. On February 7, 2001, MTS issued five-year warrants to purchase 25,000 Ordinary shares of MTS to Investec Bank (Mauritius) Ltd. in connection with certain financial services performed on MTS's behalf. The warrants have an exercise price of \$ 4.95 per share for warrants exercised until February 2004 and \$ 5.625 per share for warrants exercised until February 2006. The fair value of the warrants, at the date of the grant, using a Black-Scholes option pricing model was immaterial and therefore no compensation expenses were recorded.

F-35

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

### NOTE 15:- SHAREHOLDERS' EQUITY (Cont.)

f. Treasury shares:

During 2002, 2003 and 2004, the Company purchased 195,183, 130,510 and 3,800 treasury shares in consideration of \$ 172, \$ 147 \$ 9 and respectively, according to the stock repurchase program, which authorized the Company's officers to repurchase up to 600,000 Ordinary shares of MTS and was approved by the Company's Board of Directors.

During 2003, MTS cancelled \$457 of its treasury shares, which represent 384,610 Ordinary shares.

g. Dividends:

Dividends, if any, will be paid in NIS. Dividends paid to shareholders outside Israel will be converted into dollars, on the basis of the exchange rate prevailing at the date of payment.

### NOTE 16:- GEOGRAPHIC INFORMATION AND CLASSES OF PRODUCTS

The Company adopted Statement of Financial Accounting Standard No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). The Company operates in one reportable segment (see Note 1 for a brief description of the Company's business). The total revenues are attributed to geographic areas based on the location of the customer.

The following is a summary of revenues within geographic areas based on end customer location and long-lived assets:

	Year ended December 31,		
	2002	2003	2004
Revenues from sales:			
Israel	\$ 217	\$ 186	\$ 256
United States	6,449	4,917	4,967
Germany	1,130	1,826	1,724
Holland	756	924	798
Europe (excluding Germany and Holland)	296	516	471
Asia	469	364	635
South America	328	368	423
Others	142	129	139
	\$ 9,787	\$ 9,230	\$ 9,413
	\$ 9,787	\$ 9,230	\$ 9,413

F-36

MER TELEMANAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. dollars in thousands (except share data)

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

NOTE 16:- GEOGRAPHIC INFORMATION AND CLASSES OF PRODUCTS (Cont.)

	December 31,		
	2002	2003	2004
Long-lived assets:			
Israel	\$ 624	\$ 394	\$ 3,103
United States	2,302	2,268	2,244
Holland	10	8	7
Asia	29	16	9
South America	22	27	27
	<u>\$ 2,987</u>	<u>\$ 2,713</u>	<u>\$ 5,390</u>

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	Year ended December 31,		
	2002	2003	2004
TABS	\$ 9,787	\$ 9,230	\$ 9,327
Application suite	--	--	86
	<u>\$ 9,787</u>	<u>\$ 9,230</u>	<u>\$ 9,413</u>

NOTE 17:- SELECTED STATEMENTS OF OPERATIONS DATA

a. Financial income, net

	Year ended December 31,		
	2002	2003	2004
Financial expenses:			
Interest expenses	\$ (205)	\$ (64)	\$ --
Other expenses	(7)	--	(24)
Foreign currency translation differences	--	(11)	--
	<u>(212)</u>	<u>(75)</u>	<u>(24)</u>
Financial income:			
Interest income	310	186	83
Other income	1	13	--
Foreign currency translation differences	35	--	19
	<u>346</u>	<u>199</u>	<u>102</u>
	<u>\$ 134</u>	<u>\$ 124</u>	<u>\$ 78</u>

Other income (expenses):

Edgar Filing: MER TELEMAGEMENT SOLUTIONS LTD - Form 20-F/A

Gain (loss) on marketable securities, net	\$	(140)	\$	6	\$	--
	=====		=====		=====	

F-37

MER TELEMAGEMENT SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 18:- SUBSIDIARIES AND AFFILIATES

	Percentage of ownership -----	Juris inco -----
Subsidiaries: -----		
MTS IntegraTRAK Inc.	100%	D
MER Fifth Avenue Realty Inc. (a subsidiary of MTS IntegraTRAK Inc.)	100%	N
MTS Asia Ltd.	100%	H
Telegent Ltd.	100%	
Jaraga B.V.	100%	The
Verdura B.V. (a subsidiary of Jaraga B.V.)	100%	The
Voltera Technologies V.O.F. (a partnership held 99% by Jaraga B.V. and 1% by Verdura B.V.)	100%	The
Bohera B.V. (a subsidiary of Jaraga B.V.)	100%	The
Tabs Brazil Ltd. (a subsidiary of Jaraga B.V.)	100%	
Affiliate: -----		
Jusan S.A. (a subsidiary of Jaraga B.V.)	50%	

NOTE 19:- SUBSEQUENT EVENTS

On April 18, 2005, Amdocs (Israel) Ltd. and Amdocs Ltd. (the "Plaintiffs") filed a complaint with the Tel Aviv District Court against the Company, its Chief Executive Officer and others (the "Defendants") alleging, among other things, that professional and commercial information belonging to the Plaintiffs was transferred to the Defendants for use in the Company's activity. The Plaintiffs are seeking an injunction prohibiting the Defendants from making any use of the information and trade secrets that were allegedly transferred, injunctions requiring the return of such information and estimated damages of NIS 14,775 (approximately \$3,360). Due to the preliminary stage of the litigation, the Company and its legal advisors cannot currently advise as to its outcome or its possible adverse effect on the Company's financial position or results of

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

operations. The company intends to vigorously defend this action.

- - - - -

F-38

JUSAN, S.A.

FINANCIAL STATEMENTS

EUROS IN THOUSANDS

INDEX

	Page
	-----
Report of Registered Public Accounting Firm	F-40
Report of Independent Auditors	F-41
Balance Sheets as of December 31, 2002, 2003 and 2004	F-42
Statements of Income for the three years ended December 31, 2004	F-43
Statements of Changes in Shareholders' Equity for the three years ended December 31, 2004	F-44
Statements of Cash Flows for the three years ended December 31, 2004	F-45
Notes to Financial Statements	F-46 - F-55

F-39

[LOGO] BDO      BDO Audiberia      Juan Bravo, 3-B, 6a 28006 Madrid - Espana  
Auditores      Telefono:      00 34-914 364 190  
Fax:      00 34-914 364 191/192  
Email:      bdo@bdo.es

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

-----

Board of Directors and Stockholders of Jusan, S.A.:

1. We have audited the accompanying balance sheet of Jusan, S.A. as of

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

December 31, 2004 and the related statements of income, stockholders' equity and cash flows for the year ended December 31, 2004. 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 audit. The consolidated financial statements of the Company as of December 31, 2003 were audited by other auditors whose report dated January 14, 2004, expressed an unqualified opinion on those statements.

2. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 provide a reasonable basis for our opinion.
3. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jusan, S.A. as of December 31, 2004 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

BDO Audiberia

/s/ Peter D. Cook

-----  
Peter D. Cook  
Madrid, March 3, 2005

F-40

[LOGO] ERNST & YOUNG |X| Kost Forer Gabbay & Kasierer  
3 Aminadav St. |X| Phone: 972-3-6232525  
Tel-Aviv 67067, Israel Fax: 972-3-5622555

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of

JUSAN, S.A.

We have audited the accompanying balance sheets of JUSAN, S.A. ("the Company") as of December 31, 2003 and 2002, and the related statements of

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2003. 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 audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel  
January 14, 2004

/s/ Kost Forer Gabbay and Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

F-41

JUSAN, S.A.

BALANCE SHEETS

Euros in thousands

	December 31,	
	2002	2003
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	(euro) 338	(euro) 953
Short-term bank deposits	402	450
Trade receivables (net of allowance for doubtful accounts of 6 euros as of December 31, 2002 and 2003 and 43 euros as of December 31, 2004, and net of provision for returns of 7 euros as of December 31, 2003, and 4 euros as of December 31, 2004)	1,578	1,732
Other accounts receivable and prepaid expenses (Note 3)	262	240
Inventories (Note 4)	900	793
	3,480	4,168
<b>Total current assets</b>	<b>3,480</b>	<b>4,168</b>

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

-----	-----	-----	-----
PROPERTY AND EQUIPMENT, NET (Note 5)	118	78	
	-----	-----	
Total assets	(euro) 3,598	(euro) 4,246	(eu
-----	=====	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term bank debt (Note 6)	(euro) 16	(euro) 38	(eu
Trade payables	623	795	
Accrued expenses and other liabilities (Note 7)	386	408	
Deferred revenues	126	232	
	-----	-----	
Total current liabilities	1,151	1,473	
-----	-----	-----	
COMMITMENTS (NOTE 8)			
SHAREHOLDERS' EQUITY (Note 11):			
Share capital -			
15,052 Ordinary shares of (euro) 0.0042 par value -			
Authorized, issued and outstanding as of December 31,			
2002, 2003 and 2004			
	63	63	
Retained earnings	2,384	2,710	
	-----	-----	
Total shareholders' equity	2,447	2,773	
-----	-----	-----	
Total liabilities and shareholders' equity	(euro) 3,598	(euro) 4,246	(e
-----	=====	=====	=====

The accompanying notes are an integral part of the financial statements.

F-42

JUSAN, S.A.

STATEMENTS OF INCOME

-----  
Euros in thousands (except share and per share data)

	Year ended December 31,		
	2002	2003	2004
	-----	-----	-----
Revenues (Note 12):			
Product sales	(euro) 6,060	(euro) 5,353	(euro)
Services	819	707	
	-----	-----	-----
Total revenues	6,879	6,060	

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Cost of revenues:				
Product sales		3,336	2,797	
Services		658	538	
Total cost of revenues		3,994	3,335	
Gross profit		2,885	2,725	
Operating expenses:				
Research and development		470	425	
Selling and marketing		718	770	
General and administrative		892	882	
Total operating expenses		2,080	2,077	
Operating income		805	648	
Financial income, net (Note 13)		7	9	
Income before taxes on income		812	657	
Income taxes (Note 9)		185	131	
Net income	(euro)	627	526	(euro)
Basic and diluted net earnings per share	(euro)	41.7	34.95	(euro)
Weighted average number of shares used in computing basic and diluted net earnings per share		15,052	15,052	

The accompanying notes are an integral part of the financial statements.

F-43

JUSAN, S.A.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Euros in thousands

	Number of Ordinary Shares	Share Capital	Retained earnings	Total sharehol Equity
Balance as of January 1, 2002	15,052	(euro) 63	(euro) 2,437	(euro)

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Dividends	-	-	(680)	
Net income	-	-	627	
	-----	-----	-----	-----
Balance as of December 31, 2002	15,052	63	2,384	
Dividends	-	-	(100)	
Accrued dividend	-	-	(100)	
Net income	-	-	526	
	-----	-----	-----	-----
Balance as of December 31, 2003	15,052	63	2,710	
Net income	-	-	373	
	-----	-----	-----	-----
Balance as of December 31, 2004	15,052	(euro) 63	(euro) 3,083	(euro)
	=====	=====	=====	=====

The accompanying notes are an integral part of the financial statements.

F-44

JUSAN, S.A.

STATEMENTS OF CASH FLOWS

Euros in thousands

	Year ended	
	2002	2001
	-----	-----
Cash flows from operating activities:		
-----		
Net income	(euro) 627	(euro)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	63	
Increase in trade receivables	(236)	
Decrease (increase) in other accounts receivable and prepaid		

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

expenses		(51)	
Decrease (increase) in inventories		(252)	
Increase (decrease) in trade payables		(264)	
Increase (decrease) in accrued expenses and other liabilities		(218)	
Increase (decrease) in deferred revenues		126	
		-----	-----
Net cash provided by (used in) operating activities		(205)	
		-----	-----
Cash flows from investing activities:			
-----			
Investment in short-term bank deposits		702	
Purchase of property and equipment		(94)	
		-----	-----
Net cash provided by (used in) investing activities		608	
		-----	-----
Cash flows from financing activities:			
-----			
Dividend paid		(680)	
Short-term bank debt		(61)	
		-----	-----
Net cash used in financing activities		(741)	
		-----	-----
Increase (decrease) in cash and cash equivalents		(338)	
Cash and cash equivalents at the beginning of the year		676	
		-----	-----
Cash and cash equivalents at the end of the year	(euro)	338	(euro)
		=====	=====
Non-cash financing information:			
-----			
Accrued dividend		-	(euro)
		=====	=====
Supplemental disclosure of cash flows activities:			
-----			
Cash paid during the year for:			
Interest	(euro)	9	(euro)
		=====	=====
Income taxes	(euro)	183	(euro)
		=====	=====

The accompanying notes are an integral part of the financial statements.

F-45

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

-----  
Euros in thousands

NOTE 1:- ORGANIZATION AND OPERATIONS

## Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

- a. JUSAN, S.A. ("the Company") was incorporated in Spain on June 19, 1959. The Company is engaged in development, manufacturing and assembly, sales and distribution, and maintenance of vocal server and call billing applications, as well as is in the television rental business.
- b. The Company has two major customers (see also Note 12a).
- c. In accordance with company law the administrators present, for comparative purposes, each of the balance sheet and profit and loss account, the figures for the previous financial year, in addition to those for the financial year 2004. The financial statements refer exclusively to the annual accounts for the financial year 2004.

### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP").

- a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles 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.

- b. Financial statements in euros

Monetary accounts maintained in currencies other than the Euro are remeasured into Euros in accordance with Statement of Financial Accounting Standard No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All effects of foreign currency remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

- c. Cash equivalents:

The Company considers all highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

There are no restrictions for cash and cash equivalents.

- d. Short-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The deposits are in Euro and bear interest at an average rate of 2%. The short-term deposits are presented at their cost, including accrued interest.

F-46

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

-----  
Euros in thousands

# Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows: Raw materials, parts and supplies -using the weighted average cost method. Work in progress and finished products are recorded on the basis of direct manufacturing costs. Inventories write-offs are provided to cover risks arising from slow moving items or technological obsolescence.

f. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method, over the estimated useful lives of the assets, at the following annual depreciation rates:

	%
	-----
Computers and peripheral equipment	33
Office furniture and equipment	20
Motor vehicles	20

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

g. Research and development costs:

Research and development costs are charged to the Statement of Operations as incurred. Statement of Financial Accounting Standard No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"), requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working models and the point at which the products are ready for general release have been insignificant. Therefore, all research and development costs have been expensed.

F-47

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

-----  
Euros in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided to reduce deferred tax assets to their estimated realizable value.

i. Revenue recognition:

The Company generates revenues from selling software-based products through resellers and distributors who are considered end-users. The Company also generates revenues from rendering maintenance and support services.

Revenues are recognized when all criteria outlined in Statement of Position No. 97-2 "Software Revenue Recognition" ("SOP No. 97-2") as amended are met. Revenue from products is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable.

Where the arrangements involve multiple elements, revenue is allocated to each element based on vendor specific objective evidence ("VSOE") of the relative fair values of each element in the arrangement, in accordance with the "residual method" prescribed by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition With Respect to Certain Transactions". The VSOE used by the Company to allocate the sales price to support services and maintenance is based on the renewal rate charged when these elements are sold separately. Revenues from products are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements, and (2) all revenue recognition criteria of SOP No. 97-2, as amended, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered element.

Provision for returns in the amount of (euro) 4 is determined principally on the basis of past experience.

Revenues from maintenance and support services are recognized over the life of the maintenance agreement or at the time support services are rendered.

Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

## NOTES TO FINANCIAL STATEMENTS

-----  
Euros in thousands

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## j. Warranty costs:

The Company provides free warranty for up to one year. A provision in the amount of (euro) 20 as of December 31, 2004 ((euro) 18 in 2003 and 2002) is recorded for probable costs in connection with these services based on the Company's experience.

The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

## k. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term bank deposits, trade receivables, other accounts receivable and trade payables approximate their fair value, due to the short-term maturity of such instruments.

There are short term fixed-rate securities as an amount of (euro) 450.000 as of December 31, 2004.

## l. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term bank deposits and trade receivables.

Cash and cash equivalents and short-term bank deposits are deposited with major banks in Spain. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers in Spain and Europe (see Note 12a). The Company performs ongoing credit evaluations of its customers. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection according to management estimates (the ageing of account receivable is more than 180 days). In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

Euros in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Basic and diluted net earnings per share:

Basic net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year. Diluted earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus potential ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS No. 128").

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2002	2003
Government authorities	(euro) 201	(euro) 191
Employee advances	34	33
Deposits	16	16
Other	11	-
	(euro) 262	(euro)

NOTE 4:- INVENTORIES

	December 31,	
	2002	2003
Raw materials	(euro) 551	(euro) 489
Work in progress	38	23
Finished products	311	281
	(euro) 900	(euro) 793

The provision for obsolescence for the years ended 31, 2002, 2003 and 2004 were (euro) 0, 0 and 12, respectively.

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

Euros in thousands

NOTE 5:- PROPERTY AND EQUIPMENT

	December	
	2002	2003
Cost:		
Computers and peripheral equipment	(euro) 140	(euro)
Office furniture and equipment	285	
Motor vehicles	100	
Leasehold improvements	140	
	-----	-----
	665	
Accumulated depreciation:		
Computers and peripheral equipment	97	
Office furniture and equipment	243	
Motor vehicles	67	
Leasehold improvements	140	
	-----	-----
	547	
Depreciated cost	(euro) 118	(euro)
	=====	=====

Depreciation expenses for the years ended December 31, 2002, 2003 and 2004 were (euro) 63, (euro) 64 and (euro) 47, respectively.

NOTE 6:- SHORT-TERM BANK DEBT

The Company has a short-term bank debt as of December 31, 2004 in the amount of (euro)18, bearing interest of 3.75%.

NOTE 7:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December	
	2002	2003
Employees and payroll accruals	(euro) 53	(euro)
Income tax payable	184	
Deferred tax	-	
Government authorities	131	
Accrued dividends	-	
Current Accounts	-	
Warranty costs	18	
	-----	-----

(euro) 386 (euro)  
 =====

F-51

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

Euros in thousands

NOTE 8:- COMMITMENTS

The facilities of the Company are rented under operating leases for periods ending in 2009.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2004, are as follows:

2005	(euro)	100
2006		43
2007		8
2008		8
2009		5
		-----
	(euro)	164
		=====

Rent expenses for years ended December 31, 2002, 2003, and 2004, were approximately (euro) 142, (euro) 152 and (euro) 152, respectively.

NOTE 9:- TAXES ON INCOME

Reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statements of operations, is as follows:

		Year ended	
		2002	
		-----	
Income before taxes as reported in the statements of operations	(euro)	812	(euro)
Adjustments for tax purposes		-	
Decrease in the taxable base - Profit in sales to term		-	
		=====	=====
		812	
Statutory tax rates		35%	
		=====	=====
Theoretical tax expense	(euro)	284	(euro)
Decrease in taxes resulting from:			
Tax deduction for development		(99)	

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Deferred Tax		-	
		-----	----
Taxes on income as reported in the statements of income	(euro)	185	(euro)
		=====	=====

Under the current tax legislation, 35% of development expense can be deducted from the income tax with the limits of 35% of the theoretical tax benefits. In 2002 this limit was 35% and 2003 this limit was 45%.

F-52

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

Euros in thousands

All the income before income taxes is domestic. Income taxes include only current tax expenses.

There is a currently tax inspection at the date of the issue of financial statements. The managers do not consider it will arise significant impacts as a result of this inspection.

NOTE 10:- RELATED PARTIES TRANSACTIONS

The balances with and the revenues derived from related parties were as follows:

- a. Payments to related parties:

		Year ended	
		-----	
		2002	
		-----	
Wages	(euro)	274	(euro)
		=====	=====

In 2002, 2003 and 2004, the balance with personnel reflects short-term debt.

In 2004 the payments of wages to related parties are based on the payments to the managers ((euro) 161), the bonus of the president ((euro) 45), arised from the 10% of the year profit result, the social security paid to the directors ((euro) 26) and 20% from the leases ((euro) 23).

- b. Transactions with related parties were as follows:

Year en
-----
2002

	-----	-----
Sales through related parties	(euro) -	(euro)
	=====	=====
Amounts charged by related parties:		
Cost of revenues	(euro) 80	(euro)
	=====	=====
c. Amounts receivable from and payables to related parties:		
		D
	-----	-----
	2002	
	-----	-----
Receivables:		
Mer Telemanagement Solutions	(euro) 1	(euro)
MTS Asia	-	
MTS IntegraTRAK	-	
	=====	=====
Payables:		
Beheer - Jaraga BV	(euro) -	(euro)
	=====	=====

F-53

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

-----  
Euros in thousands

NOTE 11:- SHAREHOLDERS' EQUITY

a. Share capital:

The ordinary shares entitle their holders the right to receive notice, to participate and vote in general meetings of the Company and the right to receive dividends, if declared.

b. Legal reserve

As established by the Spanish Companies' Act, 10% of profits must be allocated to the legal reserve, until such reserve is equal to 20% of share capital. The legal reserve shall not be distributed and may only be used for compensation of losses or to increase capital.

c. Shareholding

There are 15,052 ordinary shares of (euro) 0.0042 par value, authorized, issued and outstanding as of December 31, 2004.

The shareholders at December 31, 2004 are:

Jaraga, B.V.	50%
--------------	-----

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Jose Lasry Nahon	25%
Mauricio Toledano Marques	25%

NOTE 12:- SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION

a. Major customers as a percentage of total revenues:

	Year ended D	
	2002	20
		%
Customer A		3%
Customer B		3%

b. The following is a summary of revenues within geographic areas based on end customer location:

	Year ended D	
	2002	20
Spain	(euro) 4,335	(euro)
European Community	2,067	
Other	477	
	(euro) 6,879	(euro)

F-54

JUSAN, S.A.

NOTES TO FINANCIAL STATEMENTS

Euros in thousands

NOTE 13:- SELECTED STATEMENTS OF OPERATIONS DATA

Financial income, net

	Year ended D	
	2002	20
Financial expenses:		
Interest expenses	(euro) 9	(euro)
Other expenses	13	

	22	
Financial income:	-----	-----
Interest income	29	
	-----	-----
Financial income, net	(euro) 7	(euro)
	=====	=====

-----

F-55

S I G N A T U R E S

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

MER TELEMANAGEMENT SOLUTIONS LTD.

By: /s/Eytan Bar  
-----  
Eytan Bar  
Chief Executive Officer

By: /s/Shlomi Hagai  
-----  
Shlomi Hagai  
Chief Financial Officer

Edgar Filing: MER TELEMANAGEMENT SOLUTIONS LTD - Form 20-F/A

Dated: October 7, 2005