

Powszechna Kasa Oszczędności Bank Polski SA

**Independent Registered Auditor's Report
on the financial statements
as at and for the year ended 31 December 2010**

**Independent registered auditor's report on the financial statements
To the General Shareholders' Meeting and the Supervisory Board of
Powszechna Kasa Oszczędności Bank Polski SA**

This report contains 49 consecutively numbered pages and consists of:

	Page
I. General information about the Bank.....	2
II. Information about the audit	5
III. The Bank's results and financial position	6
IV. Discussion of financial statement components	10
V. The independent registered auditor's statement.....	47
VI. Final information and comments	49

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

I. General information about the Bank

- (a) The Bank was established in 1919 as Poczтовая Kasa Oszczędnościowa (Postal Savings Bank).

In 1950, the Bank started operating as Powszechna Kasa Oszczędności Bank Państwowy (state-owned bank). On 18 January 2000, on the basis of a Decree of the Council of Ministers, Powszechna Kasa Oszczędności Bank Państwowy was transformed into a joint-stock company wholly-owned by the State Treasury, under the name of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna. On 12 April 2000, the Bank was entered in the Business Register maintained by the District Court for the City of Warsaw, Business Court, the 16th Registration Department. Currently, the Bank is registered under the number KRS 0000026438, and the District Court for the City of Warsaw, the 13th Business Department of the National Court Register, is the competent registration court.

On 14 June 1993, the Bank was assigned a tax identification number (NIP) 525-000-77-38 for making tax settlements. On 18 April 2000, the Bank was assigned a REGON number 016298263 for statistical purposes.

- (b) As at 31 December 2010 the Bank's registered share capital amounted to PLN 1,250,000 thousand and consisted of 1,250,000,000 ordinary shares, each of PLN 1 par value, including:
- 510.000.000 A-series registered shares;
 - 105.000.000 B-series bearer shares;
 - 385.000.000 C-series bearer shares;
 - 250.000.000 D-series bearer shares.
- (c) Based on art. 111 of the Act on trading in financial instruments dated 29 July 2005, the Bank conducts brokerage activities through a separate organizational unit (a branch office) of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna Oddział – Dom Maklerski PKO Banku Polskiego w Warszawie in Warsaw (hereinafter called "the Brokerage House of PKO BP SA").

The Brokerage House of PKO BP SA has existed since 1991. Based on Resolution No. 17/91 of the Polish Securities Commission dated 26 August 1991, the Brokerage House of PKO BP SA obtained a licence for public trading in securities. By Resolution No. 24/91 of Giełda Papierów Wartościowych w Warszawie SA (the Warsaw Stock Exchange) dated 26 September 1991, the Brokerage House of PKO BP SA was entered in the register of direct participants in the National Depository for Securities.

- (d) In the audited year, the Bank's operations comprised:
- accepting cash deposits payable on demand or on an agreed date and maintaining accounts for such deposits;
 - granting loans and cash advances;
 - granting and confirming bank guarantees;
 - clearing cash transactions;
 - issuing cards and conducting transactions with the use of cards;
 - conducting forward transactions.

At the same time, the Bank conducts brokerage activities through the Brokerage House of PKO BP SA and fiduciary services through the Fiduciary Office.

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

I. General information about the Bank (cont.)

(e) The following people were on the Bank's Management Board during the financial year:

Zbigniew Jagiełło	President of the Management Board	throughout the year
Piotr Stanisław Alicki	Vice-President of the Management Board	from 2 November 2010
Bartosz Drabikowski	Vice-President of the Management Board	throughout the year
Krzysztof Dresler	Vice-President of the Management Board	throughout the year
Jarosław Myjak	Vice-President of the Management Board	throughout the year
Wojciech Papierak	Vice-President of the Management Board	throughout the year
Jakub Papierski	Vice-President of the Management Board	from 22 March 2010
Mariusz Zarzycki	Vice-President of the Management Board	to 31 July 2010

(f) The Bank has the following related entities:

Bankowe Towarzystwo Kapitałowe SA	- subsidiary
Bankowy Fundusz Leasingowy SA	- subsidiary
Centrum Elektronicznych Usług Płatniczych „eService” SA	- subsidiary
Centrum Finansowe Puławska Sp. z o.o.	- subsidiary
Inteligo Financial Services SA	- subsidiary
Kredobank SA	- subsidiary
PKO BP BANKOWY Powszechne Towarzystwo Emerytalne SA	- subsidiary
PKO BP Inwestycje Sp. z o.o.	- subsidiary
PKO Finance AB	- subsidiary
PKO Towarzystwo Funduszy Inwestycyjnych SA	- subsidiary
Fort Mokotów Inwestycje Sp. z o.o.	- subsidiary
Centrum Haffnera Sp. z o.o.	- jointly controlled entity
Centrum Obsługi Biznesu Sp. z o.o.	- jointly controlled entity
Bank Pocztowy SA	- associate
Kolej Gondolowa Jaworzyna Krynicka SA	- associate
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	- associate
Agencja Inwestycyjna CORP SA	- associate

and the companies that are members of the capital groups of Bankowe Towarzystwo Kapitałowe SA, Bankowy Fundusz Leasingowy SA, Inteligo Financial Services SA and PKO BP Inwestycje Sp. z o.o. as well as indirect jointly controlled entities that are members of the capital group Centrum Haffnera Sp z o.o. and indirect associates that are members of the capital group Bank Pocztowy SA.

(g) The Bank is an issuer of securities admitted for trading on the Warsaw Stock Exchange. In accordance with the choice of selecting accounting policies permitted by the Accounting Act, the Company has decided to prepare its financial statements in accordance with IFRS as adopted by the European Union since 2005.

The decision to prepare the Bank's financial statements in accordance with these standards was made by the General Shareholders' Meeting in their Resolution No. 28/2005 passed on 19 May 2005.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

I. General information about the Bank (cont.)

- (h) As the Parent Company of the Group, the Bank has also prepared consolidated financial statements according to IFRS as adopted by the European Union as at 7 March 2011. To better understand the Bank's financial position and its results of operations as the Parent Company, the financial statements should be read in conjunction with the consolidated financial statements.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

II. Information about the audit

- (a) PricewaterhouseCoopers Sp. z o.o. was appointed independent registered auditor to the Bank by Resolution No. 26/2008 of the Supervisory Board dated 17 April 2008 in accordance with paragraph 15, clause 1, item 3 of the Bank's Memorandum of Association.
- (b) PricewaterhouseCoopers Sp. z o.o. and the principal registered auditor conducting the audit are independent of the audited entity within the meaning of art. 56, clause 2-4 of the Act on registered auditors and their council, entities entitled to provide audit of financial statements and public supervision of 7 May 2009 (Journal of Laws 2009, No. 77, item 649).
- (c) The audit was conducted in accordance with an agreement dated 12 May 2008, in the following periods:
- interim audit from 11 October to 10 December 2010;
 - final audit from 10 January to 2 March 2011.

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

III. The Bank's results and financial position

The financial statements do not take account of the effects of inflation. The consumer price index (on a December to December basis) amounted to 3.1% in the audited year (3.5% in 2009).

The observations below are based on the knowledge obtained during the audit of the financial statements.

- As at 31 December 2010, total assets amounted to PLN 167,238,919 thousand and increased by PLN 13,591,440 thousand (i.e. 9%) compared with the balance as at 31 December 2009.
- This increase was mainly financed by an increase in amounts due to customers of PLN 11,244,655 thousand (i.e. 9%) as a result of an increase in deposits and a subsidiary, PKO Finance AB, granting a loan of EUR 800,000 thousand, as well as an increase in equity of PLN 1,022,331 thousand (i.e. 5%) as a result of the accumulation of profits, accompanied by an increase in the negative valuation of derivative instruments of PLN 860,425 thousand (i.e. 56%), as well as an increase in the balance of other liabilities of PLN 467,682 thousand (i.e. 35%).
- In 2010, as in the previous year, amounts due to customers were the main source of financing for assets. The balance of amounts due to customers amounted to PLN 135,289,055 thousand as at the balance date and accounted for 81% of total assets (this percentage remained unchanged compared with 31 December 2009). The change in the balance of amounts due to customers was mainly the effect of a significant increase in amounts due to individuals (up PLN 7,719,802 thousand, i.e. 9%, compared with the balance as at 31 December 2009) and business entities (up PLN 7,159,031 thousand, i.e. 26%, compared with the balance as at 31 December 2009), including the liability in respect of the loan granted by a subsidiary, PKO Finance AB, in the amount of EUR 800,000 thousand (Note 13).
- The balance of amounts due to other banks amounted to PLN 4,164,181 thousand as at the balance date (down PLN 2,544 thousand compared with the previous year) and mainly comprised a syndicated loan received in Swiss francs whose value in the Polish currency amounted to PLN 2,999,116 thousand (PLN 2,621,791 thousand as at 31 December 2009). A 14% increase in the valuation of the loan which resulted from a corresponding increase in the exchange rate of the Swiss franc compared with 31 December 2009 was offset by a decrease in the balance of deposits accepted (down PLN 372,483 thousand, i.e. 27%) (Note 12).
- As at 31 December 2010, liabilities in respect of the negative valuation of derivative instruments amounted to PLN 2,404,795 thousand (PLN 1,544,370 thousand as at 31 December 2009). The increase in the balance as at the balance date was mainly the result of the exchange rates being higher compared with the end of 2009 and an increase in activity on the derivative instrument market (the nominal value of the derivative transactions concluded increased by PLN 139,060,951 thousand (i.e. 41%) compared with the balance as at 31 December 2009) (Note 4).
- The balance of subordinated liabilities amounted to PLN 1,611,779 thousand as at the balance date (PLN 1,612,178 thousand as at 31 December 2009) and related to the valuation of bonds issued by the Bank in 2007 in the nominal amount of PLN 1,600,700 thousand (Note 14).

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

III. The Bank's results and financial position (cont.)

- The Bank's equity as at 31 December 2010 amounted to PLN 21,201,848 thousand (PLN 20,179,517 thousand as at 31 December 2009). The increase in the balance was mainly due to the Bank generating a profit of PLN 3,311,209 thousand in 2010. At the same time, the Bank earmarked PLN 2,375,000 thousand of the profit for 2009 for paying a dividend. The remaining portion of the profit for 2009 was earmarked for increasing the reserve capital (PLN 50,000 thousand) and other reserves (PLN 7,152 thousand) (Note 17).
- The value of own funds amounted to PLN 16,563,089 thousand as at 31 December 2010 (PLN 16,944,530 thousand as at 31 December 2009) and was PLN 5,513,642 thousand higher than the total capital requirement (PLN 11,049,447 thousand as at the end of 2010). The capital adequacy ratio calculated on the basis of the banking portfolio and the trading portfolio as at the balance date amounted to 11.99% and decreased by 2.42 p.p. compared with the end of the previous year. The fall in the capital adequacy ratio was mainly due to an increase in the requirement in respect of credit risk of PLN 1,312,983 thousand (i.e. 16%) as a result of an increase in the loan portfolio, accompanied by a fall in own funds of PLN 381,441 thousand (i.e. 2%), mainly as a result of an increase in the balance of intangible assets which reduced the basic funds by PLN 259,486 thousand (i.e. 20%).
- The higher level of financing was reflected mainly in an increase in the balance of loans and advances to customers as at the balance date – up PLN 14,507,340 thousand (i.e. 13%) – and an increase in the balance of investment securities available for sale – up PLN 1,910,555 thousand (i.e. 24%). These balances amounted to PLN 128,933,129 thousand and PLN 9,876,252 thousand respectively as at the balance date.
- As at the balance date, loans and advances to customers accounted for 77% of total assets (up 2 p.p. compared with the end of 2009). The gross amount of the loan portfolio as at 31 December 2010 amounted to PLN 133,198,613 thousand and increased by PLN 15,357,879 thousand (i.e. 13%) compared with 31 December 2009. This increase was mainly due to an increase in the balance of mortgage and corporate loans granted to customers of the non-financial sector (up PLN 10,096,841 thousand, i.e. 19% and PLN 3,368,167 thousand, i.e. 10% respectively) (Note 6).
- The quality of the loan portfolio as at the balance date, measured as to the share of impaired loans in total loans and advances to customers, deteriorated compared with the end of 2009. As at 31 December 2010, the share of impaired loans in total loans and advances to customers increased by 0.7 p.p. and amounted to 7.1%. At the same time, the ratio of impairment allowances to impaired loans amounted to 39.9% as at 31 December 2010 and increased by 1.8 p.p. compared with the end of the previous year. The deterioration in the quality of the loan portfolio was mainly related to consumer loans and loans to small and medium-sized enterprises.

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

III. The Bank's results and financial position (cont.)

- The balance of financial assets designated at fair value through profit or loss amounted to PLN 10,758,331 thousand as at the balance date. A fall in the balance (of PLN 1,598,201 thousand, i.e. 13%) was mainly due to a decrease in the Bank's exposure to NBP bills (down PLN 2,996,438 thousand, i.e. 43%) and Treasury bills (down PLN 2,673,448 thousand, i.e. 59%), partly offset by an increase in the balance of Treasury bonds (up PLN 3,942,836 thousand, i.e. 495%) (Note 5).
- The balance of investment securities available for sale amounted to PLN 9,876,252 thousand as at the balance date and was PLN 1,910,555 thousand (i.e. 24%) higher than the balance as at the end of 2009. The increase mainly related to Treasury bonds (up PLN 1,199,937 thousand, i.e. 28%) and municipal bonds (up PLN 823,952 thousand, i.e. 41%) (Note 7).
- Other liquid assets – comprising cash and balances with the Central Bank, amounts due from banks, financial assets held for trading and derivative financial instruments – fell by a total of PLN 1,575,395 thousand (i.e. 12%) as at the balance date, which was mainly due to a decrease in the balance of cash and balances with the Central Bank (down PLN 881,404 thousand, i.e. 13%) and a decrease in trading assets (down PLN 709,306 thousand, i.e. 32%) (Notes 1-4).
- The Bank's 1-month and 3-month liquidity ratios calculated on the basis of data on assets receivable and the liabilities payable, adjusted to reflect the actual maturities, amounted to 1.98 and 1.80 respectively (2.47 and 1.98 respectively as at the end of 2009).
- The share of interest-bearing assets in total assets increased by 0.5 p.p. compared with 31 December 2009 and amounted to 94.0% as at the end of 2010.
- The operating profit for 2010 amounted to PLN 4,122,917 thousand and was PLN 1,067,486 thousand (i.e. 35%) higher than the profit for 2009. The operating profit comprised mainly: net interest income of PLN 6,383,776 thousand, net fee and commission income of PLN 2,937,559 thousand and net foreign exchange gains of PLN 341,348 thousand. At the same time, the operating profit was decreased by administrative expenses of PLN 3,902,112 thousand and net impairment allowance of PLN 1,767,046 thousand.
- Net interest income amounted to PLN 6,383,776 thousand in 2010 and was PLN 1,541,327 thousand (i.e. 32%) higher than the net interest income earned in 2009. The main reason for the increase was an increase in income from loans and advances to customers and banks (up PLN 1,105,746 thousand, i.e. 15%), mainly as a result of a 13% increase in the volume of the Bank's loan portfolio. In 2010, the interest margin, being the ratio of net interest income to interest income, increased by 7 p.p. compared with 2009 and amounted to 63% (Note 18). Compared with 2009, the profitability ratio on interest-bearing assets was also higher. It amounted to 6.7% in 2010 (up 0.2 p.p.). However, there was a decrease in the cost of borrowings (down from 3.1% in 2009 to 2.7% in 2010).

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

III. The Bank's results and financial position (cont.)

- In 2010, net fee and commission income was higher than in 2009 and amounted to PLN 2,937,559 thousand (up PLN 573,912 thousand, i.e. 24%). Compared with 2009, fee and commission income increased by PLN 595,428 thousand (up 19% to PLN 3,678,487 thousand), mainly in respect of loan insurance and loans and advances granted. At the same time, there was an increase in fee and commission expense of PLN 21,516 thousand (i.e. 3%) to PLN 740,928 thousand (Note 19).
- Net foreign exchange gains amounted to PLN 341,348 thousand in the audited year and were PLN 553,332 thousand (i.e. 62%) lower than in 2009. Net foreign exchange gains comprised foreign exchange losses of PLN 1,026,841 thousand (foreign exchange gains of PLN 2,713,081 thousand in 2009) on instruments measured at fair value through profit or loss and foreign exchange gains of PLN 1,368,189 thousand (foreign exchange losses of PLN 1,818,401 thousand in 2009) on other assets and liabilities and realized foreign exchange differences (Note 22).
- Net impairment allowance amounted to PLN 1,767,046 thousand in 2010 (PLN 1,393,480 thousand in 2009). The increase in impairment allowance (recognized in the income statement) mainly related to corporate and mortgage loans granted to customers – up PLN 240,305 thousand (i.e. 82%) and PLN 64,860 thousand (i.e. 34%) respectively. At the same time, the costs of recognizing provisions for off-balance liabilities were PLN 71,969 thousand (i.e. 217%) higher in 2010 (Note 23).
- In 2010, administrative expenses were PLN 2,480 thousand (i.e. 0.1%) lower than in the previous year and amounted to PLN 3,902,112 thousand. The reduction in overheads by PLN 111,961 thousand (i.e. 9%) to PLN 1,147,788 thousand was offset by a simultaneous increase in staff costs and the amortization and depreciation expense of PLN 101,683 thousand (i.e. 4%) in total (Note 24). The overall business effectiveness, being the quotient of costs and income (the C/I ratio) improved in 2010 (the ratio fell by 6.9 p.p. to 39.8%). The positive change in the ratio was due to income (mainly interest income) being higher than in 2009.
- Gross profitability (being the ratio of the profit before income tax to total income) amounted to 28.7% in the audited year and increased by 5.0 p.p. compared with the previous year.
- The income tax expense amounted to PLN 811,708 thousand in 2010 (PLN 623,279 thousand in 2009). The effective tax rate amounted to 19.7% in 2010 and was 0.7 p.p. lower than in 2009.
- As a result, in 2010 the Bank generated a net profit of PLN 3,311,209 thousand which was PLN 879,057 thousand (i.e. 36%) higher than the net profit for 2009. Net profitability (being the ratio of the net profit to total income) amounted to 23.1% in 2010 (18.8% in 2009).
- Return on assets (being the ratio of the net profit to average total assets) amounted to 2.1% in 2010 and increased by 0.4 p.p. compared with 2009. In the audited year, return on equity amounted to 16.0% and was 1.6 p.p. higher than in 2009.

The Bank's financial statements have been prepared on the assumption that the Bank will continue in operation as a going concern.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components

STATEMENT OF FINANCIAL POSITION as at 31 December 2010

ASSETS	Note	31.12.2010	31.12.2009	Change	Change	31.12.2010	31.12.2009
		PLN'000	PLN'000	PLN'000	(%)	Structure (%)	Structure (%)
Cash and balances with the Central Bank	1	6,112,562	6,993,966	(881,404)	(13)	4	5
Amounts due from banks	2	2,379,239	2,053,767	325,472	16	1	1
Trading assets	3	1,503,649	2,212,955	(709,306)	(32)	1	1
Derivative financial instruments	4	1,719,764	2,029,921	(310,157)	(15)	1	1
Financial instruments designated at fair value through profit or loss	5	10,758,331	12,356,532	(1,598,201)	(13)	7	8
Loans and advances to customers	6	128,933,129	114,425,789	14,507,340	13	77	75
Investment securities available for sale	7	9,876,252	7,965,697	1,910,555	24	6	5
Investments in subsidiaries, jointly controlled entities and associates	8	1,467,507	1,333,707	133,800	10	1	1
Non-current assets held for sale		19,784	13,851	5,933	43	-	-
Intangible assets	9	1,528,267	1,268,781	259,486	20	1	1
Tangible fixed assets	10	2,077,140	2,291,949	(214,809)	(9)	1	2
Deferred income tax assets	25	462,923	275,204	187,719	68	-	-
Other assets	11	400,372	425,360	(24,988)	(6)	-	-
Total assets		167,238,919	153,647,479	13,591,440	9	100	100

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

STATEMENT OF FINANCIAL POSITION as at 31 December 2010 (cont.)

LIABILITIES AND EQUITY	Note	31.12.2010 PLN'000	31.12.2009 PLN'000	Change PLN'000	Change (%)	31.12.2010 Structure (%)	31.12.2009 Structure (%)
Amounts due to the Central Bank		3,370	6,581	(3,211)	(49)	-	-
Amounts due to banks	12	4,164,181	4,166,725	(2,544)	-	3	3
Derivative financial instruments	4	2,404,795	1,544,370	860,425	56	1	1
Amounts due to customers	13	135,289,055	124,044,400	11,244,655	9	81	81
Subordinated liabilities	14	1,611,779	1,612,178	(399)	-	1	1
Other liabilities	15	1,787,599	1,319,917	467,682	35	1	1
Current income tax liabilities		61,854	175,165	(113,311)	(65)	-	-
Provisions	16	714,438	598,626	115,812	19	-	-
Total liabilities		146,037,071	133,467,962	12,569,109	9	87	87
Share capital		1,250,000	1,250,000	-	-	1	1
Other capital		16,640,639	16,497,365	143,274	1	10	11
Net profit for the year		3,311,209	2,432,152	879,057	36	2	1
Total equity	17	21,201,848	20,179,517	1,022,331	5	13	13
Total liabilities and equity		167,238,919	153,647,479	13,591,440	9	100	100

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

INCOME STATEMENT
for the year ended 31 December 2010

	Note	2010 PLN'000	2009 PLN'000	Change PLN'000	Change (%)	2010 Structure (%)	2009 Structure (%)
Interest and similar income		10,107,552	8,603,448	1,504,104	17	70	67
Interest expense and similar charges		(3,723,776)	(3,760,999)	37,223	(1)	37	38
Net interest income	18	6,383,776	4,842,449	1,541,327	32		
Fee and commission income		3,678,487	3,083,059	595,428	19	26	24
Fee and commission expense		(740,928)	(719,412)	(21,516)	3	7	7
Net fee and commission income	19	2,937,559	2,363,647	573,912	24		
Dividend income	20	109,895	101,560	8,335	8	1	1
Net income from financial instruments at fair value through profit and loss	21	(56,489)	61,402	(117,891)	(192)	1	-
Gains less losses from investment securities		71,282	(594)	71,876	(12.100)	1	-
Net foreign exchange gains	22	341,348	894,680	(553,332)	(62)	2	7
Other operating income		48,012	167,069	(119,057)	(71)	-	1
Other operating expense		(43,308)	(76,710)	33,402	(44)	-	1
Net impairment allowance and write downs	23	(1,767,046)	(1,393,480)	(373,566)	27	17	14
Administrative expenses	24	(3,902,112)	(3,904,592)	2,480	-	38	40
Operating profit / Profit before income tax		4,122,917	3,055,431	1,067,486	35		
Income tax expense	25	(811,708)	(623,279)	(188,429)	30		
Net profit		3,311,209	2,432,152	879,057	36		
Total income		14,356,576	12,911,218	1,445,358	11	100	100
Total expenses		(10,233,659)	(9,855,787)	(377,872)	4	100	100
Profit before income tax		4,122,917	3,055,431	1,067,486	35		

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

Selected ratios presenting the Bank's financial position and results

The following ratios characterize the Bank's business activities, its results of operations for the year and its financial position as at the balance date compared with the prior year (1):

	2010	2009
Profitability ratios		
Gross profitability (profit before income tax / total income)	28.7%	23.7%
Net profitability (net profit / total income)	23.1%	18.8%
Return on equity (net profit / average net assets) (2)	16.0%	14.4%
Return on assets (net profit / average total assets) (2)	2.1%	1.7%
Profitability ratio on interest-bearing assets (interest income / average interest-bearing assets) (2)	6.7%	6.5%
Cost/Income ratio (administrative expenses / net result on banking activities) (3)	39.8%	46.7%
Cost of borrowings (interest expense / average interest-bearing liabilities) (2)	2.7%	3.1%
Asset quality ratios		
Interest-bearing assets to total assets (4)	94.0%	93.5%
Impaired loans to total gross loans and advances to customers	7.1%	6.4%
Impairment allowances on loans and advances to customers	39.9%	38.1%
Liquidity ratios		
1-month liquidity ratio (5)	1.98	2.47
3-month liquidity ratio (5)	1.80	1.98
Other ratios		
Capital adequacy ratio	11.99%	14.41%
Own funds calculated on a regulatory basis (PLN'000)	16,563,089	16,944,530
Total capital requirement (PLN'000)	11,049,447	9,405,320

(1) The values of the individual ratios may differ from the values presented in the financial statements due to a different calculation method being used.

(2) The average balances of financial statement items were calculated on the result of the balances of individual items at the beginning and the end of the audited and prior financial year.

(3) The net result on banking activities defined as the operating result less administrative expenses and net impairment allowance.

(4) Interest-bearing assets are defined as balances with the Central Bank (excluding cash), amounts due from banks and customers, investment securities, financial assets designated at fair value through profit or loss and trading assets.

(5) Liquidity ratios are defined as the ratio of assets receivable to liabilities payable at the actual maturities as at the balance date.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

Statement of financial position as at 31 December 2010

1. Cash and balances with the Central Bank

As at 31 December 2010, the balance of the item "Cash and balances with the Central Banks" amounted to PLN 6,112,562 thousand (PLN 6,993,966 thousand as at the end of 2009), of which PLN 3,782,717 thousand represented funds maintained by the Bank on its account with the National Bank of Poland (PLN 4,625,073 thousand as at 31 December 2009).

As at the balance date, the Bank calculated and maintained a mandatory reserve in accordance with Resolution No. 15/2004 of the Management Board of the National Bank of Poland dated 13 April 2004 on the terms and procedures for banks calculating and maintaining mandatory reserve by banks. As at 31 December 2010, the declared mandatory reserve to be maintained with the National Bank of Poland amounted to PLN 4,553,482 thousand (PLN 3,491,459 thousand as at 31 December 2009).

2. Amounts due from banks

The balance of amounts due from banks as at the respective balance dates and the movements therein are presented in the table below:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Placements with other banks	1,501,919	1,133,859	368,060	32
Current accounts	557,408	354,587	202,821	57
Loans and advances granted	317,531	454,653	(137,122)	(30)
<i>including: to related entities</i>	233,476	321,322	(87,846)	(27)
Receivables due from unsettled transactions	28,089	27,013	1,076	4
Cash in transit	6,862	5,337	1,525	29
Repo transactions	-	105,427	(105,427)	(100)
Total	2,411,809	2,080,876	330,933	16
Impairment allowances	(32,570)	(27,109)	(5,461)	20
Total, net	2,379,239	2,053,767	325,472	16

Compared with the balance as at 31 December 2009, the increase in the balance of amounts due from banks (of PLN 325,472 thousand, i.e. 16%) was mainly the result of an increase in the balance of placements with other banks (up PLN 368,060 thousand, i.e. 32%) and an increase in the balance of current accounts (up PLN 202,821 thousand, i.e. 57%). This increase was partly offset by a decrease in the balance of loans and advances granted (down PLN 137,122 thousand, i.e. 30%) mainly as a result of Kredobank SA repaying a portion of the loan granted by the Bank (a fall in the exposure of PLN 87,846 thousand, i.e. 27% compared with the balance as at 31 December 2009) and no exposure due to repo transactions (down PLN 105,427 thousand, i.e. 100%).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

2. Amounts due from banks (cont.)

Receivables denominated in foreign currencies represented an equivalent of PLN 2,168,762 thousand (i.e. 90%) of the balance of amounts due from banks as at the balance date (PLN 1,828,257 thousand, i.e. 88% of the balance as at 31 December 2009).

As at 31 December 2010, the impairment allowance for amounts due from banks amounted to PLN 32,570 thousand and was PLN 5,461 thousand (i.e. 20%) higher than the balance as at 31 December 2009. The balance mainly comprised an allowance for receivables from unsettled transactions on derivatives which have been declared due, in the amount of PLN 28,089 thousand (PLN 27,013 thousand as at 31 December 2009).

3. Trading assets

As at 31 December 2010, the balance of trading assets with a value of PLN 1,503,649 thousand comprised the following items:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Treasury bonds (PLN)	1,483,144	1,810,340	(327,196)	(18)
Treasury bills	-	388,500	(388,500)	(100)
Other	20,505	14,115	6,390	45
Total	1,503,649	2,212,955	(709,306)	(32)

The fall in the valuation of trading assets of PLN 709,306 thousand (i.e. 32%) as at the balance date was due to a decrease in the Bank's exposure to both Polish Treasury bonds and Treasury bills (down PLN 327,196 thousand, i.e. 18% and PLN 388,500 thousand, i.e. 100% respectively) – as at 31 December 2010 the Bank did not have any Treasury bills in its portfolio. A particularly significant fall in the balance occurred in December 2010 – the falls in the balance of Treasury bonds and bills amounted to PLN 931,006 thousand and PLN 296,943 thousand respectively compared with November 2010.

As at 31 December 2010, Polish Treasury bonds accounted for 99% of the balance of all the trading assets.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments

The balance of receivables in respect of the positive valuation of derivative instruments decreased by PLN 310,157 thousand (i.e. 15%) compared with 2009 and amounted to PLN 1,719,764 thousand as at 31 December 2010. The balance of liabilities in respect of the negative valuation of derivative instruments amounted to PLN 2,404,795 thousand and increased by PLN 860,425 thousand (i.e. 56%) compared with the end of 2009. The above amounts comprised the following items:

	31.12.2010	31.12.2010	31.12.2009	31.12.2009
	Assets	Liabilities	Assets	Liabilities
	PLN'000	PLN'000	PLN'000	PLN'000
Interest Rate Swaps	1,586,292	2,252,113	1,717,539	1,338,133
- including CIRS	126,219	687,977	402,221	33,699
Foreign exchange forward transactions	80,560	126,585	114,223	76,530
Foreign exchange options and equity options	46,397	25,382	198,159	127,847
Other	6,515	715	-	1,860
Total	1,719,764	2,404,795	2,029,921	1,544,370

The changes in the above balances as at 31 December 2010 compared with 31 December 2009 are presented in the table below:

	Change	Change	Change	Change
	Assets	Assets	Liabilities	Liabilities
	PLN'000	%	PLN'000	%
Interest Rate Swaps	(131,247)	(8)	913,980	68
- including CIRS	(276,002)	(69)	654,278	1,942
Foreign exchange forward transactions	(33,663)	(29)	50,055	65
Foreign exchange options and equity options	(151,762)	(77)	(102,465)	(80)
Other	6,515	-	(1,145)	(62)
Total	(310,157)	(15)	860,425	56

In 2010, there was a fall in the positive valuation and an increase in the negative valuation of derivative transactions. In the case of CIRS transactions, this change was mainly due to the depreciation of the Polish zloty against the Swiss franc during the year. The average CHF exchange rate based on NBP data as at 31 December 2010 compared with 31 December 2009 increased by 14% (from PLN 2.77 to PLN 3.16).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments (cont.)

The depreciation of the Polish zloty against other currencies contributed in a similar manner to a decrease in the positive valuation and an increase in the negative valuation of foreign exchange forward transactions.

The significant fall in the positive and negative valuation of currency options and share options was mainly due to the level of customers' activity on the market being significantly lower.

In 2009, the Bank applied hedge accounting (a macro cash flow hedge) in accordance with IAS 39 F6.2 – F6.3 for the first time. In 2010, the Bank established two new hedging relationships:

- a hedge of the cash flow volatility on mortgage loans denominated in CHF and negotiated deposits in PLN as a result of the interest rate risk and the currency risk, using CIRS transactions (without the reset mechanism) – due to the strategy being pursued in 2010, a net amount of PLN (1,405) thousand was recognized in the statement of comprehensive income;
- a hedge of the cash flow volatility on floating interest rate loans in EUR as a result of the interest rate risk, using IRS transactions – due to the strategy being pursued in 2010, a net amount of PLN (16,515) thousand was recognized in the statement of comprehensive income.

In addition, the Bank continued to use the hedging relationships established in 2009:

- a hedge of the cash flow volatility on mortgage loans denominated in CHF and negotiated deposits in PLN as a result of the interest rate risk and the currency risk, using CIRS transactions (with the reset mechanism) – due to the strategy being pursued in 2010, a net amount of PLN 119,921 thousand was recognized in the statement of comprehensive income;
- a hedge of the cash flow volatility on floating interest rate loans in PLN as a result of the interest rate risk, using IRS transactions – due to the strategy being pursued in 2010, a net amount of PLN (3,353) thousand was recognized in the statement of comprehensive income.

In total, as a result of using hedge accounting the Bank recognized PLN 98,648 thousand (net of deferred tax) in the statement of comprehensive income.

In accordance with the Bank's accounting policies, the valuation of derivative hedging transactions is decomposed and affects the following items:

- foreign exchange differences on revaluation of the nominal value – net foreign exchange gains;
- interest accrued as at the balance date – net interest income;
- mark-to-market (MTM) – revaluation reserve and net income from financial instruments measured at fair value (the ineffective part).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments (cont.)

As at the balance date, the net valuation of CIRS transactions designated to hedge accounting as part of the two hedging strategies based on these instruments used by the Bank amounted to PLN (486,526) thousand:

	Assets	Liabilities	Net
	31.12.2010	31.12.2010	31.12.2010
	PLN'000	PLN'000	PLN'000
Mark-to-market, including:	114,394	202,271	316,665
- MTM until the introduction of hedge accounting (net income from financial instruments measured at fair value)	140,855	(101,320)	39,535
- MTM from the date of introduction of hedge accounting (revaluation reserve)	(26,461)	303,591	277,130
Foreign exchange differences on revaluation of the nominal value (net foreign exchange gains)	(70,029)	(801,955)	(871,984)
Accrued interest (net interest income)	6,337	62,456	68,793
Total	50,702	(537,228)	(486,526)

As at 31 December 2009, the net valuation of CIRS transactions designated to hedge accounting amounted to PLN 319,432 thousand:

	Assets	Liabilities	Net
	31.12.2009	31.12.2009	31.12.2009
	PLN'000	PLN'000	PLN'000
Mark-to-market, including:	220,180	19,953	200,227
- MTM until the introduction of hedge accounting (net income from financial instruments measured at fair value)	145,777	108,943	36,834
- MTM from the date of introduction of hedge accounting (revaluation reserve)	74,403	(88,990)	163,393
Foreign exchange differences on revaluation of the nominal value (net foreign exchange gains)	53,790	7,515	46,275
Accrued interest (net interest income)	70,681	(2,249)	72,930
Total	344,651	25,219	319,432

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

5. Financial instruments designated at fair value through profit or loss

The balance of "Financial instruments designated at fair value through profit or loss" fell by PLN 1,598,201 thousand (i.e. 13%) compared with the end of 2009 and amounted to PLN 10,758,331 thousand as at 31 December 2010. The portfolio comprised the following categories of securities:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Treasury bonds	4,738,644	795,808	3,942,836	495
NBP bills	3,997,780	6,994,218	(2,996,438)	(43)
Treasury bills	1,893,058	4,566,506	(2,673,448)	(59)
EUR municipal bonds	128,849	-	128,849	-
Total	10,758,331	12,356,532	(1,598,201)	(13)

The fall in the balance of financial instruments designated at fair value through profit or loss was mainly due to the Bank limiting its exposure to short-term securities – compared with the end of 2009 the balances of NBP bills and Treasury bills decreased by PLN 2,996,438 thousand (i.e. 43%) and PLN 2,673,448 thousand (i.e. 59%) respectively. This fall was partly offset by an increase in the balance of Treasury bonds (up PLN 3,942,836 thousand, i.e. 495% compared with the balance as at 31 December 2009). The most significant increase in the Bank's exposure to Treasury bonds occurred in April and May 2010 – an increase in the balance of PLN 1,578,360 thousand and PLN 1,386,726 thousand respectively compared with the preceding month.

Moreover, as at the end of 2010 the Bank had an exposure of PLN 128,849 thousand to a portfolio of municipal bonds denominated in EUR.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers

The portfolio of loans and advances to customers, measured as the gross value of loans granted, increased by PLN 15,357,879 thousand (i.e. 13%) in 2010 compared with the balance as at 31 December 2009, reaching PLN 133,198,613 thousand.

The analysis of the structure and quality of the loan portfolio is presented below.

a) Structure of the Bank's loan portfolio by type of loans

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Financial sector (excluding banks)	4,252,926	3,291,503	961,423	29
corporate loans	4,252,926	3,291,503	961,423	29
Non-financial sector	125,095,189	109,581,494	15,513,695	14
consumer loans	25,561,195	23,512,508	2,048,687	9
mortgage loans	62,402,937	52,306,096	10,096,841	19
corporate loans	37,131,057	33,762,890	3,368,167	10
Public sector	3,850,498	4,967,737	(1,117,239)	(22)
corporate loans	3,849,854	4,967,737	(1,117,883)	(23)
mortgage loans	644	-	644	-
Total gross loans and advances	133,198,613	117,840,734	15,357,879	13
Impairment allowances	(4,265,484)	(3,414,945)	(850,539)	25
Total net loans and advances	128,933,129	114,425,789	14,507,340	13

As at the balance date, PLN 29,852,907 thousand (i.e. 22%) of the balance of gross loans represented amounts due in foreign currencies (PLN 27,035,243 thousand, i.e. 23% as at 31 December 2009), of which 76% related to amounts due denominated in Swiss francs (79% as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers (cont.)

b) The quality of the Bank's loan portfolio

	31.12.2010	31.12.2009	31.12.2010	31.12.2009
	PLN'000	PLN'000	Structure	Structure
			%	%
Impaired loans and advances	9,490,018	7,500,728	7.1	6.4
Non-impaired loans and advances	123,708,595	110,340,006	92.9	93.6
Total loans and advances gross	133,198,613	117,840,734	100.0	100.0
Impairment allowances on loans and advances	(3,785,602)	(2,856,695)	88.7	83.7
Allowances for incurred but not reported losses (IBNR)	(479,882)	(558,250)	11.3	16.3
Total impairment allowances on loans and advances	(4,265,484)	(3,414,945)	100.0	100.0
Total loans and advances net	128,933,129	114,425,789		

In 2010, the Bank sold part of its portfolio of loans and advances to customers classified as impaired. The total gross carrying amount of the receivables sold amounted to PLN 854,681 thousand.

As at the end of 2010, the share of impaired loans in the total loan portfolio deteriorated compared with the end of 2009 and amounted to 7.1% (6.4% as at 31 December 2009). At the same time, the coverage of impaired loans with impairment allowances increased and amounted to 39.9% (38.1% as at 31 December 2009).

The deterioration of the quality of the loan portfolio was mainly related to consumer loans and loans to small and medium-sized enterprises. The sale of receivables constitutes an important part of the management of non-performing loans. The sales performed in 2010 (which mainly affected consumer loans) mitigated the increase in the ratio of non-performing loans.

The share of allowances for incurred but not reported losses (IBNR) in total impairment allowances was lower than in the previous year – the said allowances amounted to PLN 479,882 thousand as at the balance date (11.3% of total impairment allowances), whereas a year before it amounted to PLN 558,250 thousand (16.3% of total impairment allowances). This was the result of the losses incurred but not reported as at 31 December 2009 being realized in 2010.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers (cont.)

b) The quality of the Bank's loan portfolio (cont.)

The reconciliation of the change in the balance of impairment allowances on loans and advances to customers presented in the statement of financial position and the net impairment allowance as at 31 December 2010 is presented below (in PLN'000):

	consumer loans	mortgage loans	corporate loans	Total
Balance of impairment allowances on loans and advances to customers presented in the statement of financial position as at 31 December 2009	(1,325,580)	(643,055)	(1,446,310)	(3,414,945)
Net impairment allowance on loans and advances and amounts due from banks – total	(809,094)	(258,132)	(537,871)	(1,605,097)
Net impairment allowance on amounts due from banks – recognized in the income statement	-	-	4,383	4,383
Other changes (in respect of foreign exchange differences)	(3,217)	(20,377)	(3,048)	(26,642)
Decrease in impairment allowances due to the derecognition of assets, not affecting the income statement	638,488	14,221	124,108	776,817
Balance of impairment allowances on loans and advances to customers presented in the statement of financial position as at 31 December 2010	(1,499,403)	(907,343)	(1,858,738)	(4,265,484)

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

7. Investment securities available for sale

As at 31 December 2010, the balance of the item "Investment securities available for sale" increased by PLN 1,910,555 thousand (i.e. 24%) compared with the balance as at 31 December 2009 and amounted to PLN 9,876,252 thousand (PLN 7,965,697 thousand as at 31 December 2009).

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Treasury bonds	5,486,623	4,286,686	1,199,937	28
Municipal bonds	2,824,173	2,000,221	823,952	41
Corporate bonds	1,494,111	1,069,806	424,305	40
Listed equity instruments	60,866	68,067	(7,201)	(11)
Other	10,479	6,044	4,435	73
Treasury bills	-	495,688	(495,688)	(100)
Foreign bonds	-	39,185	(39,185)	(100)
Total	<u>9,876,252</u>	<u>7,965,697</u>	<u>1,910,555</u>	<u>24</u>

The change in the balance as at the balance date was mainly due to an increase in the balance of long-term securities: Treasury bonds, as well as municipal and corporate bonds (up PLN 1,199,937 thousand, i.e. 28%, PLN 823,952 thousand, i.e. 41% and PLN 424,305 thousand, i.e. 40% respectively). This increase was partly offset by a fall in the Bank's exposure to Treasury bills – as at 31 December 2010, the Bank had no such exposure within its portfolio of investment securities available for sale (PLN 495,688 thousand as at 31 December 2009).

The balance of corporate and municipal bonds comprised bonds issued by companies and local authorities for which the Bank acted as the underwriter. The material increase in the balance of municipal and corporate bonds was due to new issues being carried out in the last quarter of 2010 (up PLN 343,040 thousand, i.e. 14% and PLN 603,834 thousand, i.e. 68% respectively).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

8. Investments in subsidiaries, jointly controlled entities and associates

The balance of investments in subsidiaries, jointly controlled entities and associates as at 31 December 2010 amounted to PLN 1,467,507 thousand and was PLN 133,800 thousand higher than as at 31 December 2009.

In accordance with IAS 27.37a, the Bank measures subsidiaries, jointly controlled entities and associates at cost less impairment allowances.

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Subsidiaries	1,274,182	1,125,309	148,873	13
value at cost	1,708,571	1,559,698	148,873	10
impairment allowance	(434,389)	(434,389)	-	-
Co-subsidiaries	61,869	61,869	-	-
value at cost	61,869	61,869	-	-
impairment allowance	-	-	-	-
Associates	131,456	146,529	(15,073)	(10)
value at cost	148,029	148,029	-	-
impairment allowance	(16,573)	(1,500)	(15,073)	1.005
Investments in subsidiaries, jointly controlled entities and associates	1,467,507	1,333,707	133,800	10

The increase in the balance of investments in subsidiaries, jointly controlled entities and associates was mainly due to the Bank taking up a new issue of shares of its subsidiary, Kredobank SA (up PLN 148,873 thousand compared with the balance as at 31 December 2009).

The balance of impairment allowances on investments in subsidiaries, jointly controlled entities and associates increased slightly in 2010 due to recognizing an impairment allowance on the shares in Bank Pocztowy SA in the amount of PLN 15,073 thousand (no impairment allowance as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

8. Investments in subsidiaries, jointly controlled entities and associates (cont.)

The most important investments of the Bank in subsidiaries, jointly controlled entities and associates as at 31 December 2010 are described in the table below:

	Gross PLN'000	Impairment allowance PLN'000	Net PLN'000	Structure (%)
Subsidiaries	1,708,571	(434,389)	1,274,182	87
Kredobank SA (Ukraine)	935,619	(423,723)	511,896	35
PKO BP BANKOWY Powszechnie Towarzystwo Emerytalne SA	205,786	-	205,786	14
PKO Towarzystwo Funduszy Inwestycyjnych SA	186,989	-	186,989	13
Other	380,177	(10,666)	369,511	25
Jointly controlled entities	61,869	-	61,869	4
Centrum Haffnera Sp. z o.o.	44,371	-	44,371	3
Other	17,498	-	17,498	1
Associates	148,029	(16,573)	131,456	9
Bank Pocztowy SA	146,500	(15,073)	131,427	9
Other	1,529	(1,500)	29	-
Investments in subsidiaries, jointly controlled entities and associates	1,918,469	(450,962)	1,467,507	100

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

9. Intangible assets

As at the balance date, the balance of intangible assets amounted to PLN 1,528,267 thousand and was PLN 259,486 thousand (i.e. 20%) higher than as at 31 December 2009. The analysis of this balance is presented in the table below.

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Software	2,411,233	2,200,662	210,571	10
Other (including development costs)	301,931	79,479	222,452	280
Total, gross	2,713,164	2,280,141	433,023	19
Accumulated amortization	(1,166,881)	(995,987)	(170,894)	17
Impairment allowances	(18,016)	(15,373)	(2,643)	17
Total, net	1,528,267	1,268,781	259,486	20

The Integrated Information System ("ZSI") with net carrying amount of PLN 621,565 thousand (PLN 682,052 thousand as at 31 December 2009), was the most significant component of intangible assets as at 31 December 2010. The value of the expenditure on the ZSI amounted to PLN 82,916 thousand in the audited year (PLN 118,650 thousand in 2009).

In the audited year, the balance of impairment allowances increased by PLN 2,643 thousand compared with the balance as at 31 December 2009 due to the revaluation of capital expenditure. The value of the allowance in respect of unused functionalities of the ZSI system did not change in the audited year and amounted to PLN 15,373 thousand as at the balance date.

The wear and tear of intangible assets, measured as the ratio of accumulated amortization to gross carrying amount, amounted to 43% as at the balance date (44% as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

10. Tangible fixed assets

As at the balance date, the net carrying amount of the balance of Tangible fixed assets amounted to PLN 2,077,140 thousand and fell by PLN 214,809 thousand (i.e. 9%) compared with the end of 2009.

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Land and buildings	2,077,369	2,064,032	13,337	1
Plant and machinery	1,969,206	2,120,753	(151,547)	(7)
Fixed assets under construction	82,838	160,362	(77,524)	(48)
Vehicles	2,902	3,813	(911)	(24)
Investment properties	793	731	62	8
Other	404,230	406,545	(2,315)	(1)
Gross tangible fixed assets	4,537,338	4,756,236	(218,898)	(5)
Accumulated depreciation	(2,441,817)	(2,463,121)	21,304	(1)
Impairment allowances	(18,381)	(1,166)	(17,215)	1.476
Net tangible fixed assets	2,077,140	2,291,949	(214,809)	(9)

As at the balance date, the gross carrying amount of tangible fixed assets fell by PLN 218,898 thousand (i.e. 5%) compared with the end of the previous year. The fall in the balance mainly related to the sale and scrapping of plant and machinery in the amount of PLN 241,045 thousand.

Compared with the balance as at 31 December 2009, the balance of impairment allowances increased by PLN 17,215 thousand (i.e. 1,476%) in the audited year and mainly related to fixed assets under construction (an allowance of PLN 17,246 thousand as at 31 December 2010).

The wear and tear of tangible fixed assets, being the ratio of accumulated depreciation to gross carrying amount, amounted to 54% as at the balance date (52% as at 31 December 2009).

Tangible fixed assets are valued at cost less accumulated depreciation and impairment allowances.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

11. Other assets

The value of other assets fell by PLN 24,988 thousand (i.e. 6%) and amounted to PLN 400,372 thousand as at the balance date. The balance comprised the following categories of assets:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Settlements in respect of card transactions (a)	208,760	241,536	(32,776)	(14)
Receivables in from unsettled foreign exchange and derivative transactions	116,147	123,740	(7,593)	(6)
Settlements of financial instruments (b)	39,750	33,865	5,885	17
Prepayments and deferred costs	28,219	21,114	7,105	34
Amounts due from customers	28,031	20,402	7,629	37
Inventories relating to utilization, auxiliary and investing activities	13,047	15,499	(2,452)	(16)
Receivables from the State Budget relating to the distribution of fiscal stamps by the Bank	9,311	13,800	(4,489)	(33)
Settlements in respect of trading in securities	5,022	9,551	(4,529)	(47)
Receivables in respect of foreign exchange activities	31	336	(305)	(91)
Other (c)	119,562	106,939	12,623	12
Total, gross	567,880	586,782	(18,902)	(3)
Impairment allowances (d)	(167,508)	(161,422)	(6,086)	4
Total, net	400,372	425,360	(24,988)	(6)

- (a) The balance of settlements in respect of card transactions mainly comprised settlements in respect of payment cards in the amount of PLN 208,725 thousand (PLN 231,319 thousand as at 31 December 2009, of which PLN 109,997 thousand was presented in the item Amounts due from customers).
- (b) The balance of settlements of financial instruments as at the balance date comprised mainly the settlement of the premium paid on the purchase of foreign exchange options in the amount of PLN 18,537 thousand (PLN 21,261 thousand as at 31 December 2009).
- (c) As at 31 December 2010, the item 'Other' comprised mainly receivables relating to deficits and losses with a gross carrying amount of PLN 27,426 thousand, i.e. 23% of the balance (PLN 28,245 thousand, i.e. 23% of the balance as at 31 December 2009).
- (d) The balance of other assets as at 31 December 2010 was decreased by impairment allowances of PLN 167,508 thousand (PLN 161,422 thousand as at 31 December 2009). They mainly comprised impairment allowances on receivables arising from unsettled negotiated foreign exchange transactions and transactions in derivative instruments of PLN 102,475 thousand (PLN 103,142 thousand as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

12. Amounts due to banks

The balance of amounts due to banks as at 31 December 2010 did not undergo any major changes compared with the end of 2009 (down PLN 2,544 thousand, i.e. 0.1%) and comprised the following items:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Syndicated loan in CHF	2,999,116	2,621,791	377,325	14
Deposits from banks	1,027,502	1,399,985	(372,483)	(27)
Other money-market deposits	93,662	121,679	(28,017)	(23)
Current accounts	43,901	23,270	20,631	89
Total	4,164,181	4,166,725	(2,544)	-

As at 31 December 2010, there was a change in the structure of amounts due to banks compared with the end of 2009. The fall in the balance of deposits from banks (of PLN 372,483 thousand, i.e. 27%) was offset by an increase in the balance of the loan granted to the Bank in the amount of CHF 950,000 thousand by a consortium of Polish and foreign banks in 2007 for a period of five years with an extension option (up PLN 377,325 thousand, i.e. 14%). This increase was mainly due to a change in the CHF/PLN exchange rate (up from PLN 2.77 as at the end of 2009 to PLN 3.16 as at the end of 2010). As at 31 December 2010, the share of the balance of the loan received by the Bank in the total balance of amounts due to banks amounted to 72% (63% as at 31 December 2009).

As at the balance date, foreign currency liabilities accounted for 83% of the balance of amounts due to banks (69% as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

13. Amounts due to customers

The value of amounts due to customers amounted to PLN 135,289,055 thousand as at the balance date and increased by PLN 11,244,655 (i.e. 9%) compared with the end of 2009:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Amounts due to retail customers	94,347,108	86,627,306	7,719,802	9
Amounts due to corporate entities	34,895,145	27,736,114	7,159,031	26
Amounts due to state budget entities	6,046,802	9,680,980	(3,634,178)	(38)
Total	135,289,055	124,044,400	11,244,655	9

As at 31 December 2010, the value of the ratio of deposits to gross loans decreased and amounted to 102% (105% as at 31 December 2009).

As at the balance date, amounts due denominated in foreign currencies accounted for 9% of the balance (up 3% compared with the balance as at 31 December 2009). The material increase in the balance of liabilities denominated in foreign currencies was due to a loan being granted to the Bank in 2010 by a subsidiary, PKO Finance AB, in the amount of EUR 800,000 thousand using funds obtained from an issue of eurobonds as part of the EMTN programme.

In 2010, the Bank continued to increase its deposit base. In order to achieve this objective, the Bank actively sought new funds by offering products intended for retail customers (Deposit 3+3, Deposit 6+6, Deposit 9+9 and a building society book), as well as by offering negotiated deposits intended for corporate entities.

14. Subordinated liabilities

The balance of subordinated liabilities as at 31 December 2010 in the amount of PLN 1,611,779 thousand (PLN 1,612,178 thousand as at 31 December 2009) comprised bonds issued by the Bank in 2007 with a total nominal value of PLN 1,600,700 thousand maturing on 30 October 2017.

The bonds were issued on the basis of the Act on Bonds dated 29 June 1995 with a view to increasing the Bank's supplementary funds in accordance with Article 127, par. 3, point 2, letter b) of the Banking Law, pursuant to a decision of the Banking Supervision Commission No. 91 dated 5 December 2007 (the supplementary capital is increased by the nominal value of the bonds).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

15. Other liabilities

The balance of other liabilities as at 31 December 2010 amounted to PLN 1,787,599 thousand and increased by PLN 467,682 thousand (i.e. 35%) compared with the end of 2009. The balance comprised the following items:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Deferred income	312,480	252,675	59,805	24
Costs payable	236,504	201,827	34,677	17
Other liabilities, including:	1,238,615	865,415	373,200	43
settlements with the State Budget	277,830	127,156	150,674	118
liabilities arising from investing activities and internal operations	196,671	12,345	184,326	1,493
settlements relating to transactions in securities	181,456	276,221	(94,765)	(34)
interbank settlements	174,854	182,275	(7,421)	(4)
liabilities in respect of foreign exchange activities	131,849	47,934	83,915	175
trade payables	46,965	36,776	10,189	28
settlements of financial instruments	39,683	36,325	3,358	9
liabilities to UOKiK (Office for Competition and Consumer Protection)	22,310	22,310	-	-
liabilities in respect of payment cards	20,187	5,949	14,238	239
settlement of purchases of plant and machinery, materials, works and services relating to the construction of fixed assets and utilization activities	4,613	3,570	1,043	29
liabilities arising from transactions with non-financial entities	4,078	6,586	(2,508)	(38)
Other	138,119	107,968	30,151	28
Total	1,787,599	1,319,917	467,682	35

As at the balance date, the largest components of the balance of other liabilities were deferred income (17%) in the amount of PLN 312,480 thousand – up PLN 59,805 thousand (i.e. 24%) compared with the balance as at 31 December 2009 – and settlements with the State Budget (16%) in the amount of PLN 277,830 thousand – up PLN 150,674 thousand (i.e. 118%) compared with the balance as at 31 December 2009. The increase in the liabilities in respect of settlements with the State Budget was mainly due to a liability on lump-sum income tax on the dividend for 2009 paid in 2010 in the amount of PLN 144,890 thousand.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

15. Other liabilities (cont.)

In addition, the increase in the balance of other liabilities as at the end of 2010 was due to an increase in the level of liabilities arising from investing activities and internal operations of PLN 184,326 thousand (i.e. 1,493%), which was mainly due to an increase in payables to the providers of IT services.

16. Provisions

The balance of provisions as at 31 December 2010 comprised the following items:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Provision for anniversary bonuses and retirement benefits	410,723	367,291	43,432	12
Provision for liabilities and guarantees granted	216,137	110,642	105,495	95
Provisions for legal claims	6,311	6,841	(530)	(8)
Other provisions	81,267	113,852	(32,585)	(29)
Total	714,438	598,626	115,812	19

The increase in the balance of provisions as at the end of 2010 was mainly due to an increase in the level of provisions for liabilities and guarantees granted of PLN 105,495 thousand (i.e. 95%). This increase was mainly due to the valuation of guarantees of repayment of dues granted to a subsidiary, Kredobank SA, in 2010 in the amount of PLN 134,172 thousand.

The provision for anniversary and retirement bonuses was based on the calculation performed by an independent actuary and presented in a report prepared in January 2011. The report was prepared on the basis of the balances as at the balance date.

As at 31 December 2010, the item "Other provisions" comprised, amongst others, provisions for claims relating to the portfolios of receivables sold (PLN 11,430 thousand) and a restructuring provision (PLN 65,861 thousand). The restructuring provision relates to future liabilities in respect of compensation and severance payments to employees whose employment contracts will be terminated for reasons unrelated to the employees. In accordance with IAS 37.72, the Bank's employment restructuring plan is the basis for recognizing this provision.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

17. Equity

Movements in equity in the audited year are presented in the table below:

	Share capital PLN'000	Other capital components					Total other capital components PLN'000	Unappropriated profits PLN'000	Net profit PLN'000	TOTAL PLN'000
		Reserve capital PLN'000	Investment securities available for sale PLN'000	Cash flow hedge PLN'000	General banking risk reserve PLN'000	Other reserves PLN'000				
As at 31.12.2009	1,250,000	12,048,111	(16,282)	119,276	1,070,000	3,276,260	16,497,365	-	2,432,152	20,179,517
Change in available for sale instruments less deferred tax	-	-	(12,526)	-	-	-	(12,526)	-	-	(12,526)
Hedge accounting	-	-	-	98,648	-	-	98,648	-	-	98,648
Net profit for 2010	-	-	-	-	-	-	-	-	3,311,209	3,311,209
Transfer from retained earnings	-	-	-	-	-	-	-	2,432,152	(2,432,152)	-
Transfer from net profit to capital	-	50,000	-	-	-	7,152	57,152	(57,152)	-	-
Transfer from net profit to dividends	-	-	-	-	-	-	-	(2,375,000)	-	(2,375,000)
As at 31.12.2010	1,250,000	12,098,111	(28,808)	217,924	1,070,000	3,283,412	16,640,639	-	3,311,209	21,201,848

Powszechna Kasa Oszczędności Bank Polski SA

Independent registered auditor's report on the financial statements as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

17. Equity (cont.)

On 23 July 2010, the General Shareholders' Meeting of Powszechna Kasa Oszczędności Bank Polski SA adopted a resolution on the appropriation of the profit for 2009 in the amount of PLN 2,432,152 thousand, earmarking PLN 50,000 thousand for increasing the supplementary capital, PLN 7,152 thousand for increasing other reserves and PLN 2,375,000 thousand for paying a dividend. The above resolution provided for appropriating the profit in the aforementioned manner on condition that up until 10 December 2010 the Bank did not finally: (i) take control over a bank with its registered office in the territory of the Republic of Poland by acquiring, whether directly or indirectly, a majority shareholding, or (ii) acquire the right to take control in the manner specified in point (i) above. Due to the said condition not being met, the profit for 2009 was appropriated in the manner described above.

As at 31 December 2010, the Bank's share capital amounted to PLN 1,250,000 thousand and consisted of 1,250,000,000 ordinary shares with a par value of PLN 1 each, including:

- 510,000,000 A-series registered shares;
- 105,000,000 B-series bearer shares;
- 385,000,000 C-series bearer shares;
- 250,000,000 D-series bearer shares.

The Bank's own funds, calculated in accordance with the Banking Law and Resolution No. 381/2008 of the Polish Financial Supervision Authority, amended by Resolution No. 367/2010 of the Polish Financial Supervision Authority, amounted to PLN 16,563,089 thousand as at the balance date (PLN 16,944,530 thousand as at 31 December 2009) and were PLN 5,513,642 thousand higher than the total capital requirement (PLN 11,049,447 thousand as at the end of 2010). The capital adequacy ratio calculated as at the balance date on the basis of the banking portfolio and the trading portfolio amounted to 11.99% (14.41%¹ as at 31 December 2009).

¹ the originally published data for 2009 brought to comparability in accordance with the provisions of the aforementioned act

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

Income statement for the year ended 31 December 2010

18. Net interest income

Net interest income amounted to PLN 6,383,776 thousand in 2010 and increased by PLN 1,541,327 thousand (i.e. 32%) compared with 2009. The balance comprised the following items:

	2010 PLN'000	2009 PLN'000	Change PLN'000	Change (%)
Interest income:	10,107,552	8,603,448	1,504,104	17
Income from loans and advances to customers and banks	8,246,231	7,140,485	1,105,746	15
Income from hedging financial instruments	649,116	403,899	245,217	61
Income from securities at fair value through profit or loss	494,702	403,112	91,590	23
Income from investment securities	437,053	389,355	47,698	12
Income from deposits with banks	147,682	158,576	(10,894)	(7)
Income from trading securities	128,940	97,207	31,733	33
Other	3,828	10,814	(6,986)	(65)
Interest expense:	(3,723,776)	(3,760,999)	37,223	(1)
Interest expense on amounts due to customers and loans received from banks	(3,586,343)	(3,589,601)	3,258	-
Interest expense on debt securities in issue	(82,191)	(99,575)	17,384	(17)
Interest expense on deposits from banks	(31,218)	(47,523)	16,305	(34)
Other	(24,024)	(24,300)	276	(1)
Net interest income	6,383,776	4,842,449	1,541,327	32

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

18. Net interest income (cont.)

In 2010, the Bank included income from financial hedging instruments in the amount of PLN 649,116 thousand in interest income:

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Interest received on hedging instruments subject to hedge accounting	530,183	375,046	155,137	41
<i>including the realization of the valuation recognized in the revaluation reserve in the prior periods</i>	<i>87,566</i>	<i>16,496</i>	<i>71,070</i>	<i>431</i>
Interest accrued	270,756	72,930	197,826	271
Interest paid	(151,823)	(44,077)	(107,746)	244
Total income from financial hedging instruments	649,116	403,899	245,217	61

The increase in interest income of PLN 1,504,104 thousand in 2010 was mainly due to interest income on loans and advances to customers and banks being higher than in 2009 (up PLN 1,105,746 thousand, i.e. 15%). This was mainly the result of an increase in the portfolio of loans and advances to customers (a net increase of PLN 14,507,340 thousand, i.e. 13% in 2010 (Note 6)).

Despite the increase in the balance of amounts due to customers of PLN 11,244,655 thousand (i.e. 9%) compared with the end of 2009, in 2010 interest expense decreased slightly by PLN 37,223 thousand (i.e. 1%) and amounted to PLN 3,723,776 thousand. This fall was mainly due to a fall in the deposit interest rates offered to customers which affected the entire banking market. This trend was the effect of an improvement in the liquidity of the banking sector in 2010.

As a result, the interest margin (defined as the ratio of net interest income to interest income) improved and amounted to 63% in 2010 (56% in 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

19. Net fee and commission income

Net fee and commission income amounted to PLN 2,937,559 thousand in 2010 and increased by PLN 573,912 thousand (i.e. 24%) compared with 2009. The balance comprised the following items:

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Fee and commission income	3,678,487	3,083,059	595,428	19
Income from payment cards	963,363	932,890	30,473	3
Income from maintenance of bank accounts	908,208	882,221	25,987	3
Income from loan insurance	653,501	327,312	326,189	100
Income from loans and advances granted	524,110	365,522	158,588	43
Income from services provided to investment funds (including management fees)	170,269	92,049	78,220	85
Income from cash transactions	165,437	177,354	(11,917)	(7)
Income from securities	73,231	53,128	20,103	38
Income from foreign mass transactions	44,754	41,524	3,230	8
Income from distribution of fiscal stamps	26,255	27,842	(1,587)	(6)
Other	147,700	181,563	(33,863)	(19)
Income from fiduciary services	1,659	1,654	5	-
Fee and commission expense	(740,928)	(719,412)	(21,516)	3
Expenses on payment cards	(329,381)	(374,547)	45,166	(12)
Expenses on loan insurance	(150,842)	(92,937)	(57,905)	62
Expenses on acquisition services	(133,935)	(139,969)	6,034	(4)
Expenses on clearing services	(21,071)	(20,401)	(670)	3
Expenses on commissions for the operating services of banks	(10,113)	(6,518)	(3,595)	55
Other	(95,586)	(85,040)	(10,546)	12
Net fee and commission income	2,937,559	2,363,647	573,912	24

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

19. Net fee and commission income (cont.)

In 2010, fee and commission income increased by PLN 595,428 thousand (i.e. 19%). This increase was mainly due to the increase of PLN 326,189 thousand (i.e. 100%) in income from loan insurance, an increase of PLN 158,588 thousand (i.e. 43%) in income from loans and advances granted, and an increase of PLN 78,220 thousand (i.e. 85%) in income from the services provided to investment funds. The increase in income from loan insurance was mainly due to an increase in the loan portfolio (a net increase of PLN 14,507,340 thousand, i.e. 13% (Note 6)) and the Bank expanding the range of insurance products offered to its customers. The increase in the loan portfolio also contributed to the increase in income from loans and advances granted. Such commissions are deferred and recognized in the income statement on the straight line basis. They relate mainly to overdraft facilities, working capital loans and other credit products without fixed repayment schedules. On the other hand, the increase in income from the services provided to investment funds was related to an increase in the activity of the Bank's customers in this area.

The balance of fee and commission expenses increased by PLN 21,516 thousand (i.e. 3%) in 2010 compared with 2009. This increase was mainly due to an increase of PLN 57,905 thousand (i.e. 62%) in loan insurance expenses which mainly resulted from the aforementioned increase in the loan portfolio. This increase was partly offset by a decrease in commission expense on payment cards (down PLN 45,166 thousand, i.e. 12%), mainly as a result of the card organizations (Visa, Mastercard) lowering interchange fees in the first half of 2010.

20. Dividend income

Dividend income amounted to PLN 109,895 thousand in 2010 and was PLN 8,335 thousand (i.e. 8%) higher than in 2009. This amount mainly comprised dividends paid by PKO Towarzystwo Funduszy Inwestycyjnych SA – PLN 61,209 thousand (PLN 78,750 thousand in 2009), Centrum Elektronicznych Usług Płatniczych eService SA – PLN 29,000 thousand (PLN 9,959 thousand in 2009) and Centrum Finansowe Puławska Sp. z o.o. – PLN 12,492 thousand (PLN 7,376 thousand in 2009).

21. Net income from financial instruments measured at fair value through profit or loss

The loss on financial instruments measured at fair value through profit or loss amounted to PLN 56,489 thousand in 2010 compared with a gain of PLN 61,402 thousand in the previous year:

	2010 PLN'000	2009 PLN'000	Change PLN'000	Change (%)
Derivative instruments	(103,782)	33,567	(137,349)	(409)
Debt instruments	45,847	24,536	21,311	87
Equity instruments	1,427	1,946	(519)	(27)
Other	19	1,353	(1,334)	(99)
Total	(56,489)	61,402	(117,891)	(192)

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

21. Net income from financial instruments measured at fair value through profit or loss (cont.)

The item "Derivative instruments" contains the realized net income on and the valuation of derivative instruments excluding foreign exchange transactions whose valuation is recognized in net foreign exchange gains (Note 22).

The loss disclosed in 2010 related mainly to the ineffective part of a cash flow hedge recognized in the income statement in the amount of PLN 82,879 thousand (Note 4).

22. Net foreign exchange gains

In 2010, net foreign exchange gains amounted to PLN 341,348 thousand (PLN 894,680 thousand in 2009) and contained gains and losses on revaluation and transactions in assets and liabilities in foreign currencies, as well as the measurement of foreign exchange derivative instruments (FX forward, FX swap, CIRS and FX options) at fair value. Compared with 2009, net foreign exchange gains fell by PLN 553,332 thousand (i.e. 62%).

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Unrealized foreign exchange differences	(1,026,841)	2,713,081	(3,739,922)	(138)
Realized foreign exchange differences	1,368,189	(1,818,401)	3,186,590	(175)
Total	341,348	894,680	(553,332)	(62)

Compared with 2009, the results on the individual components of net foreign exchange gains were reversed. Due to the exchange rates of the Swiss franc and the euro increasing throughout most of 2010 (approx. 22% of the Bank's loan portfolio and approx. 7% of its customer deposits are denominated in these currencies), the net foreign exchange result (including the result on the revaluation of loans and deposits) was positive and amounted to PLN 1,368,189 thousand (up PLN 3,186,590 thousand, i.e. 175% compared with the previous year).

At the same time, in 2010 the Bank realized a loss on the valuation of instruments measured at fair value through profit or loss (a loss of PLN 1,026,841 thousand compared with a gain of PLN 2,713,081 thousand in 2009). This result was mainly determined by the valuation of derivative instruments and resulted mainly from a change in the valuation of currency interest rate swaps (CIRS) which are used primarily to manage interest rate risk. Their net valuation changed by PLN 930,280 thousand, i.e. 252% (a change from a positive net valuation of PLN 368,522 thousand as at the end of 2009 to a negative net valuation of PLN 561,758 thousand as at the end of 2010, of which PLN 486,526 thousand related to CIRS instruments subject to hedge accounting – Note 4).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

23. Net impairment allowance

The net impairment allowance was negative in 2010 (an excess of impairment allowances recognized over those released) and amounted to PLN 1,767,046 thousand (an increase in the negative balance of PLN 373,566 thousand compared with 2009):

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Loans and advances to customers and amounts due from banks	(1,605,097)	(1,284,013)	(321,084)	25
Provisions for off-balance sheet liabilities	(105,157)	(33,188)	(71,969)	217
Tangible fixed assets	(29,418)	683	(30,101)	(4,407)
Investments in subsidiaries, jointly controlled entities and associates	(15,073)	(68,085)	53,012	(78)
Intangible assets	(2,644)	-	(2,644)	-
Non-current assets held for sale	(1,281)	-	(1,281)	-
Investment securities available for sale	800	(1,050)	1,850	(176)
Other	(9,176)	(7,827)	(1,349)	17
Net impairment allowance	<u>(1,767,046)</u>	<u>(1,393,480)</u>	<u>(373,566)</u>	<u>27</u>

The change in the balance in 2010 was largely due to an increase in net impairment allowance for corporate loans of PLN 240,305 thousand (i.e. 82%) and mortgage loans – up PLN 64,860 thousand (i.e. 34%). Detailed information on the quality of the loan portfolio is presented in Note 6.

The difference between the change in the impairment allowance on loans and advances to customers recognized in the statement of financial position of PLN 850,539 thousand and the impairment charge for such exposures recognized in the income statement of PLN 1,600,714 thousand is due to (apart from the change due to foreign exchange differences of PLN 26,642 thousand) a decrease of PLN 776,817 thousand in the balance of impairment allowances in the audited period due to their being derecognized along with the corresponding assets (which did not affect the income statement). The aforementioned decrease was mainly the result of the sale of a part of the portfolio of loans and advances to customers in the audited year (Note 6).

Additionally, in 2010 the Bank recognized a provision for the valuation of a guarantee granted to a subsidiary, Kredobank SA, in the amount of PLN 134,172 thousand (Note 16) and an impairment allowance on the shares of Bank Pocztowy SA in the amount of PLN 15,073 thousand (Note 8).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

24. Administrative expenses

The administrative expenses incurred by the Bank in 2010 amounted to PLN 3,902,112 thousand and were PLN 2,480 thousand (i.e. 0.1%) lower than the expenses incurred in 2009:

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Staff costs	(2,197,253)	(2,136,166)	(61,087)	3
Overheads	(1,147,788)	(1,259,749)	111,961	(9)
Amortization and depreciation	(445,989)	(405,393)	(40,596)	10
Taxes and other charges	(57,698)	(53,661)	(4,037)	8
Contribution and payments to Banking Guarantee Fund	(53,384)	(49,623)	(3,761)	8
Total	(3,902,112)	(3,904,592)	2,480	-

The fall in the administrative expenses in 2010 was mainly due to a decrease in overheads (down PLN 111,961 thousand, i.e. 9%) and was partly offset by an increase in staff costs (up PLN 61,087 thousand, i.e. 3%) and an increase in the amortization and depreciation expense (up PLN 40,596 thousand, i.e. 10%).

The fall in overheads in 2010 comprised mainly a decrease of PLN 45,348 thousand (i.e. 31%) in the expense on promotional and advertising activities which amounted to PLN 98,867 thousand in 2010 (PLN 144,215 thousand in 2009) and a decrease of PLN 29,877 thousand (i.e. 9%) in the expense on IT activities which amounted to PLN 299,404 thousand in 2010 (PLN 329,281 thousand in 2009).

The increase in the amortization and depreciation expense in 2010 was mainly due to an increase in the cost of depreciation of plant and machinery in the amount of PLN 162,681 thousand (PLN 145,065 thousand in 2009) and an increase in the cost of amortization of software in the amount of PLN 182,784 thousand (PLN 161,042 thousand in 2009).

The increase in staff costs in 2010 was mainly due to an increase of PLN 62,580 thousand in the costs of wages and salaries which amounted to PLN 1,863,618 thousand in 2010 (PLN 1,801,038 thousand in 2009).

In the audited year, the Bank's effectiveness ratios were as follows:

	2010	2009
	PLN'000	PLN'000
Administrative expenses	3,902,112	3,904,592
Average annual number of employees	27,432	28,653
Administrative expenses per one employee	142	136
Net profit per one employee	121	85

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

24. Administrative expenses (cont.)

In the audited year, the cost to income ratio was 39.8% (46.7% in 2009). The improvement in the C/I ratio was mainly due to an increase in interest income (Note 18). At the same time, there was an increase in the net profit per one employee (up 42% compared with 2009). Administrative expenses per one employee increased mainly due to employment being reduced by 1,221 people, i.e. by 4.3% (in average annual terms).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

25. Income tax expense

The total income tax expense for the audited year was as follows:

	2010 PLN'000	2009 PLN'000	Change PLN'000	Change (%)
Deferred income tax (a)	207,922	140,506	67,416	48
Current income tax expense (b)	(1,019,630)	(763,785)	(255,845)	33
Income tax expense disclosed in the income statement	(811,708)	(623,279)	(188,429)	30
Income tax expense disclosed in other comprehensive income	(20,203)	(32,105)	11,902	(37)
Total	(831,911)	(655,384)	(176,527)	27

The effective tax rate was 19.7% in 2010 and was 0.7 p.p. lower than in the previous year.

(a) Deferred income tax

Deferred income tax is the difference between the book values of assets and liabilities and their tax bases. The deferred income tax balance comprised deductible and taxable temporary differences:

	Statement of financial position 31.12.2010 PLN'000	Statement of financial position 31.12.2009 PLN'000	Income statement PLN'000
Deferred income tax liability			
Capitalized interest on housing loans	211,576	238,446	26,870
Interest accrued on loans and advances	111,398	88,454	(22,944)
Interest on securities	44,537	37,713	(6,824)
Valuation of derivative financial instruments, including:	98,859	40,935	x
recognized in the income statement	47,741	12,957	(34,784)
recognized in other comprehensive income	51,118	27,978	x
Difference between the carrying amount and the tax base of tangible fixed assets	256,004	233,516	(22,488)
Other taxable temporary differences	2,023	2,656	633
Gross deferred income tax liability	724,397	641,720	x
recognized in the income statement	673,279	613,742	(59,537)
recognized in other comprehensive income	51,118	27,978	x

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

25. Income tax expense (cont.)

(a) Deferred income tax (cont.)

	Statement of financial position 31.12.2010 PLN'000	Statement of financial position 31.12.2009 PLN'000	Income statement PLN'000
Deferred income tax assets			
Interest accrued on liabilities	406,364	326,419	79,945
Valuation of securities, including:	57,395	15,090	X
recognized in the income statement	50,640	11,272	39,368
recognized in other comprehensive income	6,755	3,818	X
Adjustment to EIR valuation	218,000	191,507	26,493
Cost of recognized provisions to be deferred	335,477	236,494	98,983
Provisions for anniversary bonuses and retirement benefits	118,613	110,171	8,442
Valuation of derivative financial instruments, including:	19,470	17,410	x
recognized in the income statement	19,470	17,410	2,060
recognized in other comprehensive income	-	-	x
Other deductible temporary differences	32,001	19,833	12,168
Gross deferred income tax assets, including:	1,187,320	916,924	x
recognized in the income statement	1,180,565	913,106	267,459
recognized in other comprehensive income	6,755	3,818	x
Total effect of temporary differences, including:	462,923	275,204	x
recognized in the income statement	507,286	299,364	207,922
recognized in other comprehensive income	(44,363)	(24,160)	x
Deferred income tax assets	1,187,320	916,924	x
Deferred income tax liability	724,397	641,720	x
Net effect of deferred income tax on the income statement	-	-	207,922

Due to there being net deductible differences, the Bank recognized a deferred income tax asset of PLN 462,923 thousand as at the end of 2010 (PLN 275,204 thousand as at the end of 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

25. Income tax expense (cont.)

(b) Current income tax

In the current financial year, income tax was calculated at the rate of 19% based on the profit before income tax determined on the basis of the provisions of IFRS as adopted by the EU, adjusted for non-taxable income and non-deductible costs.

	2010	2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Profit before income tax	4,122,917	3,055,431	1,067,486	35
Current income tax at the tax rate on profit before income tax (19%)	(783,354)	(580,532)	(202,822)	35
Permanent differences, including:	(28,938)	(43,167)	14,229	(33)
Release of provisions and reversal of write-downs which do not constitute taxable income	(37,503)	(30,577)	(6,926)	23
Other non-deductible costs	(12,042)	(41,262)	29,220	(71)
Dividend income	20,501	19,265	1,236	6
Provision recognized for Kredobank SA	-	(12,848)	12,848	(100)
Other non-taxable income	(1,496)	16,902	(18,398)	(109)
Other	1,602	5,353	(3,751)	(70)
Other differences, including donations	584	420	164	39
Total income tax liability	(811,708)	(623,279)	(188,429)	30
Effective tax rate	19,7%	20,4%	-0,7 pp,	(3)
Temporary difference resulting from deferred income tax, disclosed in the income statement	207,922	140,506	67,416	48
Total current income tax liability	(1,019,630)	(763,785)	(255,845)	33

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

IV. Discussion of financial statement components (cont.)

26. Off-balance sheet items

The value of off-balance sheet liabilities granted and received as at the balance date is presented in the table below:

	31.12.2010	31.12.2009	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Off-balance sheet liabilities granted, including:	38,188,366	33,442,339	4,746,027	14
Financing granted	29,935,538	27,628,880	2,306,658	8
Guarantees and warranties granted – nominal value	8,252,828	5,813,459	2,439,369	42
Off-balance sheet liabilities received, including:	2,627,052	3,331,191	(704,139)	(21)
Guarantees and warranties received	2,231,427	2,702,564	(471,137)	(17)
Other	395,625	628,627	(233,002)	(37)

The increase in off-balance sheet liabilities granted of PLN 4,746,027 thousand (i.e. 14%) was due to an increase in off-balance sheet liabilities in respect of financing of PLN 2,306,658 thousand (i.e. 8%) and an increase in the nominal value of guarantees and warranties granted of PLN 2,439,369 thousand (i.e. 42%).

Off-balance sheet liabilities received decreased by PLN 704,139 thousand (i.e. 21%) in 2010.

The item "Guarantees and warranties received" comprised mainly loan repayment guarantees received of PLN 1,985,150 thousand (PLN 2,265,629 thousand as at 31 December 2009), including PLN 1,838,551 thousand relating to the guarantee granted by the State Treasury in respect of the repayment of "old portfolio" housing loans pursuant to the act on guarantees granted by the State Treasury for the repayment of certain housing loans dated 29 November 2000 (PLN 2,129,841 thousand as at 31 December 2009).

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

V. The independent registered auditor's statement

- (a) The Bank's Management Board provided all the information, explanations, and representations required by us in the course of the audit and provided us with a representation letter confirming the completeness of the information included in the accounting records and the disclosure of all contingent liabilities and post-balance-sheet events which occurred up to the date on which that letter was signed.
- (b) The scope of the audit was not limited.
- (c) The Bank has updated documentation of its accounting policies, approved by the Management Board. The Bank's accounting policies were tailored to its needs and ensured the identification of all events with a material effect on the assessment of its financial position and results, taking into consideration the prudence principle. There were no changes to the accounting policies compared with the previous year.
- (d) The closing balances as at the end of the previous year, were correctly brought forward as the opening balances of the current financial year in all material respects.
- (e) Counts of assets and liabilities and equity were carried out and reconciled in accordance with the Accounting Act, and their results were included in the accounting records for the audited year.
- (f) The financial statements of the Bank as at and for the year ended 31 December 2009 were approved by Resolution No. 5/2010 passed by the General Shareholders' Meeting on 25 June 2010. The financial statements were filed with the National Court Register in Warsaw on 3 August 2010 and published in Monitor Polski B no. 2061 on 21 October 2010.
- (g) The financial statements for the previous year were audited by PricewaterhouseCoopers Sp. z o.o. The registered auditor issued an unqualified opinion.
- (h) We have assessed the operation of the accounting system. Our assessment covered in particular:
 - the accuracy of the documentation relating to business transactions;
 - the fairness, accuracy and verifiability of the accounting records, including computerized accounting records;
 - the methods used for controlling access to data and computerized data processing systems;
 - the safeguarding of accounting documentation, accounting records and the financial statements.

This assessment together with our verification of individual items of the financial statements is a basis for expressing a general, comprehensive and unqualified opinion on the truth and fairness of these financial statements. The audit was not intended to provide a comprehensive opinion on the operations of the said system.

Powszechna Kasa Oszczędności Bank Polski SA
Independent registered auditor's report on the financial statements
as at and for the year ended 31 December 2010

V. The independent registered auditor's statement (cont.)

- (i) We determined the materiality levels at the planning stage. Materiality levels specify the limits up to which identified irregularities may be left unadjusted without any detriment to the quality of the financial statements and to the correctness of the underlying books of account, since failing to make such adjustments will not be misleading for the readers of the financial statements. Materiality measures both the quantity and quality of audited items and that is why it varies for different statement of financial position and income statement items. Due to the complexity and quantity of the materiality levels adopted for audit purposes, they are included in the audit documentation.
- (j) No significant violations of the law were identified during the audit, which might affect the financial statements.
- (k) The notes to the financial statements present all the material information required by IFRS as adopted by the European Union.
- (l) The information in the Directors' Report for the year ended 31 December 2010 has been prepared in accordance with the provisions of the Decree of the Minister of Finance dated 19 February 2009 concerning the publication of current and periodic information by issuers of securities and the conditions of acceptance as equal information required by the law of other state, which is not a member state (Journal of Laws No. 33, item 259) and is consistent with the information presented in the audited financial statements.
- (m) The total capital requirement, together with the requirement concerning the risk of excessive capital exposure, amounted to PLN 11,049,447 thousand as at the balance date. The capital adequacy ratio as at 31 December 2010 amounted to 11.99%. As at the balance date, the Bank complied with the prudence principle in all material respects.



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VI. Final information and comments

This report has been prepared in connection with our audit of the financial statements of Powszechna Kasa Oszczędności Bank Polski SA with its registered office in Warsaw, ul. Puławska 15. The audited financial statements comprised:

- (a) the statement of financial position as at 31 December 2010, showing total assets and total liabilities & equity of PLN 167,238,919 thousand;
- (b) the income statement for the period from 1 January to 31 December 2010, showing a net profit of PLN 3,311,209 thousand;
- (c) the statement of comprehensive income for the period from 1 January to 31 December 2010, showing a total net comprehensive income of PLN 3,397,331 thousand;
- (d) the statement of changes in equity for the period from 1 January to 31 December 2010, showing an increase in equity of PLN 1,022,331 thousand;
- (e) the statement of cash flows for the period from 1 January to 31 December 2010, showing a net decrease in cash and cash equivalents of PLN 417,965 thousand;
- (f) additional information on adopted accounting policies and other explanatory notes.

The financial statements were signed by the Bank's Management Board and the person responsible for maintaining the accounting records on 1 March 2011. This report should be read in conjunction with the Independent Registered Auditor's Opinion to the General Shareholders' Meeting and the Supervisory Board of Powszechna Kasa Oszczędności Bank Polski SA signed on 2 March 2011 concerning the above-mentioned financial statements. The opinion is a general conclusion drawn from the audit and involves assessing the materiality of individual audit findings rather than being a sum of all the evaluations of individual financial statement components. This assessment takes account of the impact of the facts noted on the truth and fairness of the financial statements as a whole.

Conducting the audit on behalf of PricewaterhouseCoopers Sp. z o.o., Registered Audit Company No. 144:

Antoni F. Reczek
President of the Management Board

Principal Registered Auditor
No. 90011

Warsaw, 2 March 2011