



**PKO BANK POLSKI**  
**SPÓŁKA AKCYJNA**

**DIRECTORS' REPORT ON THE ACTIVITIES OF  
PKO BP SA IN 2006**

WARSAW, MARCH 2007

**TABLE OF CONTENT:**

1.	EXTERNAL FACTORS AND EVENTS WHICH ARE SIGNIFICANT TO THE BANK'S PERFORMANCE .....	3
1.1	MACROECONOMIC FACTORS .....	3
1.2	MONETARY POLICY OF THE NATIONAL BANK OF POLAND .....	4
1.3	FINANCIAL MARKET .....	4
1.4	REGULATORY ENVIRONMENT .....	5
1.5	COMPETITION IN THE BANKING SECTOR .....	5
2.	MAJOR EVENTS THAT HAD AN INFLUENCE ON THE BANK'S ACTIVITIES IN 2006 .....	6
3.	BANK'S DEVELOPMENT STRATEGY FOR THE YEARS 2006-2008 .....	6
4.	FINANCIAL PERFORMANCE OF THE BANK .....	7
4.1	BALANCE SHEET .....	7
4.2	PROFIT AND LOSS ACCOUNT .....	9
4.3	EQUITY AND CAPITAL ADEQUACY RATIO .....	13
5.	KEY BUSINESS AREAS OF THE BANK'S ACTIVITIES .....	13
5.1	RETAIL BANKING .....	14
5.2	CORPORATE BANKING .....	16
5.3	REAL ESTATE FINANCING .....	17
5.4	ACTIVITIES ON THE MONEY MARKET .....	19
5.5	BROKERAGE ACTIVITIES .....	19
5.6	INTERNATIONAL COOPERATION .....	20
6.	ORGANIZATIONAL AND CAPITAL RELATIONS .....	21
6.1	INVESTMENT ACTIVITY .....	21
6.2	RELATED PARTY TRANSACTIONS .....	24
7.	RISK MANAGEMENT POLICY .....	25
7.1	CREDIT RISK .....	25
7.2	FINANCIAL RISK .....	27
7.3	OPERATIONAL RISK .....	27
8.	DISTRIBUTION CHANNELS .....	28
9.	INTERNAL CONSIDERATIONS .....	29
9.1	ORGANIZATION OF THE BANK .....	29
9.2	ORGANISATIONAL STRUCTURE OF THE BANK .....	30
9.3	MANAGEMENT AND SUPERVISORY BOARDS IN THE REPORTING PERIOD .....	31
9.4	HUMAN RESOURCES .....	35
9.5	SERVICE PROMOTION AND IMAGE BUILDING .....	37
10.	INVESTORS RELATIONS .....	39
10.1	SHAREHOLDERS' HOLDINGS, DIRECTLY OR INDIRECTLY THROUGH SUBSIDIARIES, AT LEAST 5% OF TOTAL VOTES AT THE GENERAL SHAREHOLDERS' MEETING .....	39
10.2	CHANGES IN ARTICLES OF ASSOCIATION .....	40
10.3	SECURITIES' ISSUES .....	40
10.4	RE-ACQUISITION OF OWN SHARES .....	40
10.5	LISTED PRICE OF THE BANK'S SHARES .....	40
10.6	COMPLIANCE WITH CORPORATE GOVERNANCE RULES .....	41
10.7	EMPLOYEE SHARES .....	41
10.8	HOLDERS OF ANY TYPE OF SECURITIES GIVING SPECIAL CONTROL RIGHTS WITH REGARD TO THE ISSUER .....	42
10.9	RESTRICTIONS FOR THE TRANSFER OF OWNERSHIP OF SECURITIES AND EXERCISING VOTING RIGHTS .....	42
11.	SIGNIFICANT CONTRACTS AND IMPORTANT AGREEMENTS WITH THE CENTRAL BANK OR SUPERVISORY BODIES .....	42
12.	FINANCIAL AND GUARANTEE LIABILITIES GRANTED .....	43
13.	LOANS TAKEN AND LOAN, GUARANTEE AND SURETYSHIP AGREEMENTS .....	43
14.	SUB-UNDERWRITING AGREEMENTS AND GUARANTEES GRANTED TO SUBSIDIARIES .....	43
15.	ENFORCEABLE TITLES ISSUED BY THE BANK .....	44
16.	SIGNIFICANT POST-BALANCE SHEET EVENTS .....	44
17.	INFORMATION REGARDING THE CONTRACT WITH THE ENTITY AUTHORISED TO AUDIT FINANCIAL STATEMENTS .....	45
18.	MANAGEMENT BOARD REPRESENTATIONS .....	45

## 1. EXTERNAL FACTORS AND EVENTS WHICH ARE SIGNIFICANT TO THE BANK'S PERFORMANCE

### 1.1 Macroeconomic factors

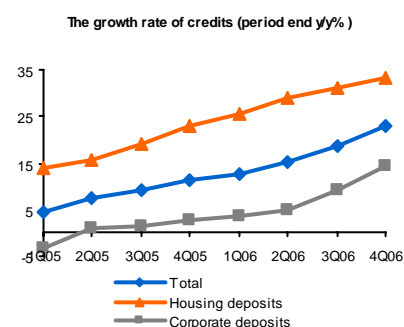
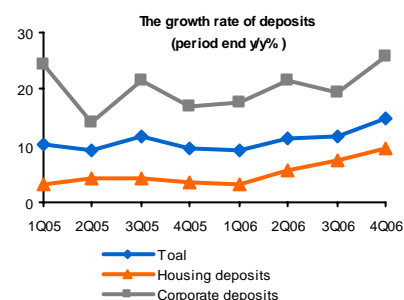
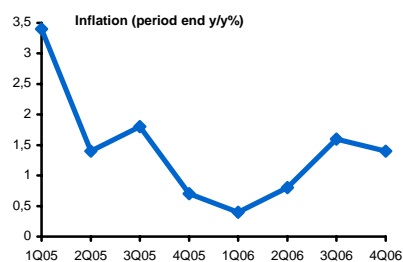
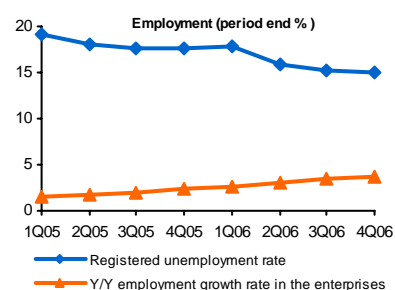
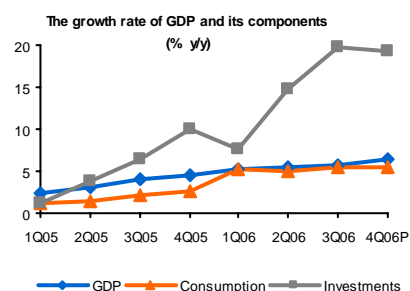
During the year 2006, the economic growth visibly accelerated. According to preliminary data of Central Statistical Office (GUS), growth dynamics of GDP in 2006 amounted to 5.8% y/y in comparison to 3.5% in 2005. The economic revival in real economy was stimulated by high dynamics in domestic consumption – especially in the area of investments, which was stimulated by the increasing use of EU funds and an increasing number of foreign investments in Poland, good financial performance of enterprises and a boom in the housing construction industry. Private consumption continued to grow at a high rate due to an increase in household disposable incomes and an improvement in the situation on the labour market.

During the year 2006, official unemployment rate decreased by 2.7 percentage points to 14.9% in December 2006 (2.3 million of unemployed). The improvement on the labour market was due to positive influence of the economic revival, inflow of the EU funds to be used for active forms of fighting unemployment and the probable increase in the number of people travelling to work abroad, especially for short periods of time.

The average annual inflation rate decreased from 2.1% in 2005 to 1% in 2006. In the first half of 2006, inflation was below 1%, in the second half of the year it amounted on average to 1.4%, and increased to the highest level of 1.6% in August and September. The low level of inflation in 2006 was mainly due to the small pressure of demand on the level of prices, which was reflected in tiny movements in prices in the particular demand categories of the inflation basket. The appreciation of PLN was an additional factor working towards a decrease in the level of inflation, as well as low prices of food in the first half of the year. Increases in energy prices, and especially the double increase in the prices of natural gas (in January and April), contributed to the increase in the inflation rate.

In 2006, household deposits increased, among others due to an improvement in the levels of household income. However, due to the low level of interest rates, the share of bank deposits in the structure of household savings further decreased. A growing proportion of household savings was kept in the form of investment fund units, shares or life insurance policies. Very good financial performance of enterprises contributed to a considerable increase in the level of corporate deposits. The value of corporate deposits in December 2006 was almost 25% greater than in the corresponding period of 2005.

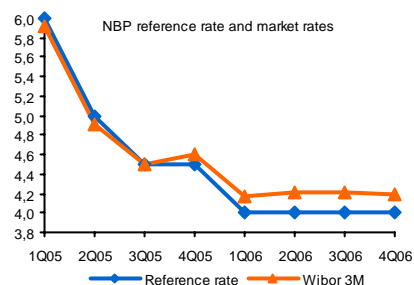
Household loans continued to grow during 2006, especially housing loans, which, among others, was due to the improved financial condition of households and greater willingness of banks to extend loans in the improved economic situation. A smaller increase was noted in the level of consumer loans. The factors that contributed to this increase were the decrease in



borrowing costs and an increase in the credit capability of less affluent households. The year 2006 saw a gradual increase in the level of corporate loans, due to the increase in the level of investments in light of lower borrowing costs.

## 1.2 Monetary policy of the National Bank of Poland

Pursuant to the NBP's "Monetary Policy Assumptions for the Year 2006", maintaining the annualised inflation rate at 2.5%, with allowable fluctuations of +/-1 percentage point, continued to be its main objective in 2006. Due to the decrease in the inflation rate significantly below 1.5% at the end of 2005 and beginning of 2006 the NBP continued to apply soft monetary policy and, in January and February of 2006, decreased the basic NBP rates by a total of 50 base points, to 4.0% for the NBP reference rate. The NBP interest rates remained unchanged till the end of 2006.



## 1.3 Financial market

During the year 2006, a decrease was recorded in the profitability of the Polish Treasury securities with maturity up to 2 years by approximately 10 points and a simultaneous increase in the profitability of long-term bonds.

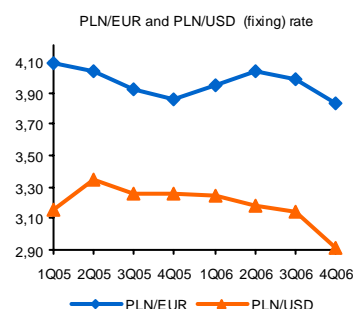
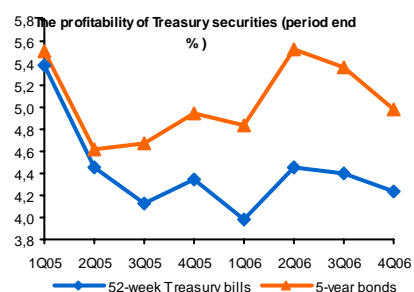
In the first half of the year, profitability was increasing due to the following reasons:

- expiration of investors' expectations for further softening of monetary policy after the termination of cyclical reductions in the NBP interest rates,
- political uncertainty due to lack of a stable majority coalition in the Polish Parliament and changes in government composition, as well as investors' concerns about possible fiscal expansion;
- continued increases in the interest rates in the United States and the Euro zone; and
- periodic outflow of capital from emerging markets.

However, in the 2<sup>nd</sup> half of 2006, profitability tended to decrease due to the following factors:

- stabilisation on the political scene;
- low level of current inflation rate, which limited investors' expectations for increases in the NBP interest rates,
- termination of the tightening of monetary policy in the United States and increased expectations for a decrease in interest rates within one year;
- good current condition of the state budget and improved fiscal perspectives.

In 2006, the Polish zloty appreciated by more than 10% against US dollar and by nearly 1% against the Euro (data at the year-end). The appreciation of the Polish zloty against the US dollar was due to a strong depreciation of the US dollar on the world markets in 2006. The appreciation of the effective PLN rate (weighted by the share of the particular currencies in the Polish exports) was due to the fact that the foundations of the Polish economy continued to be positive, as well as due to the positive influence of Poland's accession to the European Union and a high demand from investors for Central European currencies.



#### **1.4 Regulatory environment**

Major changes in the regulatory environment which had an influence on the activities of the Bank in 2006 related to the following:

- changes in the method of transferring interest on obligatory reserve, which caused an increase in the income from interest on obligatory reserve kept by the banks in the National Bank of Poland. Starting from 1 January 2006, half of the interest income from the obligatory reserve of banks represents banks' income (in 2005, only 40% of such interest contributed to banks' income),
- increase as of 1 January 2006 of the rate of interest defining the balance of the fund comprising bank guarantee funds, which is created by banks,
- implementation as of 20 February 2006 of the so-called anti-usury law (the Act dated 7 July 2005 on amendments to the Act - the Civil Law Code and certain other acts - Journal of Laws No 157, item 1316), which limited the interest rate of consumer loans and credits to four times the amount of the NBP lombard rate, and limited fees, commissions and other banking costs to 5% of the amount of the consumer loan granted, as well as imposed on banks certain additional information requirements towards clients,
- decrease as of 1 March 2006 of the fees for entering property in the Mortgage Register (by introducing a one-off lump-sum fees in the amount of PLN 200, instead of the earlier applied property value-related fees), which resulted in the increased competition among banks to acquire new clients interested in re-financing their current housing loans,
- Recommendation "S" issued by the Commission for Banking Supervision and relating to good practices to be applied with regard to mortgage-secured loan exposures, which requires that the banks should tighten their criteria for extending foreign currency loans as of 1 July 2006, as well as the planned introduction by the General Banking Supervision Inspectorate (*Generalny Inspektorat Nadzoru Bankowego – GINB*) of quantitative norms in order to reduce the dynamics of foreign currency loans and the perspective of liquidation, starting from 2007, of the so-called interest tax relief (Personal Income Tax Act), increased the demand for housing loans. In addition, Recommendation "S" increased the amount of costs incurred by the banks due to the requirements of regular monitoring of changes on the real estate market,
- changes in legal regulations improving the condition of the absorption of the EU structural funds and therefore increasing the level of loans granted by banks for implementation of projects co-financed from EU funds (among others, the amended Public Contracts Act, the Act on the National Development Plan, the Act on the EU Guarantee Fund, regulations relating to industry specific operational programs),
- amendments to the Banking Law effective as of 19 October 2006, which enabled division of banks (and simultaneously enabling the consolidation of Pekao SA with the separated part of BPH SA), which stimulated the banks to try to take over the clients of BPH SA,
- Preparation for implementation of new policies arising from the directives of the European Parliament and of the Council relating to capital adequacy based on the New Capital Accord (hereinafter: NCA; Directive 2006/48/EC and Directive 2006/49/EC), which has intensified after the publication of the draft resolutions of the Commission for Banking Supervision to be applied on the Polish banking market.

Most of the above changes in the regulatory banking environment resulted in additional financial and organisational expenditures incurred by the Bank, which was reflected in the structure of the Bank's assets and liabilities and the level and structure of its financial results, influenced the Bank's capital adequacy ratio and enabled the Bank to pursue new business initiatives.

The Act on financial support for families acquiring own flats, which came into effect in the 4<sup>th</sup> quarter of 2006 and under which the interest charged on such borrowers is subsidized by the state budget, will affect the size of lending activities undertaken by banks in 2007.

#### **1.5 Competition in the banking sector**

The favourable processes that occurred in the macroeconomic environment were reflected in the very good financial performance of the banking sector in 2006. Improving financial condition of households and enterprises, fast growth of individual consumption, improving absorption of EU funds and better perspectives for economic development have contributed to the growth of the banks' lending activities

and increased sales of investment and insurance products. As a result, banks have recorded an increase in the value of deposits and a high increase in granted loans, mainly with regard to housing and consumer loans. A significant increase has also been noted in the efficiency of banks' operations.

The most important processes that affected the competitive environment of PKO BP SA in 2006 were as follows:

- Commencement of the process of consolidation of the following banks: Pekao SA and BPH SA, which created opportunities for taking over the clients of those banks. Combined with continued demand for banking services from households and enterprises, consolidation of banks became an additional factor that increased market competition, which was reflected in, among others:
  - Improvement in the quality of banking products by adjusting them better to the needs of individual and corporate clients, especially with regard to mortgage loans, credit cards, structured products and bancassurance,
  - Development of packet services and cross-selling, including introduction of new services, e.g. mobile operator services, to penetrate various market niches,
  - Development of Internet banking services for individual and corporate clients;
- Development and modernisation of distribution network, accompanied by an increase in the number of employees - banks continued to develop the network of their own outlets (among others, Bank Millennium, BRE, Lukas Bank), more and more often changed the model of their operations and introduced specialization, and increased the number of partner outlets (among others, BPH, ING BSK, Kredyt Bank). In addition, they extended their cooperation with finance intermediaries, insurance companies and supermarket chains and established mass payment points (for example, Raiffeisen Bank),
- Development of ATMs network. By increasing the number of own ATMs the banks continued mutual cooperation and concluded contracts with other independent operators, including Euronet and Cash4You,
- The continued development of banking products and the necessity to reach potential clients increased spending of banks for promotion and advertising,
- Improvement of the quality of banks loan portfolios due to sales of non-performing loans to – among others - securitization funds, sustained losses (up to the level of sales price) were counted as tax deductible expenses by the banks,
- Entrance of new competitors onto the Polish banking market. The following banks commenced their operating activities in Poland: the Greek bank EFG Eurobank – under the name Polbank EFG, Dexia Kommunalkredit Bank Polska, which belongs to Belgian financial group, Noble Bank, which was established based on the banking license of Wschodni Bank Cukrownictwa. Over 130 foreign lending institutions expressed their intention to undertake cross-border activities on the territory of Poland.

## **2. MAJOR EVENTS THAT HAD AN INFLUENCE ON THE BANK'S ACTIVITIES IN 2006**

Major events that influenced the Bank's activities in 2006 were connected with the business activities carried out by the Bank and have been described in the following sections of this Directors' Report.

## **3. BANK'S DEVELOPMENT STRATEGY FOR THE YEARS 2006-2008**

In 2006, the Bank was implementing the Innovation Strategy, which was approved by the Bank's Supervisory Board on 8 December 2005. The Bank's activities were focused on strengthening its position on the financial market and improving operating efficiency.

As part of its business activities, the Bank pursued the following goals:

- To keep the existing and acquire new clients - the Bank continued to modernize and increase the attractiveness of its banking products; among others, it extended the functionalities of the PKO Inteligo account, modified the European Program offer, introduced mortgage loan MIX, introduced the Cash Management package, modified payment cards, increased the diversity of products offered to clients;
- To develop a mass sales network - the Bank commenced cooperation with PPUP Poczta Polska (Polish Post) and with Bank Pocztowy;

- To sell the Bank's products via external partners;
- To improve the quality of the loan portfolio - the Bank continued to carry out the loan portfolio restructuring process;
- To improve the quality of customer services in order to increase client satisfaction.

The Bank's business activities were supported by initiatives focusing on:

- Improvement of sales effectiveness; the Bank continued to develop the sales skills of its employees and to optimize the level and structure of employment;
- Implementation of Costs Optimization Program in the area of IT, telecommunications and non-personnel costs,
- Technological development; the Bank continued to prepare for implementation of the Integrated Information System;
- Preparing the Bank for implementation of capital adequacy policies based on the New Capital Accord;
- Strengthening the positive image of the Bank among its shareholders and clients; the Bank carried out a number of image strengthening and promotional campaigns to strengthen the PKO BP brand.

#### 4. FINANCIAL PERFORMANCE OF THE BANK

The Bank did not publish any forecasts relating to the financial results for the year 2006.

##### 4.1 Balance sheet

###### 4.1.1 Assets

Table 1. Main asset categories (in PLN thousands)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN thousands	%
1	2	3	4	5
1. Cash and balances with the Central Bank	4 543 677	3 832 695	710 982	18.6%
2. Amounts due from banks	13 349 723	12 631 446	718 277	5.7%
3. Financial assets held for trading	391 177	841 914	(450 737)	(53.5)%
4. Derivative financial instruments	1 199 751	1 137 227	62 524	5.5%
5. Other financial instruments valued at fair value through profit or loss	11 214 660	20 034 160	(8 819 500)	(44.0)%
6. Loans and advances to customers	57 220 980	46 051 847	11 169 133	24.3%
7. Investment securities	6 805 567	1 857 578	4 947 989	266.4%
8. Tangible fixed assets	2 157 382	2 201 163	(43 781)	(2.0)%
9. Other assets	2 169 916	1 739 486	430 430	24.7%
<b>Total assets</b>	<b>99 052 833</b>	<b>90 327 516</b>	<b>8 725 317</b>	<b>9.7%</b>

Compared to the balance as at 31 December 2005, the balance sheet of the Bank showed the following main changes in the assets' structure:

- increase in the share of "Loans and advances to customers" by 6.8 pp to 57.8% thanks to high dynamics of this item resulting from increased sales activeness of the Bank in the area of lending,
- a decrease in "Other financial instruments at fair value through profit or loss" (comprising a portfolio of securities classified into the ALPL<sup>1</sup> portfolio) by 10.9 pp. to 11.3% and an increase in the share of loans and advances and of "Investment securities", comprising a portfolio of securities classified as available for sales, by 4.8 pp. to 6.9%. The change resulted from the activities undertaken in order to build an optimum relation between assets' profitability and variability of the result realized on the portfolio of debt securities.

<sup>1</sup> Assets and liabilities valued at fair value through profit or loss.

Table 2. Loans and advances to customers (in PLN thousands)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN thousands	%
1	2	3	4	5
1. Gross loans and advances granted to customers, of which granted to:	59 554 371	48 919 393	10 634 978	21.7%
- public sector	6 061 924	6 749 221	(687 297)	(10.2)%
- financial sector (except for banks)	847 559	809 674	37 885	4.7%
- non-financial sector	52 644 888	41 360 498	11 284 390	27.3%
2. Allowances for loans showing indicators of impairment	(2 333 391)	(2 867 546)	534 155	(18.6)%
<b>Loans and advances to customers</b>	<b>57 220 980</b>	<b>46 051 847</b>	<b>11 169 133</b>	<b>24.3%</b>

Receivables from customers with maturities over 1 year had a predominant role in the term structure of gross loans and advances as at the end of 2006 and 2005. Their total share in the Bank's loan portfolio increased from 64.4% at the end of 2005 to 65.0% at the end of 2006 mainly due to high dynamics of long-term housing loans. At the same time, the share of loans and advances up to 3 months decreased to 20.3% (i.e. by 2.3 pp.).

Further information concerning the maturity terms of loans and advances given to clients contains the Note 25 of Additional Notes to the Financial Statements.

#### 4.1.2 Equity and liabilities

##### Liabilities

Table 3. Main items of liabilities and equity (in PLN thousands)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN thousands	%
1	2	3	4	5
1. Liabilities, of which:	89 017 109	81 547 122	7 469 987	9.2%
- Amounts due to the Central Bank	1 387	766	621	81.1%
- Amounts due to other banks	3 717 350	1 943 035	1 774 315	91.3%
- Derivative financial instruments	1 098 853	1 257 384	(158 531)	(12.6)%
- Amounts due to customers	81 670 039	75 886 880	5 783 159	7.6%
- Other liabilities	2 529 480	2 459 057	70 423	2.9%
2. Total equity	10 035 724	8 780 394	1 255 330	14.3%
<b>Total liabilities and equity</b>	<b>99 052 833</b>	<b>90 327 516</b>	<b>8 725 317</b>	<b>9.7%</b>

As at 31 December 2006, the most significant item of liabilities and equity (82.5%) consists of the amounts due to customers, share of which decreased by 1.6 pp. in comparison to the balance at the end of 2005 and was related to the increase of amounts due to other banks (from 2.2% to 3.8%), comprising mainly interbank placements. These items were the main source of financing of the Bank's activity.

Amounts due to customers increased by PLN 5,783 million compared to the balance as at the end of 2005, including:

- amounts due to private customers increased by PLN 3,705 million, i.e. by 5.9% (of which current deposits increased by PLN 3,931 million, i.e. by 19.1%),
- amounts due to corporate entities increased by PLN 2,104 million, i.e. by 21.6%, and this increase related almost to the same extent to current and overnight deposits, which jointly increased by PLN 1,063 million, i.e. by 24.7% and term deposits, which increased by PLN 1,026 million, i.e. by 18.9%,
- amounts due to public sector entities decreased by PLN 25 million, i.e. by 0.8%.



In the amounts due to the customers of the Bank by maturity, an increase was observed in amounts due to customers within up to 1 month (including current accounts and overnight deposits), which increased by 16.3% compared to the end of 2005, while the balance of deposits with maturities over 1 month decreased by 5.9%. This had an impact on the term structure of amounts due to customers, in which the percentage of short-term amounts due to customers (up to 1 month) increased from 61.0% to 65.9%, with a corresponding decrease in the percentage of liabilities with longer maturity periods.

As at 31 December 2006, the share of amounts due over one year accounted for 1.8% of the total amounts due to customers and compared to the state at the end of 2005 its share decreased by 0.1 pp.

## 4.2 Profit and loss account

Table 4. Main items of profit and loss account items (in PLN thousands)

Item	2006	2005	Dynamics
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
1. Net interest income	3 699 127	3 473 829	106.5%
2. Net fees and commission income	1 717 684	1 169 839	146.8%
3. Dividend income	18 624	28 881	64.5%
4. Result from financial instruments at fair value through profit or loss	(94 420)	30 579	x
5. Result from investment securities	49 091	276 724	17.7%
6. Foreign exchange result	532 570	613 715	86.8%
7. Net other operating income	134 403	209 967	64.0%
<b>8. Total income items (1-7)</b>	<b>6 057 079</b>	<b>5 803 534</b>	<b>104.4%</b>
9. Impairment losses	34 018	(98 900)	x
10. General administrative expenses	(3 589 033)	(3 631 324)	98.8%
<b>11. Profit before taxation</b>	<b>2 502 064</b>	<b>2 073 310</b>	<b>120.7%</b>
12. Income tax expense	(454 673)	(396 512)	114.7%
<b>13. Net profit</b>	<b>2 047 391</b>	<b>1 676 798</b>	<b>122.1%</b>

### 4.2.1 Income items

In the profit and loss account of the Bank for the year 2006, the total of income items amounted to PLN 6,057 million and was by PLN 254 million (i.e. by 4.4%) higher than in 2005. The main items comprising this amount were net interest income and net fees and commission income.

### Net interest income

Table 5. Interest income and expense (in PLN thousands)

Item	2006	2005	Dynamics
1	2	3	4
<b>Interest income, of which:</b>	<b>5 357 933</b>	<b>5 515 887</b>	<b>97.1%</b>
- from loans and advances granted to customers	3 717 731	3 433 506	108.3%
- from securities at fair value through profit or loss	778 620	1 279 735	60.8%
- from placements with other banks	542 783	600 319	90.4%
- from investment securities	258 095	135 317	190.7%
- other	60 704	67 010	90.6%
<b>Interest expense, of which:</b>	<b>(1 658 806)</b>	<b>(2 042 058)</b>	<b>81.2%</b>
- relating to amounts due to customers	(1 478 773)	(1 882 525)	78.6%
- relating to deposits from other banks	(90 233)	(72 054)	125.2%
- other	(89 800)	(87 479)	102.7%
<b>Net interest income</b>	<b>3 699 127</b>	<b>3 473 829</b>	<b>106.5%</b>

The increase in the net interest income of the Bank by 6.5% took place when the PLN interest rates were significantly lower (e.g. in 2006, the average 1M WIBOR was 121 base points lower than in 2005), following efforts made to move the interest result from the deposit to the credit side.

The most significant item in the Bank's interest income in 2006 was income from loans and advances granted to customers, which accounted for 69.4% of total interest income (7.1 pp. increase in relation to 2005), and then interest income from securities at fair value through profit or loss (14.5%) and interest income from inter-bank deposits (10.1%).

In the structure of interest expense in 2006, the most significant item was the expense related to amounts due to customers, which accounted for 89.1% of total interest expense and decreased by 3.0 pp. in relation to 2005 while the share on interest expense on interbank deposits increased.

In 2006 the average interest rate of loans in PKO BP SA was 6.9%<sup>2</sup> while the average interest rate of deposits was 1.9%<sup>3</sup>. Compared to 2005, these rates were by 0.8 pp. and 0.7 pp. lower, respectively.

### Net fees and commission income

Table 6. Fees and commission income and expense (in PLN thousands)

Item	2006	2005	Dynamics
1	2	3	4
<b>Fees and commission income, of which:</b>	<b>2 103 395</b>	<b>1 502 668</b>	<b>140.0%</b>
- on running of bank accounts	719 386	576 520	124.8%
- on servicing of payment cards	529 724	430 661	123.0%
- on loans and advances granted	220 866	88 895	248.5%
- on cash operations	208 467	205 324	101.5%
- on activities relating to servicing of investment funds and operations with securities	180 801	57 132	316.5%
- other	244 151	144 136	169.4%
<b>Fees and commission expense, of which:</b>	<b>(385 711)</b>	<b>(332 829)</b>	<b>115.9%</b>
- on payment cards	(224 710)	(173 274)	129.7%
- on acquisition services	(121 014)	(115 539)	104.7%
- other	(39 987)	(44 016)	90.8%
<b>Net fees and commission income</b>	<b>1 717 684</b>	<b>1 169 839</b>	<b>146.8%</b>

<sup>2</sup> Average interest rate of loans is calculated as interest income on loans divided by average amount of loans within the reporting period.

<sup>3</sup> Average interest rate of deposits is calculated as interest expenses on deposits divided by average amount of deposits within the reporting period.

Net fees and commission income achieved in 2006 was by PLN 548 million higher compared to that achieved in the prior year, thanks to higher fees and commission income by PLN 601 million, with an increase in fees and commission expense by PLN 53 million.

The increase in fees and commission income in 2006 was the effect of, among others:

- the launching of new investment products, which generate additional commission income,
- increase in the number of banking cards and the number of transactions made with the use of these cards,
- high dynamics of the sales of loans,
- changes in the level of commission and fees and introduction of new items to the Tariff of banking fees and commission of PKO BP SA as of 1 January 2006.

#### Other income items

In 2006, total other income items (other than net interest income and net fees and commission income) amounted to PLN 640 million and decreased by 44.8% in comparison to 2005. This was due to the following:

- Result on financial instruments at fair value for 2006 amounted to PLN (-) 94 million and was by PLN 125 million lower than the result recorded in the prior year; such result was mainly due to the situation on the financial market during the year 2006, including in particular the uncertainty on the domestic financial market and the risk margins of Polish Treasury securities denominated in EUR. Additionally, another factor that had an impact on the level of this result was the decrease, during the 2<sup>nd</sup> half of 2006, of the balance of securities classified under the ALPL portfolio and an increase in the balance of investment securities,
- Result from investment securities for the year 2006 amounted to PLN 49 million, whereas the result for the year 2005 was by PLN 228 million higher due to the gains realized by PKO BP SA during that year from the sales of packages of shares in companies listed on the WSE,
- Foreign exchange result for the year 2006 amounted to PLN 533 million and was by PLN 81 million lower than the result for the year 2005; the decrease in the foreign exchange result was due to the decrease in the result on interest items (from swap points) as a result of narrowing spreads between Polish and foreign interest rates after the successive decreases of Polish interest rates with simultaneous increases in interest rates abroad,
- Net other operating income for the year 2006 amounted to PLN 134 million (a decrease of 36.0% and consisted of operating income of PLN 214 million and operating expense of PLN 80 million),
- Dividend income amounted to PLN 19 million, by 35.5% lower comparing to the year 2005; the decrease in the dividend income results from high dividends received from companies listed on the WSE in 2005, whose shares were sold by PKO BP SA in 2005.

#### **4.2.2 Result on impairment allowances**

Impairment losses for the year 2006 amounted to PLN (+) 34 million and improved by PLN 133 million compared to the result for the year 2005, mainly due to:

- the improvement of the quality of loan portfolio,
- the improvement in the economic and financial standing of business customers,
- the improvement in debt collection and as a result the increase of recovery rates assumed in the calculation of impairment losses.

#### 4.2.3 General administrative expenses

Table 7. General administrative expenses (in PLN thousands)

Specification	2006	2005	Dynamics
1	2	3	4
1. Employee costs	(2 150 561)	(1 972 843)	109.0%
2. Non-personnel costs	(1 104 166)	(1 178 299)	93.7%
3. Depreciation and amortization	(268 778)	(419 287)	64.1%
4. Other	(65 528)	(60 895)	107.6%
<b>TOTAL</b>	<b>(3 589 033)</b>	<b>(3 631 324)</b>	<b>98.8%</b>

In 2006, general administrative expenses of the Bank were 1.2% lower than in 2005. The individual expense items were as follows:

- Employee costs were by PLN 178 million higher compared to 2005, mainly due to the following:
  - Updating of provisions for future liabilities towards employees relating to jubilee and retirement benefits and provisions for indemnification benefits for employees whose employment contracts will be terminated in 2007 for reasons independent of the employee, which caused an increase in the costs by a total of PLN 144 million,
  - Increase in the costs of salaries as a result of the Bank's strategy aimed at gradual adjusting the salaries level in the Bank to the average salaries level in the banking sector in Poland,
- Non-personnel costs decreased by PLN 74 million compared to 2005 mainly due to restructuring processes;
- Depreciation of tangible fixed assets and amortization of intangible assets in 2006 decreased by PLN 151 million, mainly due to the reassessment of useful lives of tangible assets and intangible assets recognized before 1 January 2006;
- Other administrative expenses in 2006 increased by PLN 5 million. The main items are: taxes and charges and contribution to the Banking Guarantee Fund, calculated as a specific percentage of risk assets weighted (determined separately for each year) in 2005.

#### 4.2.4 Key financial ratios

The 2006 results of PKO BP SA translated into better key financial ratios:

Table 8. Financial ratios

Specification	2006	2005
1	2	3
1. Profit (loss) before taxation / average assets (ROA <sup>4</sup> <sub>gross</sub> )	2.6%	2.4%
2. Net profit (loss) / average assets (ROA <sub>net</sub> )	2.2%	1.9%
3. Profit (loss) before taxation / average equity (ROE <sup>5</sup> <sub>gross</sub> )	26.6%	23.4%
4. Net profit (loss) / average equity (ROE <sub>net</sub> )	21.8%	19.0%
5. General administrative expenses / total income items (C/I)	59.3%	62.6%

<sup>4</sup> The ROA gross and ROA net ratios are calculated as the relation of, respectively, gross profit (loss) and net profit (loss) to the arithmetical mean of the balances of assets at the beginning and the end of the reporting period.

<sup>5</sup> The ROE gross and ROE net ratios are calculated as the relation of, respectively, gross profit (loss) and net profit (loss) to the arithmetical mean of the balances of shareholders' equity (including accumulated profits from previous years and net profit for the period) at the beginning and the end of the reporting period.

### 4.3 Equity and Capital Adequacy Ratio

Table 9. Equity (in PLN thousands)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN thousands	%
1	2	3	4	5
1. Share capital	1 000 000	1 000 000	0	0.0%
2. Other capital items	6 988 333	5 672 620	1 315 713	23.2%
3. Retained earnings	0	430 976	(430 976)	(100.0)%
4. Net profit for the current year	2 047 391	1 676 798	370 593	22.1%
<b>Total equity</b>	<b>10 035 724</b>	<b>8 780 394</b>	<b>1 255 330</b>	<b>14.3%</b>
<b>Capital adequacy ratio</b>	<b>11.70</b>	<b>14.06</b>	<b>(2.36) pp.</b>	

An increase of the total capital requirement by 32.3% - mainly due to the increase of the assets with a risk weight of 100% as a result of the Bank's loan portfolio growth contributed to the decrease of the capital adequacy ratio.

### 5. KEY BUSINESS AREAS OF THE BANK'S ACTIVITIES

As at 31 December 2006, the balances of interest-bearing assets and liabilities (deposits) resulting from the Bank's business activities were as follows:

Table 10. Gross interest-bearing assets (in PLN millions)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN million	%
1	2	3	4	5
I. Gross loans*), of which:	59 518.2	48 723.0	10 795.2	22.2%
- retail banking	13 650.4	11 357.9	2 292.5	20.2%
- SMEs	4 574.9	3 212.6	1 362.3	42.4%
- housing market (new portfolio)	22 461.7	16 820.1	5 641.6	33.5%
- housing loans	2 822.6	2 959.4	(136.8)	(4.6)%
- corporate	16 008.6	14 373.0	1 635.6	11.4%
II. Securities and inter-bank placements	32 099.2	35 813.8	(3 714.6)	(10.4)%
<b>Total</b>	<b>91 617.4</b>	<b>84 536.8</b>	<b>7 080.6</b>	<b>8.4%</b>

Source: Bank's management information

\*) without interest due and not due

At the end of 2006, the Bank's gross interest-bearing assets amounted to PLN 91.6 billion and were by PLN 7.1 billion, i.e. by 8.4%, higher compared to 31 December 2005. Loans accounted for 65.0% of the total amount of interest-bearing assets and, compared to the end of 2005, this share increased by 7.4 pp. due to the high growth dynamics of loans which amounted to 122.2%.

As at 31 December 2006, the gross value of loans granted by PKO BP SA amounted to PLN 59.5 billion and increased by PLN 10.8 billion throughout the year 2006.

Table 11. Interest-bearing liabilities (in PLN millions)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN million	%
1	2	3	4	5
I. Customers' deposits, of which:	81 320.3	75 999.5	5 320.8	7.0%
- retail banking	55 691.8	53 506.1	2 185.7	4.1%
- SMEs	5 787.7	4 722.0	1 065.7	22.6%
- housing	10 160.4	8 834.5	1 325.9	15.0%
- corporate	9 680.4	8 936.9	743.5	8.3%
II. Other deposits	4 356.5	2 050.2	2 306.3	112.5%
<b>Total</b>	<b>85 676.8</b>	<b>78 049.7</b>	<b>7 627.1</b>	<b>9.8%</b>

Source: Bank's management information

As at 31 December 2006, the Bank's interest-bearing liabilities amounted to PLN 85.7 billion and increased by PLN 7.6 billion, i.e. by 9.8%, since the beginning of the year. Retail banking deposits accounted for 65.0% of the total amount of deposits and, compared to the balance at the end of 2005, this share decreased by 3.6 pp. In relation to 2005: retail banking deposits increased by 4.1%, SMEs deposits increased by 22.6%, housing deposits increased by 15.0%, corporate deposits increased by 8.3% and other deposits increased by 112.5%.

As at the end of 2006, the biggest part in the structure of deposits territorial base had the following regions (excluding inter-bank deposits and deposits on Internet accounts): Mazowiecki (24.9%), Śląsko-Opolski (12.7%) and Wielkopolski (10.8%). Their share in total deposits of the Bank accounted for 48.4% and decreased by 0.9 pp compared to the end of 2005.

## 5.1 Retail banking

The Bank's activities aimed at the customer in the area of retail banking (including private banking) focused on modernizing and increasing the attractiveness of product offer of the Bank and improving service quality and sales effectiveness.

With respect to new deposit products, the Bank offered the following products:

- an annual investment – insurance deposit under which the investment part of the deposit may be allocated for the purchase of participation units issued by the PZU Życie SA capital insurance fund,
- a bi-annual deposit with an attractive fixed interest rate for the whole term of the agreement,
- an annual investment deposit BONSAI, linked to a subfund (market) of small Japanese companies; this offer was addressed to the Private and Personal Banking clients;
- an annual investment deposit "Akcji/Zrównoważony", under which the investment part of the deposit may be allocated for the purchase of participation units issued by the PKO/Credit Suisse equity open-end investment fund ("Akcji – fundusz inwestycyjny otwarty") or by the balanced open-end investment fund ("Zrównoważony – fundusz inwestycyjny otwarty").
- two other investment deposits based on participation units issued by the PKO/Credit Suisse investment funds,
- sales of 3-year foreign structured bonds denominated in PLN under a non-public subscription addressed to Financial Advisory Clients.

With respect to consumer loans, the Bank:

- carried out a promotional campaign for the Quick Credit Service (*Szybki Serwis Kredytowy*) in order to support the sales of this product, with a reduced commission for extending the loan and resigned from collecting interests till the end of 2006 for the loans granted in PLN in the third quarter of 2006 – the so-called "loan holidays";
- modified its offer of revolving loans by allowing the client to purchase an insurance policy to increase the client's security,
- finished granting commercial student loans due to low level of sales and considerable load of work involved in servicing this product.

With respect to changes in price parameters, the Bank:

- adjusted the pricing of the Quick Credit Service to the requirements of the Act of 7 July 2005 on amendments to the Civil Code Act and certain other acts, which defined the maximum rates of interest and commission for extending loans,
- changed the interest rates of consumer loans (credit card loans and revolving loans) following the decision of the Monetary Policy Council on changes to basic interest rates,
- changed the interest rates of PLN and foreign currency deposits following the decisions of the Polish Monetary Policy Council, FED and Bank of England to change basic interest rates,
- introduced a new Tariff of banking fees and commission regarding mainly fees for keeping savings-settlement accounts, debit and credit cards (including free of charge transfers to the PKO BP SA accounts, free of charge issuance or renewal of credit cards depending on the value of transactions).

With respect to intensifying sales through distribution channels, the most important activities of the Bank were as follows:

- starting a cooperation between PKO BP SA and Poczta Polska – an agreement was signed, which sets rules for servicing cash withdrawals made using banking cards via POS terminals at the post offices;
- signing an agreement between PKO BP SA and Bank Pocztowy SA, which sets rules for settling cash withdrawals made via POS terminals at post offices using banking cards issued by Bank Pocztowy SA, which are settled by Bank PKO BP SA;
- signing an agreement between PKO BP SA and emFINANSE Sp. z o.o., which sets rules, conditions and procedures for cooperation between the Bank and the Agent-representative concerning execution of banking activities and actual activities connected with banking activity on the basis of a power of attorney. Under this agreement, the Agent-representative will solicit clients interested in the Bank's products;
- providing the users of the PKO Inteligo service line with an opportunity to purchase participation units issued by the PKO/ CREDIT SUISSE investment funds, managed by PKO TFI SA, via the Internet. The Bank's clients may choose from five funds managed by this company;
- offering new services to the users of the PKO Inteligo service line, which were previously available for the holders of the Inteligo accounts. The Bank's clients may acquire life insurance, property insurance, monitor the balance of their pension fund accounts held with OFE Bankowy and make safe payments through the "I am paying with Inteligo" ("*Płacę z Inteligo*") service system.

With respect to private banking services, the Bank increased the number of partners under the Privilege Program, providing the holders of prestigious PKO BP banking cards with an opportunity to purchase products on preferential terms.

#### Savings-giro (ROR) and Inteligo accounts

In 2006, the number of savings-giro (ROR) accounts increased in relation to the end of 2005 by a total of 74 thousand accounts and reached the level of 5,423.4 thousand accounts. The number of private Inteligo accounts at the end of December 2006 amounted to 647 thousand (including 585 thousand held by retail clients) and increased during the year by approximately 92.3 thousand.

The number of users of the PKO Inteligo service line amounted to 1,434 thousand (including 1,290 thousand held by retail clients) as at 31 December 2006, which means an annual increase by 589 thousand.

#### Cards issued by PKO BP

In the year 2006:

- The Bank conducted promotional sales of credit cards, including among others VISA Turyn, MasterCard 2006 FIFA World Cup credit cards. These cards were offered to clients who held an account with the Bank, decided to open a savings-giro account, term deposit account or who have applied for the Quick Service Credit facility,

- For a selected group of card holders, the Bank carried out a telemarketing campaign combined with life insurance services in the basic version – i.e. free of charge and in the additional version – with an insurance premium charged by the Bank (agreements signed with Amplico Life),
- For the holders of the PKO Ekspres and PKO Graffiti cards, the Bank launched a new service – *Cashback*, which has been supported with a promotional temporary departure from charging fees on such services.

Table 12. Bank accounts and payment cards issued (in thousands)

Item	31.12.2006	31.12.2005	Change:
1	2	3	4
Total number of bank accounts, of which:	6 070	5 903	167
- <i>savings-giro (ROR) accounts</i>	5 423	5 349	74
- <i>Inteligo accounts</i>	647	554	93
Number of payment cards, of which	6 960	6 076	884
- <i>credit cards</i>	935	525	410

### Small and medium sized companies (SMEs)

With respect to cooperation with small and medium sized companies, the Bank's activities included the following:

- introduction of a new product, SUPER PAKIET, under which both personal and business needs of the clients may be served by a single bank. The introduction of this product was accompanied by temporary promotional offers;
- introduction of a new product, "Consolidation Plan" ("*Program konsolidacyjny*"), which includes the following two products: "Working Capital Loan Plan" ("*Kredyt Plan obrotowy*") and "Investment Loan Plan" ("*Kredyt Plan Inwestycyjny*"). These product provide for the opportunity of joining two different goal of taking loan within the particular plan,
- modification of the "Quick Credit Limit" product which consisted in extending the user group to include limited liability and joint stock companies,
- simplification of credit procedures as regards determining the maximum amount of overdraft for the Partner accounts and using investment loans and working capital loans thanks to linking those loans with the service of temporary insurance of credit repayment by PZU SA,
- supporting entrepreneurs - beneficiaries of the EU structural funds,
- continued extending of cooperation with BGK SA and other local and regional guarantee funds in order to overcome the barrier of the lack of security for loans taken out by small and micro companies.

### 5.2 Corporate banking

During the year 2006, the Bank focused its activities on further strengthening of its market position and creating the image of PKO BP SA as a financial institution active on the corporate market.

The Bank continued to develop and modify its product offer and to tailor its solutions to client needs. In doing so, the Bank, among others:

- implemented a package of services called Cash Management, which is addressed to corporate clients interested in the streamlining of cash management. Included in this package are services which meet client requirements in the following areas: day-to-day service, liquidity management, mass payment service, cash-flow service, electronic transaction-information channels,
- introduced a service under which the bank's clients are provided with on-line access to their accounts via the PKO Inteligo e-banking system,
- carried out sales of participation units issued by the PKO/CREDIT SUISSE managed by PKO TFI SA via the network dedicated to corporate client services,



- issued new banking cards: MasterCard Corporate Executive, MasterCard Corporate and MasterCard Corporate Municipium, which, depending on the client's industry segment, enable the Bank to diversify the maximum allowable transaction limit and additional services,
- introduced a new product: "Allowable debit balance on current account",

Moreover, the Bank:

- intensified sales of the Electronic Money Instrument (*Instrument Pieniądza Elektronicznego – IPE*) which is used to make payments to entitled persons using a banking card,
- concentrated on the sales of the multi-purpose credit limit, a package of products used for financing day-to-day activities of the Bank's clients under a single agreement. In 2006, the Bank signed 438 such agreements.

With respect to corporate banking, in 2006 the Bank performed the following activities:

- concluded 49 agreements for the issuance of municipal bonds with a total value of PLN 331.5 million, among others for the Opolskie region (PLN 52 million),
- concluded six agreements for the issuance of corporate bonds with a total value of PLN 2,030 million; two of these agreements were concluded with entities related to the Bank (these transactions were made at an arms' length),
- organised 13 syndicated loans, under which the Bank's exposure amounted to EUR 100 million, PLN 1,234 million and USD 67 million, and entered into 8 bilateral agreements with a total value of EUR 75 million and PLN 430 million.

### **5.3 Real estate financing**

In the area of real estate financing, the Bank has the following types of loans:

- housing market products - mortgage products for individual clients and investor loans,
- loans supported by the state budget, which were granted by the Bank until 31 March 1996 on the basis of separate regulations and they represent a portfolio that gradually distinguishes.

In the area of housing loans, the Bank, in terms of housing market products, focused its activities on maintaining its leading market position and maintaining high profitability of the products offered.

#### **5.3.1 Mortgage products for individual clients and investor loans**

The housing loan *WŁASNY KĄT* plays a predominant role in the portfolio of mortgage products. At the end of 2006, the balance of such loans amounted to PLN 19.3 billion, which accounted for 86% of the total value of loan portfolio.

In 2006, sales of mortgage products and investor loans hit the record amount of PLN 11 billion, which effectively means that it was 45% higher compared to 2005. During three months (June, November, December) sales exceeded PLN 1 billion and amounted to PLN 1.1 billion, PLN 1.0 billion and PLN 1.4 billion, respectively.

The following activities contributed to the high level of sales in 2006:

- Intensification of sales in large cities and towns. These activities translated into record sales in large cities, amounting to over PLN 600 million, which accounted for nearly 50% of total retail sales of the Bank.
- Intensification of sales of insurance products, mainly insurance against loss of work, by organizing competitions for sellers and picking out insurance leaders as a result, the percentage of loans covered by the loss of work insurance systematically increased and reached nearly 27% of all loan agreements in December.
- Intensification of sales of mortgage loans by Agencies (Active Sales System).
- Further intensification of activities aimed at acquiring clients in the segment of investor loans. As a result of these efforts, there was an increase in the sales of such loans – compared to 2005, the value of sales of investor loans increased by 60%.

In order to increase product attractiveness and to tailor them further to client needs, the Bank carried out the following activities:

- carried out two promotional campaigns for mortgage loans – spring and autumn,

- the Negocjator application was implemented, which enables the Bank to link the price of a given product with the client's use of other products and services offered by the Bank, including the loss of work insurance;
- extended its banking product offer to include a loan with the functionality of account balancing, a loan with fixed interest rate, the Mix mortgage loan (that can be used by the client to finance three different purposes, i.e. housing needs, any purpose and repayment of other liabilities);
- extended its insurance product offer to include a loss of work insurance and insurance for low own contribution, and additionally, re-negotiated insurance premiums for other types of insurance already offered by the Bank, what made these products more favourable for the customers;
- prepared for the introduction of a preferential housing loan with interest subsidized by BGK – to be included in the Bank's offer as of 24 January 2007.

In 2006, an improvement was noted in the quality of the loan portfolio – the percentage of non-performing loans decreased by 1.3 p.p., to 2.3% at the end of the year 2006.

Changes were introduced in order to adjust the Bank's regulations to Recommendation S, including the following: increased information requirements towards clients with regard to the interest rate risk, currency risk and borrowing costs in the event of unfavourable changes in interest rates and foreign exchange rates. In addition, when assessing credit capability for foreign currency loans, a requirement was introduced for the client to have credit capacity for the principal amount increased by 20% and the interest rate applicable to PLN loans.

### **5.3.2 Housing loans covered by state assistance**

At the end of 2006, the total balance of housing loans covered by state assistance (so called "old" housing loan portfolio) amounted to PLN 2,505 million and decreased by PLN 273 million i.e. 9.9% during the year 2006.

The loans subject to temporary redemption of interest, repaid according to the "normative" and "income" formulas play a predominant role in this portfolio. Their share in the structure of "old" housing loan portfolio increased by 1.1% to the level of 97.7% compared to the end of 2005.

The main goals of the Bank with respect to housing loans covered by state assistance were to:

- maintain a high level of recoverability,
- minimize the percentage of loans repaid according to the "quotient" formula,
- continue to improve the quality of this portfolio under the terms of the new assessment methodology introduced in accordance with IAS 39 through intensifying of debt collection process towards private persons and restructuring the overdue debt of housing cooperatives. As a result, non performing loans decreased, which is a positive effect taking into account the characteristics of the credit portfolio.

### **5.3.3 Activities relating to deposits held on housing plan passbooks**

As at 31 December 2006, PKO BP SA kept 2.1 million accounts for housing plan passbooks with the total value of deposits raised amounting to PLN 6,833.5 million.

As a result of the activities taken by the Bank to encourage clients to use the housing savings plans introduced by the Bank as of 2002, in 2006 the value of deposits held on housing plan passbooks without the right to guarantee premium increased by PLN 660.8 million and on the housing plan passbooks with the right to guarantee premium (new saving rules) by PLN 49.6 million.

Changes in the number and structure of housing plan passbooks occurred in comparison with the end of 2005. The percentage of housing plan passbooks without the right to guarantee premium increased by 2.5% to 26.7% in relation to the total number of accounts, and by 4.3% to 68.0% in relation to the value of collected deposits; as a result, the percentage of housing plan passbooks with the right to guarantee premium decreased to 73.3% in relation to the total number of accounts and to 32.0% in relation the value of deposits collected by the Bank.

### **5.3.4 Activities relating to corporate clients on the housing market**

In 2006, the Bank focused on strengthening its position with regard to the existing corporate clients on the housing market (i.e. housing cooperatives and communities, developers and real estate agents) as well as attracting new customers.

In order to realize this objective the Bank:

- adjusted offered prices to client needs,
- enhanced the banking product used to finance redecoration of houses and flats and changed the name of the product from "NOWY DOM remont investor loan" to "NASZ REMONT investor loan" and from "NOWY DOM investor loan with thermo-modernization premium from BGK" to "NASZ REMONT investor loan with thermo-modernization premium from BGK",
- introduced the "low-amount version" of the "NASZ REMONT investor loan", which is characterized by simplified loan granting procedures and swift processing of loan application as well as higher, fixed commission and margin rates;
- made the PKO Inteligo service line available to all clients of the housing market;
- continued to serve housing market clients by individual advisors;
- carried out promotional activities addressed to real estate managers, which allowed it to increase the number of housing communities served by the Bank.

The Bank's activities resulted in an increase in the value of deposits and loans as well as an increase in the number of clients by 18% compared to the end of 2005.

In 2006, the value of redecoration loans sold increased twofold. The number of "NASZ REMONT" loan agreement signed (with thermo-modernization premium with BGK) placed PKO BP SA (the second year of granting this loan) on the second position among 21 banks, which extend loans with thermo-modernization premium.

#### **5.4 Activities on the money market**

Treasury activities, due to the value of transactions undertaken in this area and the value of funds engaged in such transactions, comprise one of primary business segments of the Bank. The Bank's activities are focused primarily on the following areas: investment securities portfolio management, financial risk management, trade activities carried out on the inter-bank market with non-banking clients from the corporate, SME and private and personal banking segment.

In 2006, the Bank's activities were focused on the following:

- maintaining the desired effectiveness of the investment portfolio by adjusting the Bank's policy to current market conditions (during the period of increase in interest rate risk, the Bank applied hedging and withheld from purchases) and diversifying the Bank's portfolio (the carrying amount of bonds denominated in foreign currencies increased by nearly 50% compared to the end of 2005),
- managing financial risk by entering into transactions hedging against the interest rate, currency and liquidity risk; as part of management of currency liquidity, CHF deficits which arose due to the dynamic sales of foreign currency housing loans were covered by CIRS transactions,
- active participation in interest rate and interest rate derivative transactions on the inter-bank market and in currency market transactions; compared to 2005, the value of transactions in Treasury bonds and bills was nearly 30% higher, and the volume of currency transactions increased by over 20%.

In 2006, the Bank intensified activities aimed at increasing the sales of Treasury products to non-banking clients, and currency options, IRS and CIRS, became the standard element of the Bank's offer. This resulted in a significant increase in the number of transactions with corporate and SME clients. Compared to 2005, the volume of foreign exchange transactions with corporate clients increased by over 40%, and the volume of derivative transactions was almost seven times as big as in 2005. In the private banking segment, the main focus was placed on the development of investment products.

#### **5.5 Brokerage activities**

In 2006 Dom Maklerski PKO BP maintained its position on the capital market. This was supported by a revival on this market - the main indices increased on average: WIRR by 132%, WIG by 42%, WIG20 by 24%. The yearly turnover on the equity and bond market increased by 76%, i.e. to the level of PLN 329.4 billion.

Dom Maklerski PKO BP maintained its position among the 10 leading brokerage houses and its shares in the secondary market at the end of 2006 were as follows:

- 37.6% on the bonds market and maintained the leading position on this market,
- 6.8% on the stock market and maintained the 6<sup>th</sup> position on the market.

Dom Maklerski maintained the leading position on the market extending the scope of services as market maker and specialist market maker. Dom Maklerski commenced delivering services as market maker for option for WIG20 index in March 2006, extending its activity on the market.

At the end of 2006, the number of accounts (both investment and registration accounts) kept by Dom Maklerski PKO BP SA exceeded 392 thousand. Compared to the end of 2005, the number of accounts decreased by approximately 5% (18.7 thousand). This result comprised a 15% increase (by 11.7 thousand) in the number of investment accounts and a 9% decrease (by 30.4 thousand) in the number of registration accounts. The decrease in the number of registration accounts was due to redemption of Treasury bonds and a decrease in clients' willingness to purchase new issues of Treasury bonds.

At the end of 2006, the value of assets held by customers on investment and registration accounts was PLN 26.8 billion, which means an increase of 46% compared to 2005.

The President of the Management Board of the Warsaw Stock Exchange awarded Dom Maklerski PKO BP SA the first prize for introducing the greatest number of new companies to the stock exchange market in 2006.

## **5.6 International cooperation**

### Cooperation with European Bank for Reconstruction and Development

PKO BP SA participates in the "Loan Window" programme being a part of the "UE/EBRD SME Finance Facility" (on the basis of the Loan Agreement of 21 February 2003 concluded by PKO BP SA and the European Bank for Reconstruction and Development for the financing of small and medium-sized enterprises). Until 31 December 2006, the Bank had signed 2,493 loan agreements for a total amount of EUR 46.5 million.

### Cooperation with other foreign institutions

In 2006 PKO BP SA:

- entered into 7 ISDA Master Agreements with foreign banks and two Credit Support Annexes to previous ISDA agreements, and participated in 5 syndicated loans organized on the European market for foreign banks, with a total value of EUR 56 million.
- completed the process of launching the Global Loan from the European Investment Bank. Funds from the first tranche of this loan will be allocated for the financing of investment projects carried out by local self-government authorities and municipal entities.
- opened 5 *loro* accounts and 1 *nostro* account, closed 2 *nostro* accounts. As at 31 December 2006 the Bank holds 28 *nostro* accounts at correspondent banks, denominated in 3 currencies, and keeps 38 *loro* accounts denominated in three currencies.

### Cooperation with rating agencies

Ratings are currently assigned to PKO BP SA by four rating agencies: Moody's, Standard & Poor's, Capital Intelligence and Fitch Ratings. These ratings are granted free of charge on the basis of generally available information, in particular interim and annual reports, and on the basis of information provided by the Bank directly to the representatives of the above agencies.

In 2006, the domestic strength rating assigned to PKO BP SA by Capital Intelligence increased from BB+ to BBB-.

Increases in the Bank's ratings are constrained by Poland's *country ceiling*, i.e. the level of ratings assigned by the agencies to the Polish economy.

Table 13. PKO BP SA ratings as at 31 December 2006

<b>1. FITCH RATINGS</b>	
Support rating	2
<b>2. STANDARD AND POOR'S</b>	
Long-term local currency liabilities rating	BBBpi
<b>3. MOODY'S INVESTORS SERVICE LTD.</b>	
Long-term deposit rating	A2 stable outlook
Short-term deposit rating	Prime-1 stable outlook
Financial strength	C stable outlook
<b>4. CAPITAL INTELLIGENCE</b>	
Long-term foreign currency liabilities rating	BBB+
Short-term foreign currency liabilities rating	A2
Domestic strength	BBB-
Support rating	2
Outlook	Stable

## 6. ORGANIZATIONAL AND CAPITAL RELATIONS

### 6.1 Investment activity

PKO BP SA holds investments in other business entities. The tables below present the Bank's main direct and indirect investments in other entities.

Table 14. Subsidiaries, associates and jointly controlled entities of the Bank

No	Entity name	Value of investment at acquisition price	Percentage of total vote at general shareholders' meeting
		PLN thousand	%
<b>Subsidiaries</b>			
1	Powszechne Towarzystwo Emerytalne BANKOWY SA	205 786	100.00
2	KREDOBANK SA	144 605	69.933
3	Centrum Finansowe Puławska Sp. z o.o.	128 288	100.00
4	PKO Inwestycje Sp. z o.o.	123 313*	100.00
5	PKO Towarzystwo Funduszy Inwestycyjnych SA	69 055	75.00
6	Inteligo Financial Services SA	59 602	100.00
7	Centrum Elektronicznych Usług Płatniczych eService SA	55 500	100.00
8	Bankowy Fundusz Leasingowy SA	30 000	100.00
9	Bankowe Towarzystwo Kapitałowe SA	18 566	100.00
<b>Jointly controlled entities</b>			
10	CENTRUM HAFFNERA Sp. z o.o.	44 371	49.43
11	Centrum Obsługi Biznesu Sp. z o.o.	17 498	41.44
<b>Associates</b>			
12	Bank Pocztowy SA	146 500	25.0001
13	Kolej Gondolowa Jaworzyna Krynicka SA	15 531	36.71
14	Ekogips SA – in bankruptcy	5 400	23.52
15	Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	1 500	33.33
16	Agencja Inwestycyjna CORP SA	29	22.31

\*Inclusive of a specific capital injection of PLN 5.5 million

Subsidiaries, associates and jointly controlled entities of the Bank are established in order to:

- support the core business areas of PKO BP SA in realization of sales targets by supplementing their product offer; this enables the Bank to provide a greater range of services and sell greater number of products, as well as to maintain the existing and acquire new clients for the Bank,
- provide services to the Bank,
- enable PKO BP SA to participate in profits realized on international financial markets,
- increase the Bank's revenues; they allow the Bank to generate both interest income on loans granted to finance investment projects and income from the sales of the property completed under this project.

Detailed information on the Bank's Subsidiaries, associates and jointly controlled entities is included in the Directors' Report on the Activities of the PKO BP SA Group.

Table 15. Indirect investments of the Bank

No	Entity name	Value of involvement at acquisition price	Percentage of total vote at the general shareholders' meeting/Shareholders' Meeting of the parent company
		PLN thousand	%
<b>Subsidiaries of PKO Inwestycje Sp. z o.o.</b>			
1	Wilanów Investments Sp. z o.o.	82 981	100.00
2	POMERANKA Sp. z o.o.	19 000	100.00
3	Fort Mokotów Sp. z o.o.	2 040	51.00
4	UKRPOLINWESTYCJE Sp. z o.o.	359	55.00
<b>Subsidiary of PTE BANKOWY SA</b>			
5	Finanse Agent Transferowy Sp. z o.o.	2 861*	100.00
<b>Subsidiaries of Centrum HAFFNERA Sp. z o.o.</b>			
6	Sopot Zdrój Sp. z o.o.	58 923	100.00
7	Promenada Sopotcka Sp. z o.o.	10 058	100.00
8	Centrum Majkowskiego Sp. z o.o.	6 609	100.00
9	Kamienica Morska Sp. z o.o.	976	100.00
<b>Associates of Bankowe Towarzystwo Kapitałowe SA</b>			
10	FINDER Sp. z o.o.	6 500	46.43
11	INTER FINANCE Polska Sp. z o.o.	3 248	45.00

\* Inclusive of a specific capital injection of PLN 1 million

The companies in which PKO BP SA holds indirect investments carry out specific investment (construction) projects, provide services to their shareholder companies or represent equity investments of such companies (the purpose of which is to obtain return on investment in the form of dividend or gain from the sales of shares).

In 2006, the following events took place that had an effect on the structure of the PKO BP SA Group:

- Acquisition of 25% shares in PKO Towarzystwo Funduszy Inwestycyjnych SA (formerly PKO/Credit Suisse Towarzystwo Funduszy Inwestycyjnych SA); after the purchase transaction, PKO BP SA became the owner of 75% shares in the share capital of this Company and votes at the general shareholders' meeting. PKO Towarzystwo Funduszy Inwestycyjnych SA became a subsidiary of the Bank and a part of the PKO BP SA Group;
- Taking up 5,428,764,911 shares in the increased share capital of KREDOBANK SA; after registration of the above increase, the share of PKO BP SA in the share capital of this Company and in the votes at the general shareholders' meeting increased from 69.018% to 69.933%;
- Taking up shares in the increased share capital of CENTRUM HAFFNERA Sp. z o.o.; as a result of the above transaction, PKO BP SA has 49.43% shares in the share capital of the Company, which give right to 49.43% shares at the shareholders' meeting;
- Disposal of all shares held by the Bank in Wawel Hotel Development Sp. z o.o. (until that time, a jointly controlled entity of the Bank);
- Disposal of all shares held by the Bank in Hotel Jan III Sobieski Sp. z o.o. (until that time, an associate of the Bank);

- Registration of share capital increase in Kolej Gondolowa Jaworzyna Krynicka SA; the Bank's share in the share capital of that Company decreased from 37.83% to 37.53%, and its share in the total votes at the general shareholders' meeting decreased from 36.85% to 36.71%;
- Taking up shares in the increased share capital of FINDER Sp. z o.o. by Bankowe Towarzystwo Kapitałowe SA, the Bank's subsidiary. Currently, the share of Bankowe Towarzystwo Kapitałowe SA in the share capital and at the shareholders' meeting of FINDER Sp. z o.o. amounts to 46.43%;
- Taking up shares in the increased share capital of INTER FINANCE Polska Sp. z o.o. by Bankowe Towarzystwo Kapitałowe SA, the Bank's subsidiary, as a result of the above transaction, Bankowe Towarzystwo Kapitałowe SA holds 45% shares in the share capital of this Company and 45% votes at its general shareholders' meeting;
- Increase in the value of investment of PKO Inwestycje Sp. z o.o. (the Bank's subsidiary) in UKRPOLINWESTYCJE Sp. z o.o., through an increase in the nominal value of shares;
- Refund by Fort Mokotów Sp. z o.o. of the additional payment received from PKO Inwestycje Sp. z o.o. in the amount of PLN 30.09 million;
- Refund by PKO Inwestycje Sp. z o.o. of the additional payment received from PKO BP SA in the amount of PLN 30.09 million;
- Change of the Company name of PKO Towarzystwo Funduszy Inwestycyjnych SA – former PKO/CREDIT SUISSE Towarzystwo Funduszy inwestycyjnych SA

In addition, in 2006, in accordance with the agreement signed with the National Fund for Environmental Protection and Water Management (*Narodowy Fundusz Ochrony Środowiska i Gospodarki Wodnej*), the Bank purchased 644,297 shares in Bank Ochrony Środowiska SA in Warsaw, which represented 4.88% of the share capital of that Company and entitled to 4.88% of the total votes at its general shareholders' meeting. Consideration paid for these shares amounted to PLN 59.3 million.

#### Investment plans

The development of the PKO BP SA Group as envisaged in the "PKO BP SA's Strategy for the Years 2006-2008" does not preclude Bank's investments in other entities from the financial sector operating on the Polish market or in the Central and Eastern Europe. The Bank believes that the potential equity investments are feasible and will be adequate to the resources held by the Bank.

## **6.2 Related party transactions**

### Transactions involving amounts not exceeding or equal to EUR 500 thousand

In 2006, PKO BP SA provided the following services to related entities (subsidiaries, associates and jointly controlled entities):

- keeping bank accounts,
- accepting deposits,
- granting loans and advances,
- issuing debt securities,
- granting bank guarantees and conducting foreign exchange operations.

In addition, to fulfil agreement conditions under the lease agreement with Centrum Finansowe Pulawska Sp. z o.o., in 2006 the Bank made payments to the company for a total amount of PLN 42.8 million; these payments were mainly related to rent and operating fees.

All significant PKO BP SA transactions with its subsidiaries, associates and jointly controlled entities, including loan exposure of the Bank from these companies as at 31 December 2006, have been presented in the financial statements of PKO BP SA for the year 2006.

### Granted off-balance sheet liabilities

Off-balance sheet liabilities of a financial and guarantee nature granted to related entities as at the end of 2006 amounted to PLN 658.7 million, and increased by PLN 194.1 million in comparison to the end of 2005.



In the total amount of granted off-balance sheet liabilities, the biggest balances relate to the following entities:

- Bankowy Fundusz Leasingowy SA – PLN 274.0 million relating to opened credit lines and granted guarantees,
- Sopot Zdrój Sp. z o.o. – PLN 191.0 million relating to opened credit lines,
- KREDOBANK S.A – PLN 65.1 million relating to opened credit lines,

All related party transactions were made at an arm's length. Maturity dates range from 1 month to 10 years.

Detailed information on transactions with related parties is described in Note 45 of Additional Notes to the Financial Statements.

## **7. RISK MANAGEMENT POLICY**

The risk management system is one of the most important internal processes of the Bank supporting its business operations, where the aim of risk management is to ensure an appropriate level of security and profitability in changing legal and economic environment. Risk management covers both credit risk management and market risk as well as operating risk management.

### **7.1 Credit risk**

Effective management of credit risk is a key management sub-process which has a significant impact on the Bank's competitiveness and market position. For this reason, the Bank's risk management system is subject to on-going improvement and adjustment to new sources and aspects of banking risk.

In credit risk management, the Bank follows the following rules:

- each loan transaction is subject to comprehensive credit risk assessment, which is reflected in an internal rating or credit scoring,
- credit risk relating to loan transactions is measured on a cyclical basis taking into consideration changing external conditions and changes in the financial standing of the borrowers,
- credit risk assessment is subject to additional verification by credit risk assessment forces independent of the business forces, taking into account the conditions of their initiation,
- credit risk is diversified by geographic regions, industry, products and clients,
- loan decisions can only be taken by authorized persons,
- the Bank hedges against credit risk by recognizing impairment write-downs for the impairment of loan exposures.

#### Assessment of credit risk related to institutional clients

Assessment of credit risk associated with the financing of institutional clients (excluding institutional clients of the retail market, who are assessed using simplified procedures) is performed in two aspects: the client and the transaction. Assessment of the client is reflected in client's rating, which is expressed in one of the eight client rating categories. Assessment of the risk related to the transaction, taking into account the specific nature of the transaction, is reflected in transaction's rating expressed in one of the five transaction rating categories. The synthetic measure of credit risk, reflecting the level of the Bank's credit risk, is the so called combined rating.

The simplified assessment of credit risk associated with the financing of institutional clients on the retail market is performed based on data relating to the client and the transaction for which the client has applied. The result of this assessment is a recommendation issued by the system supporting the risk assessment process, which either allows or disallows a positive decision on granting the loan.

#### Assessment of credit risk related to individual clients

The assessment of credit risk related to individual clients is made in terms of credit capacity and credibility. The assessment of the credit capacity consists in examining the current financial standing of the client, including the sources and amounts of client's income, amounts of client's expenditures and liabilities, etc. Assessment of client's credibility consists in the assessment of credit scoring and assessment of information acquired from external sources and internal files of the Bank.

With respect to revolving credit facilities granted in savings-giro accounts, assessment of credit risk is performed as part of the behavioural scoring system which operates at the level of the client's account held with the Bank.

In the 2<sup>nd</sup> quarter of 2006, the Bank's internal regulations relating to the assessment of credit capacity of clients applying for foreign currency loans and the regulations on securing the Bank's loan exposures were adjusted to the requirements set out in Recommendation "S", which was issued by the Commission for Banking Supervision and relates to best practices to be applied to loan exposures secured by mortgage.

#### Limits, responsibilities and credit committees

The Bank's system of responsibilities for taking loan decisions depends on:

- the amount of the Bank's loan exposure to the given client or a group of related clients;
- the period and type of loan transaction;
- type of recommendation issued together with scoring assessment (in the case of individual clients).

The decision process is supported by credit committees which issue recommendations for persons responsible for taking decisions from the individual levels of the Bank's organizational structure. In 2006, the Bank introduced new criteria for participation of credit committees in the process of considering applications filed by institutional clients, depending on the amount of the Bank's loan exposure and the client's rating. With respect to individual clients, credit committees participate in the process of considering their loan applications if the Bank's loan exposure towards the given client exceeds PLN 500 thousand. The criteria for the involvement of credit committees have been adjusted to be in line with the criteria for the involvement of credit risk assessment forces.

In accordance with the requirements set out in Recommendation "S", the Bank set up limits for the structure of the portfolio of loans to be used for the financing of acquisition of real estate by individual clients. These limits took into consideration a number of factors, including the following: industry, group of entities, type of loan transaction, term of the loan agreement, currency of loan transaction and accepted collateral.

#### Independent verification of credit risk assessment

In the event of fulfilling certain specific criteria, the assessment of credit risk related to institutional and individual clients is subject to verification by credit risk assessment forces. In 2006, the Bank implemented new criteria for the involvement of these forces with respect to institutional clients, depending on the amount of the Bank's loan exposure towards the client or group of related clients, client's rating and industry segment.

#### Impairment losses and provisions for credit risk

The Bank identifies loan exposures subject to the risk of impairment and determines the amount of impairment losses in accordance with IAS 39. For the purpose of regulatory reporting and determining the upper limit of tax deductible costs that may be recognized in respect of impairment of loan exposures, the Bank applies the regulations concerning classification of loan exposures and method of determining specific provisions.

#### Portfolio credit risk management methods

The Bank continues its work connected to the development of portfolio credit risk measurement methodology and the widening of the extent of estimated portfolio credit risk measures. The methods of portfolio credit risk measurement allow the Bank to, among others, account for credit risk in the price of its services, assess profitability adjusted for the risk factor, collateral policy management and determine the level of impairment rates based on internal models. Portfolio credit risk analysis also includes those companies from the PKO BP SA Group which are exposed to significant credit risk (KREDOBANK SA, Bankowy Fundusz Leasingowy SA).

As part of implementation of recommendations included in Recommendation "S" of the Commission for Banking Supervision on best practices to be applied with respect to loan exposures secured by mortgage, the Bank has developed methodology and started to perform stress tests on the portfolio of housing loans, taking into consideration unfavourable changes in interest rates, foreign exchange rates and possible decrease in the prices of the properties representing collateral for granted loans.

Since the beginning of 2006, the Bank finalized the project relating to the development of a detailed timetable of activities to be taken in order to achieve full compliance with the requirements of the NCA

and the CRD directive by the end of 2007. At the same time, the Bank decided to implement the standardized approach with respect to credit risk, in accordance with the directive on capital requirements. In 2006, the Bank carried out intense activities in order to implement appropriate solutions with regard to internal processes, information systems and the required internal regulations.

#### Tools supporting credit risk assessment

Assessment of credit risk related to the financing of institutional clients is supported by the KREDYTOR application, whereas assessment of credit risk related to the financing of individual clients is performed using the Infokred and ScorZa applications.

## **7.2 Financial risk**

In 2006, the Bank has amended its policies and procedures relating to management of currency risk, derivative risk, liquidity risk, credit risk associated with financial institutions, as well as classification of transactions and calculation of capital adequacy requirements with respect to the specific types of risk. These amendments in the Bank's internal regulations resulted from changes in the Bank's business activities, changes in the macroeconomic and legal environment, as well as the development of risk measurement methodologies and the results of analyses performed by the Bank's Market Risk Department.

The rules concerning financial risk management adjusted the scope of duties and competences of the Bank's divisions and units dealing with risk management to the reorganization and modernization processes in the Bank.

In 2006, the Bank continued to carry out development work on the specialized IT system supporting financial risk management, which improves the operating efficiency and IT security of the financial risk management process and increases the level of automation of computations and allows for their centralization. The Bank is now in the process of adjusting this IT system to its existing requirements and to the changes in the macroeconomic environment in which the Bank operates.

In 2006, the Bank has undertaken activities in order to achieve compliance with the directive on capital requirements in respect of adjusting the system supporting financial risk management to make it able to determine capital requirements relating to market risk. In addition, the Bank modified its internal regulations on classification of transactions for the purpose of calculating capital requirements and on consideration of ratings assigned by external financial institutions in the calculation of capital requirements relating to credit risk.

#### Financial risk profile of the Bank in 2006

In 2006, as in previous periods, the Bank maintained high PLN liquidity, which throughout the year considerably exceeded the thresholds in all time horizons. The Bank converted PLN liquidity to foreign currency liquidity in order to finance foreign currency loans.

The measures of interest rate, currency, derivatives and liquidity risk were at all times at the level which did not represent a threat to the Bank.

The Bank used derivatives for investment and balance sheet security purposes; it also held speculative positions on interest rates and foreign currencies.

In 2006, the Bank performed regular reviews of the standing of financial institutions and the level of granted credit and settlement limits. In addition, it was setting new limits for new clients on the inter-bank market, in response to the requirements reported by its business departments.

## **7.3 Operational risk**

Operational risk is defined as the risk of a loss arising from non-compliance or weakness of internal processes, people and systems or from external events. Operational risk includes legal risk and does not include the risk of a loss of reputation or the strategic risk.

The objective of operational risk management is to optimise operational efficiency by reducing operating losses, rationalization of costs and increasing the speed and adequacy of the Bank's response to events which are beyond its control. The Bank mitigates operational risk by undertaking activities aimed at optimising quality management, human resources management and the Bank's organization, as well as by insurance, contingency plans, establishing legal security measures,

anticipating the effects of operational events, controlling or avoiding operational risk and reducing adverse effects of operational events.

In 2006, operational risk management regulations were extended to include provisions regulating cooperation between the PKO BP SA Group companies in the area of operational risk management. On that basis, Group companies started to cooperate in the area of operational risk identification, measurement, monitoring and reporting.

As part of preparations for the implementation of the provisions of the New Capital Accord, the Bank developed methodology for the calculation of capital requirements relating to operational risk. In accordance with this methodology, capital requirement for operational risk will be calculated using the basic indicator approach.

## 8. DISTRIBUTION CHANNELS

Table 16. Distribution network

Specification	31.12.2006	31.12.2005	Change
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<b>1. Total number of branches</b>	<b>1 239</b>	<b>1 251</b>	<b>-12</b>
- Retail market:	1 156	1 168	-12
Regional retail branches	12	12	0
Independent branches	574	537	37
Subordinated branches	570	619	-49
- Corporate market:	83	83	0
Regional corporate branches	13	13	0
Corporate client teams	13	13	0
Corporate centrem	57	57	0
<b>2. Number of agencies</b>	<b>2 277</b>	<b>2 510</b>	<b>-233</b>
<b>3. Number of ATMs</b>	<b>2 024</b>	<b>1 862</b>	<b>162</b>

### Branches

At the end of 2006 PKO BP SA had 1,239 branches and their number decreased by 12 in 2006. There were positive changes in the structure of retail branches – the number of independent branches has increased resulting from improvement in efficiency ratios.

### Agencies

The year 2006 was the period of further changes in the structure of PKO BP SA agencies. These changes resulted primarily from adjusting agencies' equipment, labelling and premises safeguarding to the standards set out by the Bank. In 2006, the number of agencies decreased by 233 when compared with the previous year. As at 31 December 2006, the Bank cooperated with 2,277 agencies.

During the year 2006, the Bank granted more than 57 thousand loans via its agencies, for a total amount of PLN 500 million (the amount of loans sold increased by 3% when compared with 2005). In addition, agencies acquired approximately 46 thousand savings-giro accounts (ROR), which accounts for 7.1% of the total number of accounts acquired by the Bank.

The Bank's clients who make cash withdrawals using payment cards at POS terminals are now able to obtain information about the amount of cash available on their accounts. In 2006, PKO BP SA agencies realized more than 11 million cash withdrawals using cards at POS terminals, for a total amount exceeding PLN 3.7 billion.

### Internet banking

In the area of retail banking, year 2006 marked a period of a constant and dynamic growth in the number of the users of e-banking services provided via the PKO Inteligo service line. The number of the users of the PKO Inteligo service line has increased from approximately 850 thousand at the beginning of 2006 to over 1.4 million at the end of December 2006.

In the segment of customers with savings-giro (ROR) accounts, the percentage of the users of e-banking services amounts to approximately 23%, whereas in the segment of customers with Partner accounts - it amounts to approximately 52%.

The total number of the users of e-banking services at the end of 2006, including the Inteligo account users, amounted to approximately 2 million, which reinforced the Bank the leading position in the e-banking sector in Poland.

Since the beginning of 2006, the Bank's clients using the PKO Inteligo e-banking services were provided with the possibility of recharging their pre-paid phone cards directly from their bank account. In addition, the Bank launched a new service "I am paying with Inteligo" ("*Płacę z Inteligo*"), under which the holders of traditional bank accounts who use the PKO Inteligo e-banking services can make safe and swift purchases via the Internet without the need to provide their banking card number. Furthermore, in 2006 the Bank extended the scope of its e-banking services to include an access to the account held with the Bankowy Open-end Pension Fund. Using this service, the clients of OFE Bankowy who make use of an Inteligo account or the PKO Inteligo service line may at any time check the value of collected funds, the number of fund units or the amount of contributions.

Starting from June 2006, clients using PKO Inteligo services may also buy property insurance policies offered by PZU. Considerable popularity was gained by insurance of medical costs incurred abroad – thanks to buying this type of insurance via the Internet, PKO BP clients may safely travel all over the world.

Due to the development of on-line services of the Bank, starting from August 2006 clients using PKO Inteligo services have been provided with the possibility to buy and redeem the participation units issued by the PKO/CREDIT SUISSE.

In the 4<sup>th</sup> quarter of 2006, PKO BP SA made available a new functionality to the users of PKO Inteligo services which enables them to recharge their mobile phone cards using the automatic IVR telephone service line.

Another facility that was introduced by the Bank in 2006 for clients using the PKO Inteligo e-banking services is the possibility to print out their bank statements via the Internet.

As far as corporate banking is concerned the main e-banking system is Multicash system. Additionally new service was implemented in 2006, which enables corporate clients do access current accounts via e-banking PKO Inteligo. The dynamic development of electronic distribution channels resulted in the fact that share of e-banking transfers in the total number of transfers equalled 83% at the end of 2006 (comparing to 66.4% at the end of 2005).

#### Self-service terminals and personnel support equipment

At the end of 2006, PKO BP SA had the largest ATM network in Poland, which accounted for over 20% of all ATMs in Poland. At the end of 2006, the number of ATMs available to the Bank's clients was 2,024 (including 858 ATMs with deposit function). The PKO BP SA ATMs carried out approximately 211 million transactions for a total amount exceeding PLN 54 billion. The percentage of transactions carried out at PKO BP SA ATMs using cards issued by other banks amounted to 5.6%. During the year 2006, the Bank accepted over 153 thousand deposit envelopes and sold 283 thousand Simplus mobile phone cards via its ATM network. During the 12 months of 2006, the number of operations performed at the Bank's ATMs in order to check the bank account balance amounted to nearly 60 million (in December 2006, the number of such operations hit the record amount of 5.5 million).

At the end of 2006, the number of self-service terminals available to customers within the PKO BP SA network amounted to 222 and the number of cash dispensers supporting the work of the PKO BP SA personnel amounted to 538.

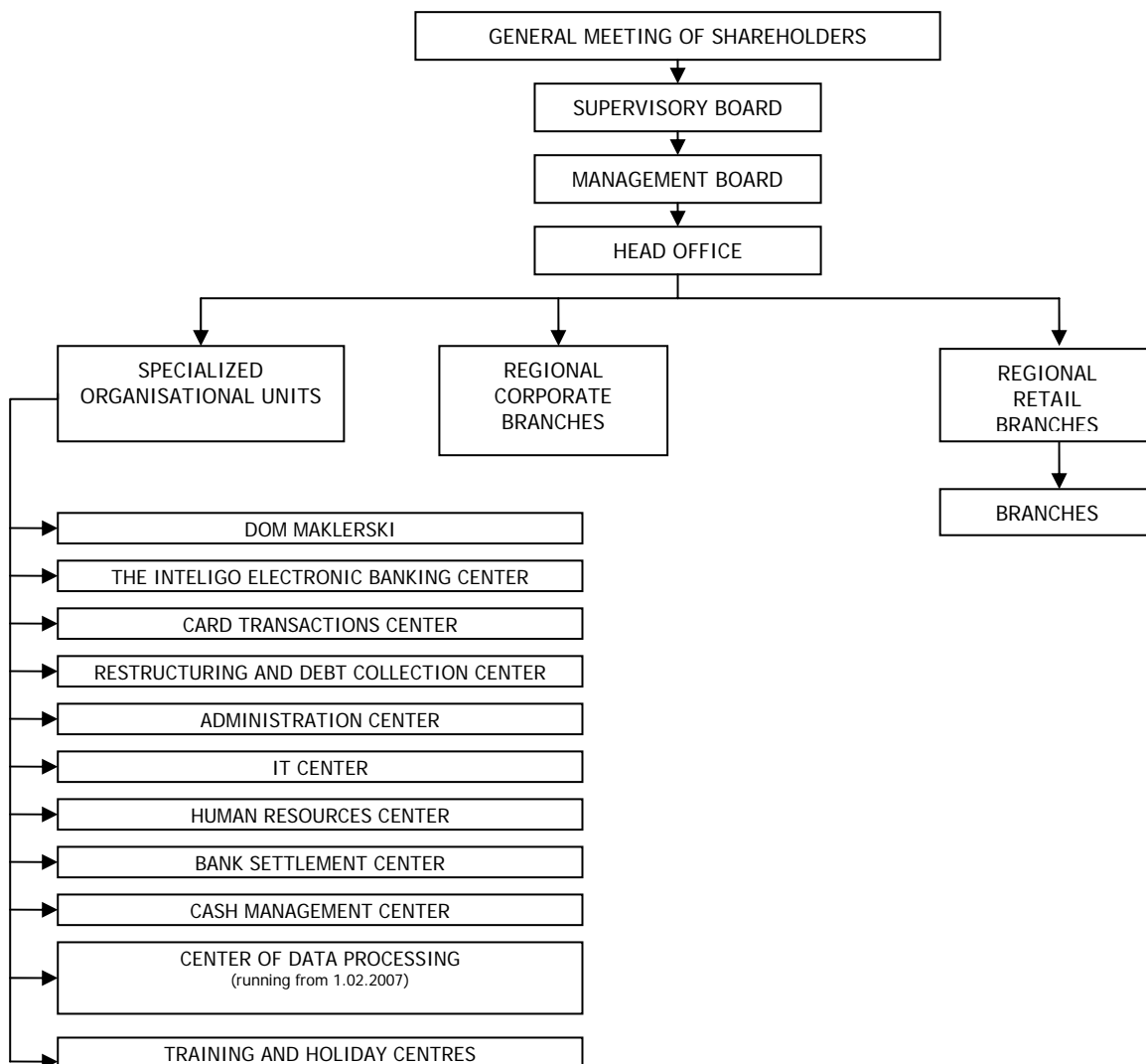
## **9. INTERNAL CONSIDERATIONS**

### **9.1 Organization of the Bank**

In terms of vertical structure, the Bank operates through separate functional and organisational areas which group functional sections and the organisational units of the Bank and the Bank's head office which are outside these functional sections. The Bank's vertical structure allows for clear assignation of tasks, supervision over the process of completion of these tasks and assessment of the head office

organisational units, regional corporate branches, regional retail branches, branches and specialized organisational units. During the year 2006, the Bank focused its organisational activities on improving management and increasing the efficiency of operations of the Bank's organizational units.

## 9.2 Organisational structure of the Bank



### 9.3 Management and Supervisory Boards in the reporting period

#### Members of the Management Board in the reporting period

Table 17. Members of the Management Board in the reporting period

No	Name and surname	Function	Date of appointment
<b>Members of the Management Board as at 31.12. 2006</b>			
1.	Sławomir Skrzypek	Deputy President	<ul style="list-style-type: none"> <li>▪ 20.12.2005 – appointed for the common term of Management Board which commenced on 19.05.2005</li> </ul>
		Acting President of Management Board	<ul style="list-style-type: none"> <li>▪ 29.09.2006</li> <li>▪ resigned from these positions as of 10.01.2007</li> </ul>
2.	Kazimierz Małecki	First Deputy President	<ul style="list-style-type: none"> <li>▪ 04.07.2002</li> <li>▪ 19.05.2005 – re-appointed to another term which commenced on this day</li> <li>▪ Resigned from this position as of 31.12.2006</li> </ul>
3.	Danuta Demianiuk	Deputy President	<ul style="list-style-type: none"> <li>▪ 02.01.2003</li> <li>▪ as of 16.09.2005 re-appointed to another term of the Management Board which commenced on 19.05.2005</li> <li>▪ Resigned from this position as of 31.12.2006</li> </ul>
4.	Rafał Juszcak*	Member	<ul style="list-style-type: none"> <li>▪ As of 01.07.2006 appointed to the common term of the Management Board which commenced on 19.05.2005</li> </ul>
		Deputy President	<ul style="list-style-type: none"> <li>▪ 29.09.2006</li> </ul>
5.	Wojciech Kwiatkowski**	Deputy President	<ul style="list-style-type: none"> <li>▪ As of 01.11.2006 appointed to the common term of the Management Board which commenced on 19.05.2005</li> </ul>
6.	Jacek Obłąkowski	Member	<ul style="list-style-type: none"> <li>▪ 20.06.2002</li> <li>▪ 19.05.2005 – re-appointed to another term which commenced on this day</li> </ul>
		Deputy President	<ul style="list-style-type: none"> <li>▪ 29.09.2006</li> <li>▪ Resigned from this position as of 31.01.2007</li> </ul>
7.	Zdzisław Sokal*	Member	<ul style="list-style-type: none"> <li>▪ As of 01.07.2006 appointed for the common term of the Management Board which commenced on 19.05.2005</li> </ul>
		Deputy President	<ul style="list-style-type: none"> <li>▪ 29.09.2006</li> <li>▪ Resigned from this position as of 13.03.2007</li> </ul>
<b>Board Members who resigned from their positions in 2006</b>			
8.	Andrzej Podsiadło	President of Management Board	<ul style="list-style-type: none"> <li>▪ 20.06.2002</li> <li>▪ 19.05.2005 re-appointed to another term which commenced on this day</li> <li>▪ Resigned from this position as of 29.09.2006</li> </ul>
9.	Krystyna Szewczyk	Member	<ul style="list-style-type: none"> <li>▪ 14.05.2004</li> <li>▪ 16.09.2005 re-appointed to another term which commenced on 19.05.2005</li> <li>▪ Resigned from this position as of 26.06.2006</li> </ul>
10.	Piotr Kamiński	Member	<ul style="list-style-type: none"> <li>▪ 10.03.2002</li> <li>▪ 16.09.2005 re-appointed to another term which commenced on 19.05.2005</li> <li>▪ Resigned from this position as of 9.03.2006</li> </ul>
11.	Jarosław Myjak**	Deputy President	<ul style="list-style-type: none"> <li>▪ As of 02.10.2006 appointed to the common term of the Management Board which commenced on 19.05.2005</li> <li>▪ Resigned from this position as of 30.11.2006</li> </ul>

\* Appointed by the Supervisory Board of the Bank with the resolution dated 26 June 2006

\*\* Appointed by the Supervisory Board of the Bank with the resolution dated 29 September 2006

On 10 January 2007, Mr Sławomir Skrzypek resigned from the position of Deputy President of the Management Board of PKO BP SA due to his appointment as the President of the National Bank of Poland. On the same day, the Supervisory Board of PKO BP SA delegated Dr Marek Głuchowski, the Chairman of the Supervisory Board of PKO BP SA, to temporarily act as the President of the Management Board until 23 January 2007. Due to the fact that, in the period from 24 January 2007 to 26 January 2007, no person has been appointed by the Supervisory Board to act as President of

Management Board, Dr Marek Głuchowski has been delegated to temporarily act as President of the Management Board of PKO BP SA as of 27 January 2007, for a period not longer than by 10 April 2007.

Table 18. Other functions performed by Board Members during the reporting period

No	Name and surname	Function
<b>Board Members holding specific functions as at 31 December 2006</b>		
1.	Kazimierz Małecki	<ul style="list-style-type: none"> <li>▪ Chairman of the Asset and Liability Committee</li> <li>▪ Chairman of the Integrated Information System Steering Committee</li> </ul>
2.	Danuta Demianiuk	<ul style="list-style-type: none"> <li>▪ Deputy Chairperson of the Asset and Liability Committee</li> <li>▪ Chairperson of the Bank's Credit Committee</li> <li>▪ Member of the Integrated Information System Steering Committee</li> </ul>
3.	Sławomir Skrzypek	<ul style="list-style-type: none"> <li>▪ Deputy Chairman of the Bank's Credit Committee (from 14.03.2006 to 25.10.2006)</li> <li>▪ Deputy Chairman of the Steering Committee for Implementation of Branch Modernisation Program</li> <li>▪ Chairman of the Corporate and Commercial Governance Committee (since 31.10.2006)</li> </ul>
4.	Rafał Juszcak	<ul style="list-style-type: none"> <li>▪ Deputy Chairman of the Integrated Information System Steering Committee (since 10.07.2006)</li> <li>▪ Member of the Steering Committee for Implementation of Branch Modernisation Program (since 17.07.2006)</li> <li>▪ Chairman of the IIS Project Committee (since 01.07.2006)</li> </ul>
5.	Jacek Obłąkowski	<ul style="list-style-type: none"> <li>▪ Chairman of the Steering Committee for Implementation of Branch Modernisation Program</li> <li>▪ Deputy Chairman of the Integrated Information System Steering Committee</li> <li>▪ Deputy Chairman of the IIS Project Committee</li> </ul>
6.	Zdzisław Sokal	<ul style="list-style-type: none"> <li>▪ Member of the Asset and Liability Committee (since 10.07.2006)</li> <li>▪ Member of the Integrated Information System Steering Committee (since 10.07.2006)</li> <li>▪ Deputy Chairman of the Corporate and Commercial Governance Committee (since 31.10.2006)</li> </ul>
<b>Board Members who resigned from their functions before 31.12.2006</b>		
7.	Piotr Kamiński	<ul style="list-style-type: none"> <li>▪ Deputy Chairman of the Bank's Credit Committee (until 8.03.2006)</li> </ul>
8.	Krystyna Szewczyk	<ul style="list-style-type: none"> <li>▪ Member of the Asset and Liability Committee (until 26.06.2006)</li> <li>▪ Deputy Chairperson of the Integrated Information System Steering Committee (until 26.06.2006)</li> <li>▪ Member of the Steering Committee for Implementation of Branch Modernisation Program (until 26.06.2006)</li> </ul>



## Members of Supervisory Board

Table 19. Supervisory Board of the Bank in the reporting period

No	Name and surname	Function	Date of appointment / Dismissal
1.	Bazyl Samojlik	Chairman of the Supervisory Board	Dismissed as of 18.04.2006
2.	Krzysztof Zdanowski	Secretary of the Supervisory Board	Dismissed as of 18.04.2006
3.	Andrzej Giryn	Member of the Supervisory Board	Dismissed as of 18.04.2006
4.	Stanisław Kasiewicz	Member of the Supervisory Board	Dismissed as of 18.04.2006
5.	Ryszard Kokoszczynski	Member of the Supervisory Board	Dismissed as of 18.04.2006
6.	Czesława Siwek	Member of the Supervisory Board	Dismissed as of 18.04.2006
7.	Władysław Szymański	Member of the Supervisory Board	Dismissed as of 18.04.2006
8.	Marek Głuchowski	Chairman of the Supervisory Board	Appointed on 18.04.2006 Delegated to the temporary acting functions of the President of the Management Board from 10.01 to 23.01.2007 and since 27.01.2007 not later than until 10.04.2007
9.	Urszula Pałaszek	Member of the Supervisory Board	Appointed on 19.05.2005
		Vice-chairman of the Supervisory Board	Since 20.05.2005
10.	Tomasz Siemiątkowski	Member of the Supervisory Board	Appointed on 18.04.2006
		Secretary	Since 26.06.2006
11.	Jerzy Michałowski	Member of the Supervisory Board	Appointed 18.04.2006
12.	Jerzy Osiatyński	Member of the Supervisory Board	Appointed 25.03.2002
		Member of the Supervisory Board	Appointed 19.05.2005 Resigned from this position as of 31.01.2007
13.	Adam Skowroński	Member of the Supervisory Board	Appointed 18.04.2006
14.	Agnieszka Winnik-Kalemba	Member of the Supervisory Board	Appointed 18.04.2006

In 2006, the Supervisory Board of the Bank established Audit Committee and the Bank's IT Infrastructure Development Committee and adopted regulations for these committees.

### Holders of commercial powers of attorney. Board meetings and implementation of resolutions of General Meetings and recommendations of the State Treasury Minister

- As at 1 January 2006, there were 18 holders of commercial powers of attorney in PKO BP SA. During the year 2006, 4 holders of commercial powers of attorney were appointed and 7 holders of commercial powers of attorney were dismissed. As at 31 December 2006, there were 15 holders of commercial powers of attorney.
- In 2006, the Management Board held 59 minuted meetings and took 422 resolutions.
- The most important activities and decisions taken by the Management Board, which had an influence on the economic and financial position and activity of the Bank, have been presented in the relevant parts of the Directors' Report.
- The general shareholders' meeting of PKO BP SA was held on 18 April 2006 and the resolutions passed during the general shareholders' meeting, which assumed certain activities of the Management Board to be undertaken, were implemented.
- On 27 March 2006 the Supervisory Board of the Bank accepted the recommendation of the Ministry of State Treasury to include information on implementation of Integrated IT System in the quarterly information on the Company, which is sent to the Ministry. This information is

passed on to the Ministry of State Treasury periodically with effect from the Quarterly information on the Company as at 31 March 2006.

#### Rules for appointing and dismissing members of the Management Board

In accordance with § 19 section 1 of the Bank's Articles of Association, Management Board members are appointed by the Supervisory Board for a common three-year term. Board members may only be dismissed for important reasons.

#### Authorisations granted to members Management Board

In accordance with § 20 section 1 of the Bank's Articles of Association, the scope of Management Board responsibilities includes all matters related to the conducting of Bank's affairs that have not been reserved by law or Articles of Association for the general shareholders' meeting or Supervisory Board, including purchase and disposal of property, property interests or perpetual usufruct, which do not require consent of the General Meeting in accordance with § 9 section 1 point 5 of the Bank's Articles of Association.

In accordance with §20 Section 2 of the Bank's Articles of Association, making decisions on incurring liabilities or disposing of assets the total value of which exceeds 5% of the Bank's equity in a transaction with a single entity shall fall within the scope of competence of the Management Board, with the proviso for the scope of competence of the general shareholders' meeting set out in §9 or the scope of competence of the Supervisory Board set out in § 15 of the Articles of Association.

#### Contracts concluded between the issuer and persons performing management functions

In accordance with the definition contained in § 2 section 1 point 35 letter a) of the Decree of the Minister of Finance of 19 October 2005 on current and periodic information provided by the issuers of securities (Journal of Laws No 209 item 1744), members of the Management Board are the persons who manage the Bank.

With each member of the Management Board, the Bank concluded two contracts binding in 2006, which provide for compensation in the event of resignation or dismissal without an important reason:

- employment contract, which provides for a severance payment amounting to a 3-month basic salary recently received by the Board member,
- anti-competition contract, which provides compensation for complying with competition ban over a 6-month period after termination of the employment contract. This compensation amounts to 100% of the monthly basic salary received by the Board member prior to termination of the employment contract and is to be paid in arrears over the period of the ban.

The monthly basic salary is the equivalent of six times average the remuneration determined in the Act of 3 March 2000 on the remuneration of persons managing certain legal entities (Journal of Laws No 26, item 306 with subsequent changes), the so called "chimney act".

#### Emoluments and other benefits provided to members of management and supervisory boards

Full information on emoluments and other benefits provided to members of the Bank's Management and Supervisory Boards in the reporting period has been presented in Note 45 of Additional Notes to the Financial Statements for 2006.

#### Bank's shares held by members of Management and Supervisory Boards

Table 20 presents Bank's shares held by members of Management and Supervisory Boards as at 31 December 2006. The nominal value is PLN 1 per share.

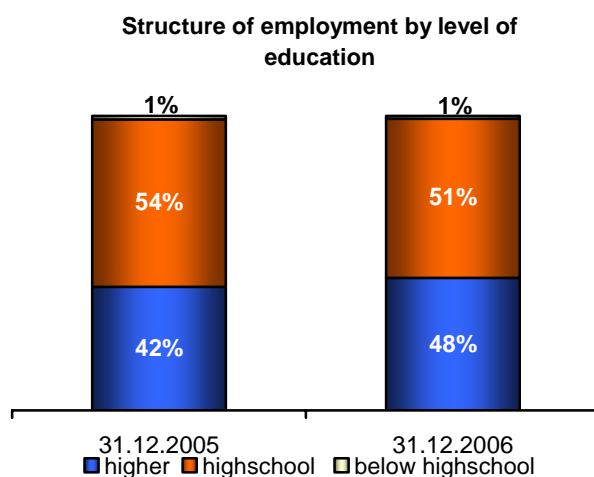
Table 20. Shares held by members of Management and Supervisory Boards as at 31 December 2006.

No	Name and surname	Number of shares held by members of Management and Supervisory Boards
<b>I. Management Board</b>		
1.	Sławomir Skrzypek	-----
2.	Kazimierz Małcki	2 627
3.	Danuta Demianiuk	-----
4.	Rafał Juszcak	-----
5.	Wojciech Kwiatkowski	-----
6.	Jacek Obłokowski	512
7.	Zdzisław Sokal	-----
<b>II. Supervisory Board</b>		
1.	Marek Głuchowski	-----
2.	Urszula Pałaszek	-----
3.	Jerzy Michałowski	-----
4.	Jerzy Osiatyński	-----
5.	Tomasz Siemiątkowski	-----
6.	Adam Skowroński	-----
7.	Agnieszka Winnik-Kalemba	-----

The Bank's Management and Supervisory Boards' members did not hold any shares of companies related with the Bank as at 31 December 2006.

#### 9.4 Human Resources

The number of PKO BP SA employees as at 31 December 2006 was 31,955 (in terms of full-time equivalent) and decreased by 1,524 i.e. 4.6% compared to 31 December 2005. Average number of employees in 2006 amounted to 32,673 (in terms of full-time equivalent) and decreased by 1,849 compared to 2005.



#### Activities relating to changes in employment level and its structure

In 2006, the Bank continued the process of optimising employment in order to adjust the level of employment in particular organizational units to the scope and type of tasks performed by these units, resulting from development and changes in banking activities carried out by the Bank, including in particular sales supporting activities. The Bank's target is to achieve the following structure of employment: 80% in sales and 20% in sales support. Employment optimization was supported by selection of employees whose qualifications and professional skills matched the requirements of their jobs.

Optimisation of employment was taking place first of all by releasing simple natural reserves, including employees' leaving due to regular or early retirement.

#### Remuneration system

The primary legal act that regulates the remuneration system at the Bank is the Collective Bargaining Agreement, which covers all employees working for the Bank on the basis of employment contracts, except for members of Management Board, whose salaries are subject to the limitations resulting from the so-called "chimney law".

The Collective Bargaining Agreement determines the following aspects of remuneration:

- remuneration for work performed,
- benefits arising from employment relationship – paid out upon the fulfilment of conditions defined in the Collective Bargaining Agreement, such as jubilee bonuses and retirement benefits,
- general table of employment positions linked to 9 employment position categories, which sets out the required level of education and minimum length of service to hold these positions,
- a table of minimum monthly basic remuneration rates defined for the particular employment position categories.

Based on delegation contained in the Collective Bargaining Agreement, specific regulations are determined by way of Management Board resolutions agreed with the trade unions with respect to the following aspects:

- granting discretionary bonuses (on a quarterly basis),
- granting one-off awards for outstanding professional achievements,
- granting annual bonuses based on the Bank's performance.

In 2006, the rules for granting bonuses to Bank's employees have been modified, giving consideration to changes in and diversity of functions and the specific nature of tasks performed in the particular business areas:

- retail and corporate market,
- specialized organisational units performing supporting functions,
- Head Office being part of the retail and corporate market area.

The Bank introduced a system of bonuses aimed at intensifying business activities, improving work effectiveness and creating the Bank's value.

#### Training

The main directions of training activities in 2006 were determined based on the needs of particular business areas and employees' individual needs in respect of professional development. Particular emphasis was placed on further strengthening of client-oriented organisational culture.

During the year 2006, more than 77 thousand employees participated in training programs, of which 67% participated in in-house training programs conducted by internal lecturers.

The main directions of training activities, supporting the realization of strategic goals, focused on, among others, adjusting employees' professional qualifications to the Bank's needs arising from its strategic and operating goals, including in particular:

- improving employees' selling skills and pro-client attitudes to ensure high quality of customer service and efficient sales of the Bank's products and services,
- supporting professional development of the Bank's management in the area of efficient human resources management,
- developing the qualifications of top specialists employed by the Bank in order to strengthen the Bank's position on the finance services market,
- supporting implementation of projects, including the Integrated Information System.

In addition, the Bank continued the process of knowledge sharing by organizing in-house training programs, including in the cascade system, conducted by internal lecturers – Bank's employees.

#### Group redundancies

In connection with the process of employment optimization and the planned reduction of employment in 2006, following consultations with the trade unions on the intended redundancies due to reasons

independent of employees, on 29 November 2005 the Bank signed an "Agreement on the rules of terminating employment contracts with PKO BP SA employees for reasons independent of employees". In 2006, 1,338 persons left the Bank under the group redundancy program.

Employees whose employment contracts were terminated by the Bank for reasons independent of employee, received severance payments as set out in the Act of 13 March 2003 on the special rules for termination of employment contracts for reasons independent of employees (Journal of Laws, No 90, item 844 with subsequent changes) and other monetary benefits in addition to statutory allowances. In addition, they received assistance to mitigate the effects of employment termination, including the refund of the costs of training courses undertaken to adjust their qualifications to current labour market requirements.

#### Collective disputes

In the reporting period no collective disputes.

### **9.5 Service promotion and image building**

In 2006, promotional activities of the Bank were mainly focused on the following:

- Strengthening the image of the Bank as a leader in the area of banking services in Poland – a modern organisation with an established reputation, safe, friendly (close to the client) and open to clients needs in each market segment,
- Increasing attractiveness of the Bank's image – demonstrating the developments taking place in the Bank - PKO BP SA as a friendly and modern bank: universal, efficient and dynamically developing bank with Polish character, leader in banking services,
- Increasing the aspirations and prestige of the PKO BP brand,
- Intensifying promotional activities covering the strategic and other important from the Bank's interest point of view products and services offered by the Bank.

The above objectives were realised through activities carried out using various promotional instruments, in particular advertising and public relations as well as communication activities.

As part of advertising activities, the Bank carried out an intense multi-media campaign addressed to the business sector: both small and medium-sized enterprises as well as large corporations, which promoted the Bank as a business advisor, expert and partner and market leader in corporate banking services.

#### The Bank carried out the following activities to promote its products and services:

- For the Retail Market Area:
  - promotional campaigns for: SUPERKONTO (communicating modern access channels), SZYBKİ SERWIS KREDYTOWY ("Quick Credit Service - communicating the most easily available credit on the banking market), structural deposits, credit cards, including in particular PKO Mastercard 2006 FIFA World Cup - linked to the Football World Championships (campaigns supporting sales and the use of credit cards) and PKO Visa TURYN, promotion of Visa Infinite cards, a program dedicated to PLATINIUM private banking clients, promotion of VISA banking cards (campaigns supporting the use of banking cards),
  - promotion of SME products and services, including in particular two new credit products, SZYBKİ LIMIT KREDYTOWY (Quick Credit Limit) and Program Konsolidacyjny (Consolidation Program),
  - promotion of subscribed deposits,
  - promotion of leading housing market products: housing loan WŁASNY KĄT MIX, products for housing cooperatives and housing communes as well as housing plan passbooks,
  - promotional and communication activities connected with sales of Treasury bonds as part of the Bank's obligations as bonds issuance agent,
  - promotion of products and services for housing cooperatives and developers.
- For the Corporate Market Area:
  - activities creating the Bank's image as a competent advisor on the financial services market, through an effective use of selected business events (seminars, conferences, meetings, business competitions), especially of a local nature,

- Promotion of the following financial services: banking cards (MC Executive, MC Corporate, MC Municipium, Electronic Money Instrument), the European Program, municipal bonds, Foreign Trade Transactions.

Public relations activities were carried out especially through the sponsorship and charity activities of the Bank aimed at supporting culture, life saving and health care. During the year 2006, the Bank continued the long-term program "*PKO Bank Polski Kulturze Narodowej*" (PKO BP for the National Culture), under which the Bank provided support to a number of theatres and philharmonics all over Poland. Among others, the Bank was the patron of the exhibition "Jan Bułhak. Photographer" in the National Museum in Warsaw and an exhibition of manuscripts accompanying the Tenth Easter Ludwig van Beethoven Festival. The Bank continued to cooperate with the Great Theatre – National Opera, the National Philharmonic, the National Library and the Cracow cabaret "*Piwnica pod Baranami*", which celebrated in 2006 the 50<sup>th</sup> anniversary of its artistic activities. The Bank was the patron of a special issue of classical music collection "Great Composers" on CDs prepared by Agora S.A.

As part of the "*PKO Bank Polski Blisko Ciebie*" (PKO BP Close to You) program, the Bank sponsored, among others, the multi-media exhibition "Communico Ergo Sum". As each year, the Bank was present at the Stage-play Song Competition (*Przegląd Piosenki Aktorskiej*) in Wrocław, the "Rawa Blues" Festival and the international cross-country skiing event "*Bieg Piastów*". In addition, the Bank was the main sponsor of the Arab Horse Days (*Dni Konia Arabskiego*) and the Polish Junior and Young Rider Championships in hurdle jumping on horseback.

As part of the "*PKO Bank Polski Reprezentacji Olimpijskiej*" (PKO BP for the Olympic Team) program, in 2006 the Bank continued its cooperation with the Polish Olympic Foundation (*Polska Fundacja Olimpijska*). The Bank was a sponsor of the Polish women's foil team and the title sponsor of the Word Cup in women's foil "*Dwór Artusa PKO BP*".

As part of its charity activities, the Bank supported the organisation of the Pilgrimage of Pope Benedict XVI to Poland, provided financial assistance to the families of the miners who lost their lives in the accident in the "Halemba" mine, subsidized the summer and winter holidays of children and youth from poor families, provided assistance in modernization and development of schools. As in the past, the Bank provided support to a number of family group homes. As part of its health care and health promotion activities, the Bank provided financial support for the Polish artificial heart program and for the purchase of specialist medical equipment for a number of clinics and hospitals. In addition, the Bank cooperated with a number of foundations and associations involved in the treatment and rehabilitation of children.

Along with ongoing promotional activities, in 2006 the Bank continued to modernize its external and internal communication systems. With respect to external communication, these activities involved in particular a continued increase of utilization of electronic and interactive communication tools as well as direct marketing tools in the Bank's operations. With respect to internal communication, the Bank carried out activities in order to increase the utilisation of electronic information exchange, especially via the Intranet, i.e. electronic mail and the new Intranet portal.

#### Awards and Distinctions

In 2006, PKO BP SA received a number of awards and distinctions. The most important are listed below:

- Promotional Golden Branch ("*Złoty Oddział*") emblems for 14 branches and a special distinction – Platinum Statuette – for 4 branches granted in a competition for the "Business Friendly Bank" ("*Bank Przyjazny Przedsiębiorstwu*") organized by the Polish Chamber of Commerce, Polish-American Foundation for Counselling Small and Medium Business and the Warsaw Institute of Banking (January 2006),
- a distinction for the SIZ-RAJD central reporting system granted in a competition for The Best IT Product in banks and financial institutions organized by "*Gazeta Bankowa*" (January 2006),
- Trusted Brand 2006 – PKO Bank Polski received a Golden Trusted Brand Statuette in the annual consumer survey organised by *Reader's Digest* (February 2006),
- ALICJA 2005 – an award for the Electronic Money Instrument in a competition organised by, the magazine TWÓJ STYL; this award has been granted to the Bank for the most innovative and user-friendly financial service (February 2006),

- Employer of the Year 2005 – the Bank was ranked 3<sup>rd</sup> in a ranking organised by a students' organization, AIESEC; this was the highest position among financial institutions (March 2006),
- European Medal – an award granted to the Bank for the Electronic Money Instrument in the 12<sup>th</sup> edition of a prestigious competition organized by the Business Centre Club and the European Integration Committee (March 2006),
- The Most Valuable Company in Poland in 2005 in the banking industry – title granted to PKO BP for the 3<sup>rd</sup> place in the ranking of 100 Most Valuable Companies in Poland in 2005, organized by Newsweek Polska and A.T. Kearney Sp. z o.o. (April 2006),
- 1<sup>st</sup> place in *Rzeczpospolita's* ranking of the best financial institutions (June 2006),
- Premium Brand in the category of financial institutions - a title awarded for the first time on the Polish market in a ranking of most reputable brands organised under the patronage of the monthly "*Forbes*" in cooperation with Midwest ITSE and Maison Research Consulting. In addition, the Bank received a special award from "*Forbes*" (June 2006),
- Diamond to the Golden Statuette of the Polish Business Leader awarded by the Business Centre Club to companies that were previously awarded the Polish Business Leader statuette,
- STUDENTS' PRODUCT OF THE YEAR 2006 for SUPERKONTO STUDENT (a bank account for students) in a competition organized by Platforma Mediowa Point Group, the owner of the "*Dlaczego*" magazine and the Korba.pl portal (June 2006),
- 1<sup>st</sup> place for PKO Bank Polski in the ranking of "50 biggest banks in Poland" organised by the financial monthly "*Bank*" (June 2006),
- Golden Medal in the category "Bank - Business Partner" ("*Bank - Partner Przedsiębiorców*"), awarded during the Financial Services Olympics accompanying the 12<sup>th</sup> edition of the "Your Money" Fairs (*Targi Twoje Pieniądze*) (October 2006),
- 2<sup>nd</sup> place for SUPERKONTO STUDENT in a ranking of the best bank accounts for students organised by the magazine "*Dlaczego*" (October 2006),
- 2<sup>nd</sup> place in *Rzeczpospolita's* ranking of "The biggest issuers of credit cards" (October 2006),
- THE EUROPRODUCT – a title granted to the Bank in the services category for: "Quick Credit Limit for Businesses" ("*Szybki Limit Kredytowy dla firm*") and Electronic Money Instrument ("*Instrument Pieniądza Elektronicznego*") (October 2006),
- PRODUCT OF THE YEAR 2006 – a certificate granted in a competition organised by *Reader's Digest* in category "Finance", sub-category "Banking Deposit" (October 2006),
- 5<sup>th</sup> place in *Rzeczpospolita's* MARQA ranking of "The Strongest Polish Brands" and the 1<sup>st</sup> place in the category of financial brands in that ranking (November 2006),
- Promotional Golden Branch ("*Złoty Oddział*") emblems for 13 branches and a special distinction – Platinum Statuette – for 2 branches granted in a competition for the "Business Friendly Bank" ("*Bank Przyjazny Przedsiębiorstwu*") organized by the Polish Chamber of Commerce, Polish-American Foundation for Counselling Small Business and the Warsaw Institute of Banking (November 2006),
- 1<sup>st</sup> place in *Forbes's* ranking of "The most prestigious credit cards" for the PKO Visa Infinite card (November 2006).

## **10. INVESTORS RELATIONS**

### **10.1 Shareholders' holdings, directly or indirectly through subsidiaries, at least 5% of total votes at the general shareholders' meeting**

According to the Bank's knowledge, the State Treasury is a shareholder which holds, directly or indirectly through subsidiaries, at least 5% of total votes at the Bank's general shareholders' meeting.

According to the Bank's knowledge, the State Treasury had the following number of PKO BP SA shares as at 31 December 2006:

Table 21. Shares held by the State Treasury as at 31 December 2006

Shareholder	Number of shares held	Percentage of Bank's share capital	Number of votes at AGM resulting from shares held	Percentage of votes held at AGM
State Treasury	514 959 296	51.50%	514 959 296	51.50%

## 10.2 Changes in Articles of Association

The Bank's Articles of Association were amended on 18 April 2006 on the basis of Resolution No 29/2006 of the Ordinary General Meeting of PKO BP S.A. concerning amendments to the Articles of Association of PKO BP S.A. – by adopting the consolidated text of these Articles.

The Articles of Association were amended as a result of the following laws coming into effect:

- the Act of 1 April 2004 on amendments to the Banking Law and other laws (Journal of Laws No 91, item 870), which set out the requirements that should be met by the bank's articles of association. In accordance with Art. 16 of this Act, within 2 years of its effective date all banks should adjust their articles of association to the requirements set out in Art. 31.3 of the Banking Law, by 1 May 2006,
- the Act of 29 July 2005 on trading in financial instruments (Journal of Laws No 183, item 1538), which has amended the terminology used in the previous articles of association.

The amendments made to the Bank's Articles of Association related, among others, to the following matters:

- indicating those members of Management Board whose appointment is subject to consent of the Commission for Banking Supervision;
- defining the rules for submitting declarations of intent on behalf of the Bank;
- defining the rules for taking decisions in the Bank;
- defining the basic organisational structure of the Bank as required by the Banking Law and adjusting the Bank's Articles of Association to the organisational changes made in the Bank;
- defining the principles of functioning of internal control by indicating the subject and objective of the internal control system;
- adjusting the Bank's Articles of Association to the provisions of the Banking Law defining banking and other activities that may be performed by the Bank;
- implementation of the principle No 14 of the best practices in public companies 2005 that aims to guarantee that the shareholders who applied for including a given issue on the general shareholders' meeting's agenda will participate in deciding that the issue will be deleted from the agenda or will not be considered by the general shareholders' meeting;
- specifying the entities subject to regulations on granting loans, advances, bank guarantees or suretyships;
- exclusion of the responsibility for determining the rules for signing the Bank's documents from the duties of President of Management Board of the Bank.

The consolidated text of the Bank's Articles of Association is included on the website of PKO BP SA.

## 10.3 Securities' issues

The Bank did not issue any own securities in the period covered by this report.

## 10.4 Re-acquisition of own shares

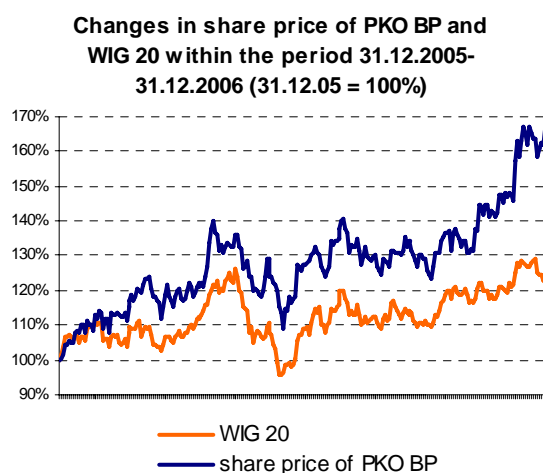
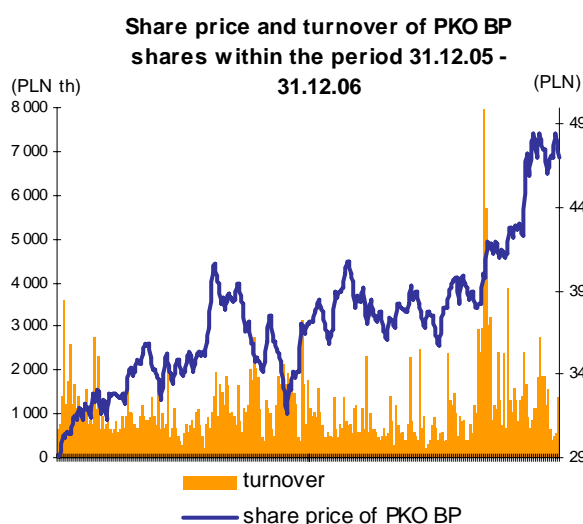
During the period covered by this Report, the Bank did not re-acquire its shares on its own account.

## 10.5 Listed price of the Bank's shares

During the year 2006, the price of the PKO BP S.A. shares demonstrated a stable growth tendency and the highest level (PLN 48.50) gained on 13 and 27 December 2006. The prices of the Bank's shares were affected by trends prevailing on the Warsaw Stock Exchange and the Bank's financial performance.



Average daily turnover in the Bank's shares in 2006 amounted to 1,150 thousand, with the highest turnover (7,953 thousand) recorded on 6 November 2006, i.e. the date on which employee shares were admitted to public trading (see point 10.7 below).



	2005	2006
PKO BP share price at the beginning of the period	27.80	29.00
PKO BP share price at the end of the period	29.00	47.00
Dividend per 1 share	1.00	0.98
<b>Return for the shareholder</b>	<b>7.9%</b>	<b>64.8%</b>

## 10.6 Compliance with corporate governance rules

PKO BP SA complies with all corporate governance rules enacted by Resolution No 44/1062/2004 of the Stock Exchange Board dated 15 December 2004 on adopting corporate governance rules for joint stock companies being the issuers of shares, convertible bonds or bonds with priority right admitted to trading on the official market, except for the following rules: Rule 5 (relating to the requirement to document the participation of a shareholder's representative at general shareholders' meeting), Rule 24 (relating to the details of personal, factual or organisational relations between members of the Supervisory Board and the given shareholder), Rule 28 (relating to the activities of the Supervisory Board, including appointment of Audit and Remuneration Committees), Rule 38 (relating to the salaries of Management Board members), Rule 43 (relating to selection of the auditors), with which the Bank complies only partially, and Rule 20 (relating to independent members of Supervisory Board), which the Bank does not comply with.

## 10.7 Employee shares

In accordance with the Act of 30 August 1996 on Commercialisation and Privatisation (with subsequent amendments), the biannual period in which the PKO BP shares that had been acquired free of charge by the entitled employees were not allowed for trading expired on 4 November 2006.

At the request of the PKO BP S.A. Management Board, as of 6 November 2006, 105,000,000 ordinary bearer "B" series shares that were registered with the National Depository of Securities under symbol PLPKO0000032 (employee shares) were assimilated with ordinary bearer shares registered under symbol PLPKO0000016, in the number of 385,000,000 shares.

Simultaneously, as of 6 November 2006, the Management Board of the Warsaw Stock Exchange admitted the assimilated shares to trading on the main stock exchange market.

### **10.8 Holders of any type of securities giving special control rights with regard to the issuer**

PKO BP SA does not issue any securities which give special control rights with regard to the Bank. However, the State Treasury holds a package of 514,959,296 shares which give right to 51.50% of votes at the general shareholders' meeting.

### **10.9 Restrictions for the transfer of ownership of securities and exercising voting rights**

In accordance with the provisions of the Article 6.2 of the Bank's Articles of Association, the conversion of registered "A" series shares with the value of PLN 510,000,000 into bearer shares and the transfer of these shares require an approval of the Council of Ministers in the form of a resolution. Acquiring such consent results in the expiry of the above restrictions to the extent that such consent was given.

## **11. SIGNIFICANT CONTRACTS AND IMPORTANT AGREEMENTS WITH THE CENTRAL BANK OR SUPERVISORY BODIES**

In 2006, the Bank disclosed in its current reports all agreements with clients for which the total value of services arising from long-term agreements with the given client met the criteria defined in Art. 2.2 of the Decree of the Minister of Finance of 19 October 2005 on current and periodic information provided by issuers of securities (Journal of Laws No 209, item 1744).

In addition, the following agreements were signed with respect to the Bank's receivables:

- On 9 June 2006, Stalexport SA (STX) and the Bank (represented by ING BSK SA on the basis of a power of attorney) signed an "Agreement for the Taking Up of New Shares". Under this agreement, part of the Bank's receivables from Walcownia Rur "Jedność" Sp. z o.o. (WRJ), guaranteed by STX, was converted to shares in the increased share capital of STX. The value of receivables subject to conversion amounted to approximately PLN 6,800 thousand. The above "Agreement" results from the Agreement concluded between STX and the banks participating in the consortium providing funds to WRJ, led by ING BSK SA, which regulates matters connected with STX's guarantee for the repayment of loans granted to WRJ by the banking consortium.
- On 29 August 2006, the Bank signed an Agreement for the sales of receivables which covered part of the portfolio of debts due to PKO BP SA from corporate clients and individuals related to these clients. These receivables were sold in a package to a securitisation fund. The Bank sold 1,009 receivables, with a total value of PLN 754.5 million, including: 773 balance sheet receivables with a value of PLN 490.7 million and 236 off-balance sheet receivables with a value of PLN 263.8 million.
- On 17 October 2006 the Bank signed the agreement for sales of receivables which covered part of the portfolio due to PKO BP SA from retail clients. These receivables were sold to a securitisation fund. The Bank sold 63,058 receivables, with a total value of ca. PLN 582.0 million, including 50,693 balance sheet receivables with a value of PLN 489.1 million and 12,365 off-balance sheet receivables with a value of PLN 92.9 million.
- Agreement for sales of receivables and shares of the company Hotel Jan III Sobieski Sp. z o.o.:
  - On 13 April 2006, a Pre-final Agreement was signed resulting in a conversion of debt for the shares of the Company:
    - PKO BP SA took up shares in the increased share capital of the Company, with the nominal value equalled the Company's debt towards PKO BP SA (ca. PLN 78.5 million) for a price equal to their nominal value,
    - Shares, which were taken up, were paid by cash by PKO BP SA and transferred to the blocked account of the Company – the fund from this account were used for repayment of 100% of the Company's debt towards PKO BP SA.

On 31 October 2006, PKO BP SA concluded a Final Agreement for the sales of shares in Hotel Jan III Sobieski Sp. z o.o. for a total amount of EUR 11.966 thousand (the funds were transferred into PKO BP's account). Moreover, the Agreement states that sales price will be adjusted by net working capital as at a day of transaction, which is 31 October 2006. It was agreed that net working capital would be calculated by KPMG on the basis of the audited

financial statements of the Company within 90 working days from the day of conclusion of the transaction.

In 2006, the Bank did not enter into any important agreements with either the Central Bank or the supervisory bodies.

On the reporting date, the Bank is not aware of any agreements resulting in changes of proportion of shares held by the current shareholders.

## 12. FINANCIAL AND GUARANTEE LIABILITIES GRANTED

Table 22. Financial and guarantee liabilities granted (in PLN thousands)

Item	As at:		Change:	
	31.12.2006	31.12.2005	in PLN thousands	%
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
1. Financial liabilities granted:	22 583 330	17 545 743	5 037 587	28.7%
of which: irrevocable	12 286 757	9 025 801	3 260 956	36.1%
2. Guarantee liabilities granted:	2 512 634	1 508 044	1 004 590	66.6%
<b>Total</b>	<b>25 095 964</b>	<b>19 053 787</b>	<b>6 042 177</b>	<b>31.7%</b>

On 31 December 2006, 84.6% of total off-balance sheet liabilities granted by the Bank related to liabilities of non-financial entities and compared to 2005 this share increased by 7.0 pp.

## 13. LOANS TAKEN AND LOAN, GUARANTEE AND SURETYSHIP AGREEMENTS

During the year 2006, the Bank did not take out any loans or advances or receive any guarantees or suretyships that were not related to its operating activity.

## 14. SUB-UNDERWRITING AGREEMENTS AND GUARANTEES GRANTED TO SUBSIDIARIES

On 20 June 2006, PKO BP S.A. signed an Agreement for Organisation, Conducting and Servicing of a Bond Issuance Program with its subsidiary, Bankowy Fundusz Leasingowy S.A., for an amount of PLN 100 million.

On 14 December 2006, PKO BP S.A. signed an Agreement for Organisation, Conducting and Servicing of a Bond Issuance Program with its subsidiary, Bankowy Fundusz Leasingowy S.A., for an amount up to PLN 500 million, with the proviso that until 30 June 2007 the Company may issue bonds for an amount not exceeding PLN 350 million. On the date of signing this agreement, BFL S.A. terminated the previous agreement dated 20 June 2006.

As at 31 December 2006:

- Bankowy Fundusz Leasingowy S.A. issued bonds for a total amount of PLN 175 million, including bonds amounting to PLN 20 million under the agreement dated 20 June 2006 and bonds amounting to PLN 155 million under the agreement dated 14 December 2006,
- The total value of PKO BP S.A.'s commitments to take up bonds under the underwriting agreements (in order to close the issue of bonds) amounted to PLN 175 million.

In August 2006, PKO BP S.A. extended the guarantee granted to its subsidiary, PKO Towarzystwo Funduszy Inwestycyjnych S.A., for an amount up to USD 67 thousand, in respect of timely settlement of liabilities arising from the rental agreement signed with Centrum Finansowe Puławska Sp. z o.o.

In November 2006, PKO BP S.A. granted a guarantee for Bankowy Fundusz Leasingowy S.A. for an amount up to PLN 9,724 thousand, for the benefit of ABB Sp. z o.o. This guarantee expired on 14 December 2006 as a result of repayment of the liability by the Company.

## **15. ENFORCEABLE TITLES ISSUED BY THE BANK**

During the year 2006, PKO BP SA issued 33,909 banking enforceable titles for a total amount of PLN 423,429.6 thousand.

## **16. SIGNIFICANT POST-BALANCE SHEET EVENTS**

- On 10 January 2007, Mr Sławomir Skrzypek resigned from the position of Deputy President of the Management Board of PKO BP SA due to his appointment as the President of the National Bank of Poland.
- The Supervisory Board of PKO BP SA, at its meeting on 10 January 2007 delegated Mr Marek Głuchowski, PhD - President of the Supervisory Board of PKO BP SA to act temporarily as President of the Management Board of PKO BP SA until 23 January 2007. In the event that, during the period from 24 January 2007 to 26 January 2007, no candidate is appointed by the Supervisory Board, Mr Marek Głuchowski has been delegated to act temporarily as President of the Management Board of PKO BP SA from 27 January 2007 until 10 April 2007 at the latest.
- On 30 January 2007, PKO BP SA signed an agreement with KREDOBANK SA resulting in granting a USD 7.5 million subordinate loan to the Company.
- On 31 January 2007, the Supervisory Board of PKO BP suspended the qualification procedure for the positions of President and two Deputy Presidents of the Management Board of PKO BP due to the resignation of Professor Jerzy Osiatyński from the position of member of Supervisory Board.
- Mr Jacek Obłąkowski resigned from the position of the Deputy President of PKO BP SA's Management Board as of 31 January 2007.
- On 1 February 2007, the Management Board of PKO BP SA convened the Extraordinary General Shareholders' Meeting as at 6<sup>th</sup> March, 2007; the agenda included the adoption of the resolutions on changes in the composition of the Supervisory Board.
- On 22 February 2007, the Supervisory Board adopted resolutions appointing:
  - Mr Robert Działak as the Deputy President of the Management Board of the Bank, as of 23 February 2007,
  - Mr Stefan Świątkowski as the Deputy President of the Management Board of the Bank, as of 1 May 2007.

According to the adopted resolutions Mr Działak and Mr Świątkowski were appointed to these functions for the common term of the Management Board that commenced on 19 May 2005.

- On 24 February 2007 Moody's Investors Service rating agency assigned to the Bank two new ratings: Aaa – long-term rating of domestic currency deposit with the stable prospects and P-1 – short-term rating of domestic currency deposits with the stable prospects. New ratings have been assigned due to the implementation of the new JDA methodology (gaining the external support) and update of the BFSR methodology (internal financial strength of the Bank).
- On 8 March 2007 the report of the Capital Intelligence rating agency was sent to the Bank, informing about the increased rating of the financial strength of PKO BP SA from BBB- to BBB with the stable prospects. The report was dated February 2007. The agency justified the change of the rating with the systematic increase of the profitability. Additionally, the improving quality of the loan portfolio and the reporting transparency was emphasized.
- On 13 March 2007 Mr Zdzisław Sokal resigned from the position of Deputy President of the Management Board of PKO BP SA.
- The Extraordinary general shareholders' meeting of PKO BP SA convened preliminary for 6 March 2007, and the continued meeting on 19 March 2007, appointed Mr Maciej Czapiewski the Member of the Supervisory Board as of 19 March 2007.
- On 19 March 2006 the Management Board informed in the current report about the adopted resolution and about the decision to submit to the general shareholders' meeting the recommendation of the dividend payments for 2006 in the amount of PLN 980 million (PLN 0.98 per share).

## **17. INFORMATION REGARDING THE CONTRACT WITH THE ENTITY AUTHORISED TO AUDIT FINANCIAL STATEMENTS**

On 8 August 2005, the Bank entered into a contract with Ernst & Young Audit Sp. z o.o., an entity authorised to audit financial statements, for an audit of stand-alone financial statements and consolidated financial statements for the years ended 31 December 2005, 2006 and 2007 and a review of stand alone financial statements and consolidated financial statements for 6-month periods ended 30 June 2005, 2006 and 2007.

Total fees under the contracts related to reviews and audits of standalone and consolidated financial statements amounted to PLN 855.0 thousand (net of VAT) for the year 2006 and PLN 1,216.3 thousand (net of VAT) for the year 2005.

The total amount of fees arising from contracts concluded between the Bank and Ernst & Young Audit Sp. z o.o. for remaining services other than reviews and audits of financial statements was as follows: PLN 3,398.9 thousand (net of VAT) for the year 2006 and PLN 2,319.4 thousand (net of VAT) for the year 2005.

The significant part of remuneration arising from contracts other than reviews and audits of financial statement concluded between the Bank and Ernst & Young Audit Sp. z o.o. was associated with projects connected with the Bank's capital investments, consulting and advisory services and translation of interim reports.

## **18. MANAGEMENT BOARD REPRESENTATIONS**

The Management Board of PKO BP SA hereby represents that according to its best knowledge:

- the annual financial statements and comparative data were prepared in accordance with the accounting principles in force and give a true and fair view of the Bank's financial position and results;
- the annual Directors' Report on the Bank's activities gives a true view of the Bank's development, achievements and standing, including a description of the main risks and threats.

The Management Board of PKO BP SA hereby represents that the entity authorised to audit financial statements that performed an audit of the annual financial statements of PKO BP SA was selected in accordance with law, and that both this entity and the certified auditors who performed this audit met the conditions required to issue an impartial and independent audit opinion, in accordance with the relevant national laws.

This *Directors' Report on the activities of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna in 2006* consists of 45 consecutively numbered pages.

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Acting as President of Management Board  
Marek Głuchowski

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Deputy President  
Robert Działak

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Deputy President  
Rafał Juszcak

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Deputy President  
Wojciech Kwiatkowski