



PKO BANK POLSKI
SPÓŁKA AKCYJNA

DIRECTORS' REPORT
ON THE ACTIVITIES OF
POWSZECHNA KASA OSZCZĘDNOŚCI
BANK POLSKI SPÓŁKA AKCYJNA
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1. EXTERNAL FACTORS AND EVENTS WHICH ARE SIGNIFICANT TO THE BANK'S PERFORMANCE

1.1 Macroeconomic environment

During the year 2005, the economic growth slowed down in comparison with the year 2004. According to preliminary estimations of GUS (Central Statistical Office), the growth of GDP in the most recent year amounted to 3.2%, compared to 5.3% in the year 2004. The main reason for the economic slow-down which took place in the first half of 2005 was the decline in internal demand due to the following factors: smaller growth of consumption (the effect of extinguishment of the consumption boom from the period of Poland's accession to EU), smaller growth of investments (the effect of greater than expected difficulties with acquiring financing from the EU aid funds, weaker domestic demand, appreciation of Polish zloty and increase in real interest rates) as well as a smaller increase in inventories compared to the period of Poland's accession to EU. However, in the second half of the year, the Polish economy saw certain signs of improvement: gradual increase of people's real income resulted in moderate revival in individual consumption, while the continued good financial performance of enterprises and decreased interest rates, combined with gradual restoration of domestic demand and the continued inflow of direct foreign investments contributed to moderate growth of investments. At the same time, throughout the whole period under analysis, the main driver of economic growth was the decrease in foreign trade deficit.

Despite the economic revival in the second half of the year and the overall improvement in companies' financial standing, in 2005 only a slight improvement was observed in the labour market. In December 2005, official unemployment rate decreased by 1.4 percentage points and amounted to 17.6%, with 2.8 million persons without regular employment.

After the period of a significant growth in the inflation rate (4.4% year to year at the end of 2004), the inflation rate in 2005 showed a declining trend. In the second half of the year, the inflation rate was slightly below the borderline for the inflation target of the National Bank of Poland (NBP) and oscillated around 1.5%, which was within the bottom range of fluctuations of the inflation rate around the NBP's target. The decrease of the inflation rate in the second half of the year 2005 was mainly the effect of the so called "high reference base", i.e. a considerable increase in prices in the corresponding period of the year 2004 resulting from Poland's accession to the European Union. Moderate salary increases and appreciation of the Polish zloty were also conducive to the decrease in the inflation rate. On the other hand, inflation was boosted by fuel prices, which were increasing over a prevailing part of the year due to increases in the prices of crude oil on the world markets. Eventually, the inflation rate as at the end of 2005 amounted to 0.7% on a year-to-year basis (as estimated by PKO BP SA). In 2005 yearly average inflation rate amounted to 2.1%, and 3.5% in 2004.

In the previous year, household deposits increased by 3.6% due to a slow increase in the level of household income. However, the decreases in the NBP interest rates and the resulting decreases in the interest rates of bank deposits brought about a decrease in the share of bank deposits in the household savings' structure. At the same time, a growing proportion of household savings was kept in the form of trust fund units, shares or life insurance policies. The reluctance of enterprises to increase the size of investments, combined with good financial performance of enterprises, contributed to a considerable increase in the level of corporate deposits. As a result, the value of corporate deposits in December 2005 was almost 17% greater than in the corresponding period of 2004.

Household loans continued to grow during 2005, especially housing loans, which, among others, was due to the increasing level of household income and decreasing interest rates. In mid 2005, a small growth was noted in corporate loans, which, to a large extent, was due to low reference base, as monthly increases only slightly exceeded or approximated those noted in the previous year. The decline in the growing trend was due to the reluctance of enterprises to launch new investment projects and the relatively small use of external financing.



1.2 Monetary policy of the National Bank of Poland

Pursuant to the NBP's *Monetary Policy Assumptions for the Year 2005*, maintaining the annualised inflation rate at 2.5%, with allowable fluctuations of +/- percentage point, continued to be its main objective in 2005. The macroeconomic data published in the first half of 2005 (relating mainly to the growth of GDP and, in particular, domestic demand) proved to be worse than expected, which resulted in NBP decreasing its projections with regard to future GDP and inflation. As it became more probable that the inflation rate in 2005-2006 will be below the NBP's inflation objective, the Polish Monetary Policy Council decided to decrease interest rates in the period from March to August by 200 base points altogether (by 225 base points in the case of the bills of exchange rediscount rate). As a result, at the end of 2005, the NBP reference rate amounted to 4.5%.

1.3 Financial market

During the year 2005, a significant decrease was recorded in the profitability of the Polish Treasury securities, which varied from 190 b.p. in the case of short-term instruments to 80 b.p. in the case of long-term bonds. At the same time, in the fourth quarter of 2005 the profitability of Treasury securities increased, mainly due to increased uncertainty relating to the development of political situation after the September Parliamentary and October Presidential elections. Another factor which contributed to the decrease in the prices of Polish Treasury securities was related to the fact that investors no longer expected any further decreases in interest rates by the Monetary Policy Council.

In 2005, the Polish zloty appreciated by more than 5% in relation to euro and depreciated by 9% in relation to US dollar (data at the year-end). The depreciation of the Polish zloty in relation to the US dollar was due to a strong appreciation of the US dollar on the world markets in 2005. 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 the high demand from investors for Central European currencies.

1.4 Regulatory environment

Major changes in the regulatory environment which had an influence on the position of PKO BP SA in 2005 related to the following:

- Amendments of 27 August 2004 (Journal of Laws No. 213 item 2155), which imposed an obligation on listed companies to prepare their consolidated financial statements in accordance with the International Accounting Standards, International Financial Reporting Standards, as well as amendments to executive regulations in the area of accounting, including the Decree of the Minister of Finance dated 10 December 2001 on the specific accounting principles for banks (Journal of Laws No. 149 item 1673 with subsequent amendments), which requires that banks measure specific financial assets and liabilities at amortised cost using the effective interest rate method,
- New rules regulating the functioning of the capital market, introduced as of 24 October 2005 by three acts comprising the new capital market law: the Act on Capital Market Supervision, the Act on Trading in Financial Instruments and the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies; those acts created conditions for further liberalisation of the capital market and increase in competition by, among others, allowing brokers to carry out transactions in securities outside the stock exchange market, enabled better protection of investors' interests, introduced changes to the reporting requirements for issuers of securities listed on the stock exchange market and made it easier to undertake brokerage activities;
- Changes in the definition of "own funds", modification of prudence regulations, including changes in calculation of capital adequacy, made on the basis of the Banking Law Act amended in 2004 (Journal of Laws No. 91 item 870) and the executive regulations issued for this Act (Resolution 4/2004 of the Banking Supervisory Commission and Resolution 6/2004 of 8 September 2004 – NBP Journal No. 15 items 25 and 27);
- Amendments to the VAT Act and the related executive regulations relating to, among others, tax reliefs for bad debts, definition of taxable income, new exemptions in the scope of taxable trading, list of deductible input VAT items;



- Increase in banks' costs due to increased protection of consumer rights (relates to the loss of copies of certain banking documents by the clients), resulting from the Banking Law amended in 2004 (Journal of Laws No. 91 item 870);
- Decrease in the banks' share in the EU Guarantee Fund (*Fundusz Poręczeń Unijnych*) in relation to the interest revenues from the obligatory reserve, according to the Law on the EU Guarantee Fund (Journal of Laws 2004, No. 121 item 1262);
- Reduction of banks' costs relating to the bank deposits guarantee system, resulting from the decrease in the obligatory annual payment and the ratio determining the amount of the guaranteed funds;
- New requirements for banks concerning banking secrecy, resulting from the amendments to the Act on Protection of Classified Information;
- Modified requirements for reporting to the Securities and Exchange Commission (KPWiG) as well as the National Bank of Poland and the General Inspectorate for Banking Supervision (GINB) in respect of information required for defining monetary policy and assessing country's monetary situation, banks' financial standing and banking risk, as well as additional reporting requirements relating to taxation of interest on deposits held by non-residents and requirements relating to identification of such individuals;
- Changes in the conditions that must be met while carrying out brokerage activities, including with respect to services provided, settlements processing, transaction recording, loan collaterals, issuing loans for the purchase of securities admitted to public trading by banks conducting brokerage activities, as introduced by the Decree of the Council of Ministers dated 19 April 2005 and the amended reporting requirements concerning brokerage and trust fund activities;
- Changes in tax proceedings resulting from the amended Tax Ordinance Act, including in authorisation for taxpayers to issue guarantees and grant suretyships in order to secure tax liabilities;
- New regulations concerning operating risk management, determined in Recommendation M of the Chief Inspector for Banking Supervision.

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

In addition, the Bank's activities in the year 2005 were also affected by the preparation for the introduction of new capital adequacy regulations based on the New Capital Accord (Basel II Accord).

1.5 Competition in the banking sector

In 2005, majority of banks observed an increase in income from banking activities and a significant improvement in the efficiency of operations. As a result, the banking sector reported the highest ever financial result. This was due to the following factors:

- increase in household demand for loans, especially mortgage loans and credit cards,
- further improvement in quality of bank loan portfolios,
- increase in the amount of deposits held by banks' clients.

The most important factors that affected the development of the banking sector were as follows:

- increasing competition on the banking services market, resulting, among others, in:
 - development of financial services offered by non-banking institutions, in particular investment funds, financial intermediaries, lease companies, factoring companies, SKOKs and supermarket and gas station chains;
 - extension and modernisation of banking products for individual and corporate customers; in particular, banks intensively developed products relating to housing loans, *bancassurance* and capital market products, as well as products for small and medium enterprises and local authorities, including assimilation of the EU aid funds. Banks have diversified the prices of their services by promoting loyalty programs and packages;



- e-banking development, including the development of credit card products and on-line services for individual and corporate customers;
- extension of distribution channels for banking products; banks modernised their existing and opened new outlets, concluded agreements for cooperation with financial intermediaries, agreements for mutual cash dispenser services and developed direct and Internet sales; the development of business activities was accompanied by an increase in the level of employment and the standard of customer service;
- reducing operating expenses via *outsourcing* – more and more banks opted for *outsourcing* in certain areas of their activities; this related in particular to administrative functions, IT support, legal services, debt collection and pay card processing;
- entrance of new foreign competitors to the Polish banking market – nearly 90 foreign banks, mainly from the European Union, expressed their interest in providing products and services in a cross-border form in the area of real estate financing, mortgage loans, asset management, servicing the most affluent clients, as well as the provision of financial services to local governments;
- merger of European financial groups, UniCredito and HVB, resulting in the potential formal merger of two Polish banks – Pekao SA and BPH SA.

2. MAJOR EVENTS THAT HAD A SIGNIFICANT INFLUENCE ON THE BANK'S ACTIVITIES AND RESULTS

Major events that had a significant influence on the Bank's activities in the year 2005 were related to its business activities and have been described in the following sections of this Report.

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

In 2005 the Bank completed the implementation of the Bank's Modernisation Strategy for the years 2003-2005. On 8 December 2005 the Supervisory Board of the Bank approved the Strategy of PKO BP SA for the years 2006-2008. This is an Innovation Strategy, and its implementation will ensure dynamic activities of the Bank on new markets, as well as creating new quality of the Bank's products and customer service based on modern solutions in the area of management, and in particular in the area of corporate culture.

While strengthening its strong position on the retail banking market and its leading role on the market of housing loans, the Bank also intends to strengthen its position in services offered to businesses, including small and medium enterprises. As an entity which has a significant influence on the stabilisation of the Polish financial system, PKO BP SA will take an active part in the processes of market consolidation and will strengthen its position on foreign markets. It will effectively manage the capital entrusted to the Bank by its shareholders and will create conditions for satisfactory professional development for its employees.

In order to strengthen its market position and improve the effectiveness of its operations, PKO BP SA intends to:

- intensify organic development by maintaining the existing customers and active acquisition of new customers in all market segments,
- continue to expand its operations on the most attractive markets of Central and Eastern Europe,
- develop a multi-channel sales network which will improve the effectiveness of the customer service system,
- develop an effective Group to create new opportunities for distribution of its products and services,
- optimise the costs of the Bank's operations,
- protect business profitability, among others by increasing other-than-interest revenues and stabilising interest revenues,
- diversify the sources of income, among others by expanding and modernising the scope of the Bank's activities and increasing the effectiveness of the Bank's capital exposures,
- prepare for the implementation of the capital adequacy rules based on the New Capital Accord,
- implement modern technological and IT solutions,
- effectively develop intellectual resources.



The financial effects that PKO BP SA may achieve at the end of 2008 by implementing the Innovation Strategy are as follows:

- ROE of app. 20%,
- The costs to income (C/I) ratio at the level of 57%,
- The result on commission and fees to administrative expenses (without depreciation) ratio at the level of 56%.

4. FINANCIAL PERFORMANCE OF THE BANK

The Bank did not publish any forecasts concerning its financial performance for the year 2005.

4.1 Balance sheet structure

4.1.1 Assets

Table 1. Major asset categories (in PLN thousands)

Assets	As at:		Change	
	31.12.2005	31.12.2004	PLN thousands	%
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
1. Cash and balances with the Central Bank	3 832 695	3 490 505	342 190	9.8%
2. Amounts due from banks	12 631 446	13 146 115	(514 669)	(3.9%)
3. Financial assets	841 914	346 131	495 783	143.2%
4. Derivative financial instruments	1 137 227	1 362 379	(225 152)	(16.5%)
5. Other financial instruments valued at fair value through profit or loss	20 034 160	0	20 034 160	x
6. Loans and advances to customers	46 051 847	39 577 723	6 474 124	16.4%
7. Investment securities	1 857 578	23 498 314	(21 640 736)	(92.1%)
8. Property, plant and equipment	2 201 163	2 218 233	(17 070)	(0.8%)
9. Other assets	1 739 486	1 472 196	267 290	18.2%
Total assets	90 327 516	85 111 596	5 215 920	6.1%

In comparison to 2004, the most significant change in the structure assets is the transfer of assets from "Investment securities" to "Other financial instruments valued at fair value through profit or loss" in connection with separation of the ALPL¹ portfolio from the previous "available for sale" portfolio. This allowed the Bank to reflect the results from valuation of hedged items and hedging instruments within the same category of the profit and loss account, which increased the transparency of presented results from valuation of debt securities.

The most significant item in the Bank's assets (51.0%) consists of loans and advances to customers.

¹ Assets and liabilities at fair value through profit or loss



Table 2. Loans and advances granted to the Bank's customers (in PLN thousands)

Item	As at		Change	
	31.12.2005	31.12.2004	PLN thousands	%
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
1. Gross loans and advances granted to customers, of which:	48 919 393	42 184 202	6 735 191	16.0%
- public sector	6 749 221	7 613 858	(864 637)	(11.4)%
- financial sector (except for banks)	809 674	615 938	193 736	31.5%
- non-financial sector	41 360 498	33 954 406	7 406 092	21.8%
2. Allowances for impaired loans	(2 867 546)	(2 606 479)	(261 067)	10.0%
Loans and advances to customers	46 051 847	39 577 723	6 474 124	16.4%

Receivables from customers with maturities over 1 year had a predominant role in the aging structure of gross loans and advances as at 31 December 2005 and 2004. Their total share in the Bank's loan portfolio increased from 62.7% at the end of 2004 to 64.4% at the end of 2005. In the aging structure of receivables, the greatest increase (by 3.0 pp.) was observed in the category of receivables due in more than 5 years, which was mainly due to the high dynamics of long-term housing loans.

Detailed information about maturity term of loans and advances granted to customers are included in note 25 of additional notes to financial statements.

4.1.2 Equity and Liabilities

Liabilities

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

Item	As at		Change	
	31.12.2005	31.12.2004	PLN thousands	%
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
1. Liabilities, of which:	81 547 122	76 204 549	5 342 573	7.0%
- Amounts due to the Central Bank	766	144	622	431.9%
- Amounts due to other banks	1 943 035	800 403	1 142 632	142.8%
- Derivative financial instruments	1 257 384	793 739	463 645	58.4%
- Amounts due to customers	75 886 880	72 576 273	3 310 607	4.6%
- Other liabilities	2 459 057	2 033 990	425 067	20.9%
2. Total equity	8 780 394	8 907 047	(126 653)	(1.4)%
Total liabilities and equity	90 327 516	85 111 596	5 215 920	6.1%

The most significant item of liabilities and equity (84.0%) consists of amounts due to customers, which amounted to PLN 75,887 million as at 31 December 2005 and increased by 4.6% compared to the balance at the end of 2004. This represented the main source for financing of the Bank's activity.

As at 31 December 2005, the main item in the Bank's liabilities to customers (accounting for 82.9% of the total balance) consisted of amounts due to private customers, which amounted to PLN 62,941 million. The most significant item in this category consisted of term deposits, which amounted to PLN 42,289 million at the end of 2005 and decreased by 1.0% compared to the end of 2004.

The following changes took place in amounts due to customers compared to the end of 2004:

- amounts due to corporate entities increased by PLN 3,272 million (i.e. 50.4%) - this mainly related to term deposits, which increased almost twice,
- amounts due to private customers increased by PLN 2,222 million (3.7%) – of which current deposits increased by PLN 2,685 million (15.0%),



- amounts due to public sector entities decreased by PLN 2,183 million (40.7%) – the main reason for such a decrease was the withdrawal of funds by the Ministry of State Treasury in accordance with the Act on Bank Gospodarstwa Krajowego of 14 March 2003 and the Decree of the Minister of Finance dated 28 December 2004 on the rules for investing public funds.

Compared to the end of 2004, in the amounts due to customers by maturity structure, an increase was observed in amounts due to customers within up to 3 months (including current accounts and overnight deposits), which increased by 12.1 % compared to the end of 2004, while the balance of deposits with maturities over 3 months decreased by 15.4 %. This had an impact on the aging structure of amounts due to customers, in which the percentage of amounts due to customers within up to 3 months increased from 72.7% to 77.9%, with a corresponding decrease in the percentage of liabilities with longer maturity periods. Liabilities with maturities over 1 year comprise approximately 2% of total amounts due to customers.

4.2 Off-balance sheet items

Table 4. Off-balance sheet items (in PLN thousands)

Item	As at		Change	
	31.12.2005	31.12.2004	PLN thousands	%
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
I. Contingent liabilities granted:	10 533 845	7 148 458	3 385 387	47.4%
1. Financial	9 025 801	6 290 493	2 735 308	43.5%
2. Guarantees	1 508 044	857 965	650 079	75.8%
II. Liabilities arising from purchase/sale transactions	279 032 527	170 088 351	108 944 176	64.1%
III. Other	11 422 181	12 368 143	(945 962)	(7.6)%
1. Irrevocable liabilities	8 519 942	9 504 544	(984 602)	(10.4)%
2. Collaterals received	2 902 239	2 863 599	38 640	1.3%
Total off-balance sheet items	300 988 553	189 604 952	111 383 601	58.7%

In comparison to the balance as at the end of 2004 total off-balance sheet liabilities of PKO BP SA increased by 58.7%, mainly due to increase in liabilities related to purchase/sale transactions, which increased by 61.4%. This item mainly consisted of derivative transactions and forward exchange transactions which were concluded by PKO BP SA in order to manage the Bank's foreign currency liquidity as well as for speculation and arbitrage purposes.

4.3 Profit and loss account

Table 5. Main profit and loss account items (in PLN thousands)

Item	2005	2004	Dynamics
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
1. Net interest income	3 473 829	3 471 947	100.1%
2. Net fees and commission income	1 169 839	1 581 055	74.0%
3. Dividend income	28 881	22 291	129.6%
4. Result from financial instruments at fair value	30 579	(45 976)	X
5. Result from investment securities	276 724	(21 028)	X
6. Foreign exchange result	613 715	434 934	141.1%
7. Net other operating income	209 967	133 467	157.3%
8. Total income items (1-7)	5 803 534	5 576 690	104.1%
9. Impairment losses	(98 900)	(133 274)	74.2%
10. General administrative expenses	(3 631 324)	(3 645 236)	99.6%
11. Profit before taxation	2 073 310	1 798 180	115.3%
12. Income tax expense	(396 512)	(350 330)	113.2%
13. Net profit	1 676 798	1 447 850	115.8%



4.3.1 Income items

In the profit and loss account for the year 2005, the total of income items amounted to PLN 5.804 million and was PLN 227 million (4.1%) higher than in 2004. The main items comprising this amount were net interest income and net fees and commission income.

Net interest income

Table 6. Interest income and expense

Item	2005	2004	Dynamics
1	2	3	4
1. Interest income, of which:	5 515 887	5 244 964	105.2%
- from loans and advances granted to customers	3 433 506	3 005 397	114.2%
- from securities at fair value through profit or loss	1 256 445	1 398 947	89.8%
- from placements with other banks	600 319	421 924	142.3%
- from investment securities	135 317	323 022	41.9%
- other	90 300	95 674	94.4%
2. Total interest expense, of which:	(2 042 058)	(1 773 017)	115.2%
- relating to amounts due to customers	(1 882 525)	(1 600 753)	117.6%
- relating to deposits from other banks	(72 054)	(53 905)	133.7%
- other	(87 479)	(118 359)	73.9%
Net interest income	3 473 829	3 471 947	100.1%

The net interest income consists of interest income of PLN 5,516 million and interest expense of PLN 2,042 million, which increased, respectively, by 5.2% and 15.2% in comparison to 2004. Higher dynamics of expenses was connected to an increase in the volume of deposits and better competitive position of the Bank with respect to deposit interest rates.

The most significant item in the Bank's interest income in 2005 was income from loans and advances granted to customers, which accounted for 62.2% of total interest income (4.9 pp. increase in relation to 2004), and then interest income from securities at fair value through profit or loss, which accounted for 22.8% of total interest income (3.9 pp. decrease in relation to 2004). These securities mainly included bonds and Treasury and money bills.

In the structure of interest expense in 2005, the most significant item was the expense related to amounts due to customers, which accounted for 92.2% of total interest expense and increased by 1.9 pp. in relation to 2004.

In 2005, the average interest rate of loans was 7.7%², while the average interest rate of deposits was 2.6%³. Compared to 2004, these rates increased by 0.3 pp. in the case of deposits and remain unchanged in the case of loans and advances.

² The average interest rate for loans was calculated as the relation of interest income from loans to the average balance of loans in the reporting period.

³ The average interest rate for deposits was calculated as the relation of interest expense relating to deposits to the average balance of deposits in the reporting period.



Net fees and commission income

Table 7. Fees and commission income and expense (in PLN thousands)

Item	2005	2004	Dynamics
1	2	3	4
1. Fees and commission income, of which:	1 502 668	1 865 208	80.6%
- from loans and advances granted by the Bank	65 798	483 711	13.6%
- other	1 436 870	1 381 497	104.0%
2. Total fees and commission expense	(332 829)	(284 153)	117.1%
Net fees and commission income	1 169 839	1 581 055	74.0%

Net fees and commission income decreased by 26% in relation to 2004. The reasons of the above were lower incomes and higher costs generated by the Bank in comparison to 2004.

The decrease in fees and commission income mainly relates to income from loans and advances, which decreased by 86.4% due to the fact that, starting from 2005, such income is deferred and measured at amortized cost using the effective interest rate, which discounts the expected cash flows to net carrying amount over the period to maturity. Fees and commissions are included in the calculation of the effective interest rate because they are an integral part of the effective return on the loan or advance and adjust their carrying amount.

In terms comparable with 2004, i.e. including all fees and commissions recognised on a cash basis in 2005, the dynamics of fees and commission income would amount to approximately 111%.

As of 1 January 2006, the Bank introduced a new "Table of Banking Fees and Commission Rates". This change resulted from market conditions and new products and services offered by the Bank.

Other income items

The total of other income items (other than net interest income and net fees and commission income) amounted to PLN 1,160 million and increased more than twice (+121.5%) in comparison to 2004. This was due to the following:

- The result from financial instruments at fair value, which was negative and amounted to PLN (-) 31 million, was PLN 77 million better than the corresponding balance in the previous year;
- The result from investment securities amounted to PLN 277 million (an increase of PLN 298 million compared to 2004) – the increase was a result of an increased activity of the Bank on the Stock Exchange, especially in the third quarter of 2005, due to the boom on the stock exchange market during this period;
- Foreign exchange result amounted to PLN 614 million and increased by 41.1% in relation to 2004, mainly due to better result on FX SWAP and CIRS transactions (the result on these transactions is of an interest type);
- Net other operating income amounted to PLN 210 million (an increase of 57.3%) and consisted of other operating income of PLN 260 million and other operating expense of PLN 50 million;
- Dividend income amounted to PLN 28.9 million (an increase of 29.6%).

4.3.2 Impairment losses

The result from impairment losses amounted to PLN (-) 99 million in 2005 and improved by PLN 34,4 million compared to 2004. This was due to better quality of the loan portfolio as well as the finalisation in the fourth quarter of 2005 of the sale of a portfolio of doubtful retail debts and the reversal of the related specific provisions.



4.3.3 General administrative expenses

In 2005, the Bank's general administrative expenses amounted to PLN 3,631 million and decreased by 0.4% in relation to 2004.

The individual expense items were as follows:

- Employee costs – personnel costs incurred by the Bank in 2005 amounted to PLN 1,973 million and increased by PLN 86.9 million, i.e. 4.6%, compared to 2004. The main reason for the increase was a change in the salaries level in the Bank. The employment level in the Bank at the end of 2005 was 33,479 employees and decreased by 1,907 employees compared to 31 December 2004. The increase in the costs of salaries was the result of the Bank's strategy aimed at adjusting the salaries level in the Bank to the average salaries level in the banking sector in Poland and the planned restructuring of employment;
- Non-personnel costs amounted to PLN 1,178 million in 2005 and decreased by PLN 48.7 million, i.e. 4.0%, compared to 2004;
- Depreciation of tangible fixed assets and amortization of intangible assets amounted to PLN 419.3 million in 2005 and decreased by PLN 52.1 million, i.e. 11.1%, compared to 2004;
- Other administrative expenses in 2005 amounted to PLN 61 million, which was slightly less than in 2004. The main items are: taxes and charges, which amounted to PLN 52.9 million in 2005 and increased by 7.6 % compared to 2004, and contribution to the Banking Guarantee Fund, calculated as a specific percentage of assets weighted by risk (determined separately for each year), which in 2005 amounted to PLN 8 million and decreased by PLN 3.7 million, i.e. 31.8%, compared to 2004.

4.3.4 Key financial ratios

PKO BP SA's financial results for 2005 resulted in the following levels of the key financial ratios:

Ratio	2005	2004
1	2	3
1. Profit (loss) before taxation / average assets (ROA ⁴ _{gross})	2.36%	n/a ⁵
2. Net profit (loss) / average assets (ROA _{net})	1.91%	n/a
3. Profit (loss) before taxation / average equity (ROE ⁶ _{gross})	23.44%	n/a
4. Net profit (loss) / average equity (ROE _{net})	18.96%	n/a
5. General administrative expenses / total income items (C/I)	62.57%	65.37%

⁴ 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 end of the reporting period.

⁵ The ROA gross and ROA net ratios for the year 2004 can not be calculated comparable to 2005 owing to lack of information about opening balance of assets and equity according to MSSF i.e. as at 31 December 2003

⁶ 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 end of the reporting period.



4.4 Equity and Capital Adequacy Ratio

Table 8. Equity of PKO BP SA (PLN thousands)

Item	As at		Change by:
	31.12.2005	31.12.2004	
1	2	3	5
1. Share capital	1 000 000	1 000 000	0.0%
2. Other capital items	5 672 620	5 900 933	(3.9)%
3. Retained earnings	430 976	558 264	(22.8)%
4. Net profit for the period	1 676 798	1 447 850	15.8%
Total equity	8 780 394	8 907 047	(1.4)%
Capital adequacy ratio	14.06	18.70	4.64 pp.

In comparison to 2004 the Bank's equity decreased by 1.4%. A decrease in equity in spite of the relatively high net profit for the period was the effect of a number of factors, among which the most significant were: the appropriation of PLN 1 billion from the net profit for 2004 to shareholder dividends, adjustments made in respect of IAS 39 and reduction of the revaluation reserve.

The capital adequacy ratio as at 31 December 2005 was 14.06% and decreased by 4.64 percentage points in relation to 2004.

The following reasons contributed to the decrease of the capital adequacy ratio:

- decrease of the Bank's own funds used in the calculation of the ratio - mainly as a result of reduction of the revaluation reserve (due to revaluation gains realised on the sale of available for sale financial assets and transferred from the revaluation reserve to the result on financial operations in the profit and loss account) and an increase in the Bank's investment exposures which decreases the amount of the Bank's own funds used in calculation of the capital adequacy ratio,
- increase of the total capital requirement - mainly due to the increase of assets with a risk weighting of 100% as a result of growth of the loan portfolio and the application of the amended rules for calculating capital requirements which came into force on 1 January 2005.

5. KEY BUSINESS AREAS

At 31 December 2005, the balances of interest-bearing assets and liabilities (deposits) resulting from the Bank's business activities were as follows:

Table 9. Gross interest-bearing assets of PKO BP SA (in PLN millions)

Item	31.12.2005	31.12.2004	Change by:
1	2	3	4
I. Gross loans ^{*)}, of which:	48 723.1	41 108.8	7 614.3
- retail banking	11 357.9	9 527.4	1 830.5
- housing market (new portfolio)	16 820.1	13 324.1	3 496.0
- housing loans	2 959.4	3 085.2	(125.8)
- corporate ^{**)}	17 585.6	15 172.1	2 413.5
II. Securities and inter-bank placements	35 813.8	36 747.6	(933.8)
Gross interest-bearing assets (I+II)	84 536.9	77 856.4	6 680.5

Source: Bank's management data

^{*)} without interest

^{**)} For comparability purposes, loans granted to SMEs are included in the corporate market.

At the end of 2005, the Bank's gross interest-bearing assets amounted to PLN 84.5 billion and increased by PLN 6.7 billion (i.e. 8.6%) compared to 31 December 2004. Loans accounted for 58% of



the total amount of interest-bearing assets and, compared to the end of 2004, this share increased by 5 pp. due to the growth in the balance of loans which amounted to 118.5%.

At 31 December 2005, the gross value of loans granted by PKO BP SA amounted to PLN 48.7 billion and increased by PLN 7.6 billion i.e. 18.5% throughout the year 2005.

Table 10. Interest-bearing liabilities (deposits) of PKO BP SA (in PLN millions)

Item	31.12.2005	31.12.2004	Change by:
1	2	3	4
Deposits:			
- retail banking	53 506.1	52 932.6	573.5
- housing deposits	8 834.5	7 327.8	1 506.7
- corporate deposits*	13 658.9	12 106.3	1 552.6
- other (treasury operations, capital investments, BDM brokerage house)	2 050.2	894.6	1 155.6
Total deposits	78 049.7	73 261.3	4 788.4

Source: Bank's management data

*) For comparability purposes, SMEs' deposits are included in the corporate market.

As at 31 December 2005, the Bank's interest-bearing liabilities amounted to PLN 78 billion and increased by PLN 4.8 billion (6.5%) since the beginning of the year. Retail banking deposits accounted for 68.6% of the total amount of deposits and, compared to the balance at the end of 2004, this share decreased by 3.7 pp., for the benefit of the other types of deposits. In relation to 2004, retail banking deposits increased by 1.1%, housing deposits increased by 20.6%, corporate deposits (including SMEs) increased by 12.8% and other deposits increased by 129.2%.

As at 31 December 2005 the biggest part in structure of deposits territorial base had the following regions (including retail banking and corporate deposits): Mazowiecki (24.3%), Śląsko-Opolski (12.4%) and Wielkopolski (10.1%). Their share in total deposits of the Bank amounted 46.80 % and decreased by 2.2 pp compared to 2004.

Table 11. Bank accounts and pay cards issued by PKO BP SA (in thousands)

Item	31.12.2005	31.12.2004	Change by:
Total number of bank accounts, of which:	5 903	5 512	391
- savings-giro (ROR) accounts	5 349	5 148	201
- Inteligo accounts	554	364	190
Number of pay cards	6 076	5 443	633
of which: credit cards	525	327	198

Throughout the year 2005, the number of savings-giro (ROR) accounts and Inteligo accounts increased by the total of 391 thousand and amounted to 5,903 thousand as at 31 December 2005 (of which: the total number of Inteligo accounts amounted to 554 thousand).

Since the beginning of 2005, the number of payment cards issued by PKO BP SA increased by 633 thousand, of which 200 thousand accounted for an increase in the number credit cards.

5.1 Retail banking

The Bank's activities in the area of retail banking (including private banking) focused on maintaining the volume of deposits and increasing the volume of loans by increasing the attractiveness of products offered by the Bank and improving service quality and sales effectiveness through the completion of the following tasks:

- With respect to new, non-standard deposit products:
 - Introducing to the Bank's offer an annual structural deposit (*Lokata Bawarska*) – with a guaranteed interest rate which may be increased depending on the EUR/PLN exchange rate,
 - Conducting a subscription campaign for *Lokata Czeska* – 12-month deposit with an attractive interest rate and progressive structure,



- Sales of *Lokata Paryska* - 12 to 60-month deposit with an attractive, progressive interest rate structure; the holders of such deposits who opened a savings-giro (ROR) account with the Bank have been additionally released from the fees charged by the Bank for maintaining such accounts for a period of 6 months,
- Conducting a subscription campaign for *Lokata Flamenco* – 12-month deposit combined with investing funds in trust fund units;
- For the private banking customers there were implemented financial advisory services regarding different forms of investments;
- With respect to consumer loans:
 - introduction of a new loan product - "Quick Credit Service" (*Szybki Serwis Kredytowy*), which changes the form of cooperation with the clients from the previous one which focused on financing only defined client needs to one which allows for flexibility in the relationships with the client without the need to focus on the target of financing, while maintaining the same level of risk;
 - introduction of a new loan product – a loan secured by shares acquired free of charge;
 - modification of credit risk assessment concerning financing of those customers, who applied for revolving credit in the current account, which consists in the introduction of the system of behavioural scoring, which will significantly increase the efficiency of the decision taking process and will enable the Bank to manage the related credit risk,
 - modification of the Quick Credit Service facility, which consists in providing clients with the possibility of taking a loan and signing an insurance contract which will increase safety of the client and his/her family; such insurance relates to the repayment of the loan in the case of the following events: loss of employment, death of the insured, permanent disability as a result of illness or accident and temporary disability as a result of accident;
 - The cash loan for the private banking customers offer modification: extension of the crediting time up to 96 months, cease certain limitation concerning collaterals, launching bill of exchange in blanco as the standard collateral for loan not exceeding given amount, implementation of new condition for non-residents for AURUM/PLATINIUM loans granting;
 - Sales performance improvement by granting INWESTOR credit for private banking customers for securities acquisition, including interest rates based on the arms length basis.
- With respect to investment banking, the most important activities of the Bank consisted in placing two new investment funds in the Bank's offer:
 - PKO/Credit Suisse Akcji Nowa Europa [New Europe] – which offers products tailored to the needs of private customers, in particular customers from the Private Banking sector who expect satisfactory return on investments,
 - PKO/Credit Suisse Światowy Fundusz Walutowy [World Monetary Fund] – offered to private customers, holders of foreign currency deposits placed with PKO BP SA and other banks in Poland and members of the foreign currency funds that were previously established on the Polish market.
- With respect to development and intensification of distribution channels:
 - Launching 90 Mobile Points of Sales focusing on the sales of the Quick Credit Service facility; by opening external points of sale of consumer loans in attractive locations, this project is targeted at customers who do not use banking services, do not have any loans and do not have a savings-giro (ROR) account with PKO BP SA;
 - Conducting an information campaign addressed to the holders of savings-giro (ROR) accounts concerning the PKO Inteligo e-banking services; throughout the year 2005, the Bank acquired 757 thousand customers who signed contracts for the use of on-line and call center services in relation to savings-giro (ROR) accounts and the Partner-type current accounts.

Moreover in the area of Private Banking launched sales of selected products via agents network, and also the number of partners of Privileges Programme AURUM/PLATINIUM significantly increased. This program enables clients to acquire products and services from non financial Bank's partners on the preferential conditions. Furthermore, the new condition of Privileges Programme were prepared



aiming to increase pay cards transaction ratio, through conditional preferences dependent on payment using the PKO BP SA card.

Small and medium-sized enterprises (SMEs)

The most important activities of the Bank in 2005 relating to small and medium-sized enterprises were as follows:

- Improving competitiveness of the Bank's products offered to SMEs and increasing availability of loans by:
 - Introducing the "Quick Credit Service" product, which creates new value in terms of time required to obtain the loan and documents that must be filled in when applying for the loan for financing current activities,
 - Modification of the Hipoteka PARTNER loan which finances real estate investments – the product is combined with loan repayment insurance granted by PZU S.A.,
 - Modification of the AUTO PARTNER loan which is designed to finance vehicle purchases,
 - Providing support to entrepreneurs - beneficiaries of the EU structural funds,
 - Initiating and developing cooperation with guarantee funds – overcoming barriers arising from the inability of small and micro-enterprises to provide collateral for a loan;
- creating a new value in cooperation with PKO BP SA agents and loan intermediaries, which creates conditions for an increase in the efficiency of these distribution channels in sales among small and medium-sized enterprises;
- cooperation with the European Bank for Restructuring and Development – as described in section 5.6 of this Report.

Cards issued by PKO BP SA

The total number of cards issued by PKO BP SA to retail customers increased by 631 thousand (12%) throughout the year 2005 and exceeded 6 million at the end of 2005.

As at 31 December 2005, the number of credit cards amounted to 525 thousand (an increase more than 60%) in relation to December 2004). Throughout the year 2005, the number of credit cards increased by 198 thousand.

The number of transactions executed using cards increased in 2005 by approximately 35% in relation to 2004.

Throughout the year 2005, the Bank enhanced attractiveness of its credit card offer by:

- conducting promotional sales of credit cards, including new cards with a sports-related image such as VISA Turyn, MasterCard FIFA World Cup, under which the Bank does not charge the fees for issuing and using the card during the first year of use;
- introducing the balance transfer service which allows for the transfer of the balance under the card previously used by the client to a new credit card issued by PKO BP SA;
- extending the interest-free period on non-cash transactions from 52 to 55 days and reducing the minimum repayment amount from 5 to 4%;
- reducing the minimum level of income required in order to obtain a credit card from PKO BP SA;
- conducting work on changes to the mechanism of charging fees for issuing and using credit cards, where the fee will be charged depending on the value of transactions made in the given month using the card.

In 2005 the Bank issued two new credit cards, dedicated to the Private Banking sector:

- PKO MasterCard Platinum,
- PKO Visa Infinite.

Other services

- Compensation payments made from State Treasury funds

Compensation is paid to public sector employees whose salaries were not revalued in the second half of 1991 or in the first half of 1992, and to pensioners who, in 1991, lost their pension increases or additional payments due for working in specific conditions or doing work of a specific nature.



In 2005, the Bank made 26.4 thousand payments to entitled persons, with a total value of PLN 77.5 million.

- Benefit payments made from Fundacja "Polsko-Niemieckie POJEDNANIE"

In 2005, the Bank made 158.2 thousand payments to entitled persons, with a total value of PLN 177.2 million.

5.2 Corporate banking

In 2005, the Bank's activities in the area of corporate banking focused in particular on improving the efficiency of corporate customer service in order to strengthen business relations, improve market position and create an image of the Bank as an active financial institution which is dynamically developing on the corporate market.

In pursuing its objectives the Bank focused on the following activities:

- extended and modified product offer;
- introduced package-based solutions which enable the Bank to develop appropriate product and price policy with respect to the individual customer segments, thus activating sales of particular groups of products;
- improved the sales system based on individual relationships between advisors and clients, which has been functioning since 2004;
- developed and implemented uniform standards in customer relationships;
- stimulated increase in the effectiveness and efficiency of operation of the network dedicated to corporate customer service;
- extended the scope of cooperation with existing clients, in particular by increasing transaction service.

In order to improve competitiveness of PKO BP SA's products designed for corporate customers, the Bank introduced new products, such as:

- trust account and conditional settlements account, designed for gathering funds and making settlements between business parties specified in the agreement;
- multi-purpose credit limit, under which the customer may benefit from different forms of financing, in different currencies depending on customer's current needs;
- the e-money instrument for entities making payments to retail customers.

In addition, the Bank continued the products development which will help to increase the Bank's other-than-interest revenues. As part of this work, in 2005 the Bank modernised the following:

- cash management services,
- launched *cash pooling* services dedicated to entities operating within the same capital group,
- developed the functionality of the Virtual Business Partner Account System,
- and the MultiCash home-banking system.

As at 31 December 2005, the number of cards issued by PKO BP SA to corporate clients amounted to approximately 51 thousand (of which 5.3 thousand related to a new product – the e-money payment instrument issued to the Municipal Social Assistance Center (*Miejski Ośrodek Pomocy Społecznej*) in Poznań. In 2005, the number of issued cards increased by 2 thousand.

In addition, the Bank's activities in the area of corporate banking included:

- issuing securities, as a result of which the Bank organised:
 - 38 issues of municipal bonds for a total amount of PLN 317.1 million, among others for the cities of Zamość, Świnoujście, Rzeszów;
 - 7 issues of corporate bonds for a total amount of PLN 753.3 million, of which the largest ones related to entities from the energy industry, development and investment industry and financial sector,
 - 2 issues of PKO BP SA commercial papers, for a total amount of PLN 300.8 million;



- cooperated with domestic financial institutions, thus contributing to the increase of activity on the debt securities market.

5.3 Real estate financing

In the area of real estate financing, PKO BP SA has the following types of loans:

- mortgage products for individual clients,
- investor loans,
- loans supported by the state budget, which were granted by the Bank until 31 March 1996 on the basis of separate regulations.

In the area of mortgage loans, in 2005 the Bank focused its real estate financing activities on maintaining its leading market position.

Loans supported by the state budget show a continued declining trend.

5.3.1 Mortgage loans for individual clients and investor loans

As at 31 December 2005, the credit exposure of mortgage loans products amounted to PLN 16.8 billion. Compared to the balance at the end of 2004, it increased by PLN 3.5 billion i.e. 26%.

The Bank maintains a very high share in the market of sales of PLN loans – average share in this market in 2005 amounted to 40%. At the same time, the Bank records a high level of sales of foreign currency loans – on average PLN 380 million per month, which translates into a 32% share in the market of foreign currency loans.

The sales of the mortgage loans products in 2005 amounted to PLN 7.5 billion, which means an increase of 42% and 71% in relation to 2004 and 2003, respectively. The highest levels of sales were recorded in June and December – PLN 788 billion and PLN 799 billion, respectively.

The sales of the WŁASNY KĄT loan predominated in the structure of sales in 2005 – they accounted for 81% of total sales. At the same time, an increase was noted in the percentage of mortgage collateralized non-housing loans – the share of consolidation loans in retail sales increased from 5% in 2004 to 6% in 2005.

The housing loan WŁASNY KĄT played a predominant role in the Bank's portfolio. The balance of such loans at the end of 2005 amounted to PLN 14.1 billion, which accounted for 85% of the total value of the "new" housing loan portfolio.

The following activities contributed to the high level of the Bank's sales:

- focusing on sales in big cities; the activities taken by the Bank resulted in an increase in the value of sales – in December 2005, sales in big cities amounted to PLN 322 million, which accounted for almost 50% of total sales.
- intensification of activities aimed at acquiring clients on the market of investment loans, which resulted in an increase in the sales of such loans; the growth in the sales of investment loans in 2005 in relation to the previous year amounted to 234%;

In order to enhance the attractiveness of its offer and tailor it to the clients' needs, the Bank:

- introduced unemployment and hospitalization insurance;
- modified the institution of Escrow Housing Account (*Mieszkaniowy Rachunek Powierniczy*) by introducing 3 types of accounts tailored to the nature of transactions carried out on the real estate market:
 - open and closed accounts designed for investors and used for collecting funds from home buyers,
 - transaction account designed for private customers who purchase homes on the secondary market;
- extended its investment loan offer by introducing loan facility commitment,
- introduced new referential rates for products addressed to private customers as well as expanded its offer in the area of referential rates for investment loans;



Furthermore, in order to attract new clients and increase the total value of extended credit facilities, the Bank prepared special financing programs for customers purchasing homes from developers, focusing in particular on housing projects co-financed by PKO BP SA; these special programs have been designed so as to attract as many clients as possible; they make it possible for home buyers to finance their housing investments using a double formula: an investment loan and a loan for the purchase of housing property.

In addition, the Bank implemented internal regulations regarding control over construction projects and rules for determining the value of property representing loan collateral.

The restructuring of the portfolio of loans with deferred payment was completed. As a result of taken action, about 7.3% of the number of loans and 8% of the value of deferred payment loans were converted to WŁASNY KĄT loans. As a result of the restructuring activities and repayments made by the borrowers, the balance of debt under these loans decreased in 2005 by approximately 32%.

5.3.2 Housing loans covered by state assistance ("old" housing loans)

At the end of 2005, the total balance of housing loans covered by state assistance amounted to PLN 2,778.4 million and decreased by PLN 286.3 million i.e. 9.3% compared to the balance at the end of 2004.

The loans subject to temporary redemption of interest, repaid according to the "normative" and "income" formulas, accounted for 96.6% of the old housing loans portfolio and thus played a predominant role in this portfolio.

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

- maintain a high level of recoverability,
- minimise the percentage of loans repaid according to the "quotient" formula,
- restructure irregular loans,
- continue to improve the quality of this portfolio under the terms of the new assessment methodology introduced in accordance with IAS 39.

5.3.3 Activities relating to deposits held on housing plan passbooks

As at 31 December 2005, PKO BP SA kept 2.1 million accounts for housing plan passbooks, with total savings of PLN 6,259.3 million.

In 2005, the Bank recorded an increase of 145.5 thousand in the number of passbooks without the right to guarantee premium and an increase of 4.4 thousand in the number of activated passbooks with guarantee premium, which resulted in an overall increase in the value of deposits of PLN 1,283.3 million. As a result of the above changes (and taking into account liquidations of passbooks with the right to guarantee premium), the structure of housing plan passbooks changed compared to the end of 2004: passbooks with the right to guarantee premium account for about 75.7% of total accounts (a decrease of 6.2%) and passbooks without the right to guarantee premium account for 24.3%.

5.3.4 Activities relating to corporate clients on the housing market

In 2005, 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.

This was achieved by:

- introducing a new investment loan "NOWY DOM remont" which includes a thermo-modernisation premium from BGK,
- making the PKO INTELIGO services available to housing communities,
- expanding cooperation with existing clients, in particular by providing transaction services and cash management services.

These activities resulted in:

- an increase in the volume of deposits and loans,
- an increase in the number of customers served by the Bank.



5.4 Activities on the money market

In 2005, the Bank's activity on the money market focused mainly on liquidity, interest rate and foreign exchange risk management, investment portfolio management and trade activities carried out on the inter-bank market and with the Bank's clients.

The most important activities focused on:

- bank debt securities portfolio management - during almost all of the first half of the year the duration of portfolio was lengthened, however in the second half of the year the utilisation of the current bank interest rate limits was lower,
- an increase of investments in securities denominated in foreign currencies; on the one hand this was due to an increase in surplus funds in EUR and USD, and on the other hand the requirement to diversify the portfolio of securities; the portfolio of foreign securities consists of treasury bonds and bonds issued by financial institutions; at the end of 2005, the value of the portfolio was PLN 2.3 billion and was almost three times higher in comparison with 2004,
- assuring long-term financing in CHF – in 2005 the level of structural exposure in this currency was increased almost to CHF 3 million (at the end of 2004 it was CHF 1 million); in 2005, the main instrument used to acquire financing on the interbank market consisted of long-term CIRS (Currency Interest Rate Swaps);
- the activity of Bank on the treasury securities market and interest rate derivatives - PKO BP maintained the position of one of the major market markers at this market; as a result of intense activities on this market, the bank gained the First Price in a ranking organised by the Ministry of Treasury for the selection of the Dealer in Treasury Securities; in 2005 the Bank made its first derivatives transactions on the Stock Exchange (futures for bonds), maintained high share in trading on the secondary market and in tenders organised on primary markets;
- development of transactions with non-bank clients – in 2005 the Bank extended its product offer related to derivatives (options, FX Swaps) and sales to non-bank clients increased by 64%.

5.5 Brokerage activities

In 2005 Bankowy Dom Maklerski PKO BP SA strengthened its position on the capital market. This was accompanied by a revival on this market – the main indices increased on average by 30% and the yearly turnover on the Stock Exchange increased by 58% and exceeded the amount of PLN 186 billion.

BDM PKO BP SA kept its position among the 10 leading brokerage houses and its share in the secondary market for all types of instruments increased throughout the year:

- the share in the sales on the stock market amounted to 8.1%, which accounts for a growth of 2.0 percentage points compared to 2004 (sixth position on the market in 2005, the seventh position in 2004);
- the share in the sales on the bond market amounted to 37.6%, which accounts for a growth of 8.8 percentage points compared to 2004 (first position on the market in 2005, the second position in 2004),
- the share in the sales on the forward market amounted to 6.0%, which accounts for a growth of 0.9 percentage points compared to 2004 (sixth position on the market in 2005, the seventh position in 2004);
- the share in the sales on the market of options for indices amounted to 9.0%, which accounts for growth of 3.0 percentage points compared to 2004 (fifth position on the market in 2004 and 2005).

At the end of 2005, the number of accounts (both investment and registration accounts) kept by BDM PKO BP SA was approximately 411 thousand. When compared to the end of December 2004, the number of accounts increased by approximately 13%, while the BDM turnover on the stock market amounted to PLN 14.6 billion, e.i. the turnover increase by 120%.

The value of assets held by customers on investment and registration accounts was PLN 18.4 billion at the end of 2005, which translates to a 36% increase compared to 2004.



As a result of its activities, BDM PKO BP SA received three awards from President of the Management Board of the Polish Stock Exchange:

- for the greatest share in the sales of bonds in 2005;
- for the greatest activity as an animator on the stock market in 2005;
- for introducing to the Stock Exchange the greatest number of new companies in 2005.

5.6 International cooperation

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).

As at 31 December 2005, the Bank has signed 1,775 loan agreements for a total amount of EUR 32.7 million. Apart from granting loans to small and medium-sized enterprises, PKO BP SA also participated in improving the lending process and identifying the needs of small and medium-sized enterprises in their relations with banks.

Cooperation with other foreign institutions

PKO BP SA signed five ISDA agreements with foreign banks and one annex to a previously signed framework agreement as well as one note agreement with a foreign bank.

Three *nostro* accounts have been closed. At 31 December 2005, the Bank holds 28 *nostro* accounts at correspondent banks, denominated in 12 currencies, and keeps 31 *loro* accounts denominated in three currencies for foreign banks.

The Bank signed two additional agreements to the Global Loan Agreement with the European Investment Bank:

- Amendment No. 1 dated 31 October 2005 – which postpones all deadlines in the agreement by one year,
- Amendment No. 2 dated 28 November 2005 – which supplements the agreement with the rules for using the Municipal Finance Facility and the Municipal Infrastructure Facility (credit lines available under the Global Loan and sponsored by the European Commission).

The Bank cannot use the Global Loan facility due to the fact that EIB did not agree the procedures for establishing pledges on Treasury securities in the National Depository for Securities (*Krajowy Depozyt Papierów Wartościowych - KDPIW*).

Cooperation with rating agencies

Rating scores 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 above agencies.

In 2005, the following rating agencies changed the ratings of PKO BP SA:

- Moody's – increased its financial strength rating twice: on 13 January from D+ to C- and on 28 November from C- to C,
- Capital Intelligence – on 1 February the Bank received a report from this agency on PKO BP SA, dated December 2004, in which the support rating was decreased from 1 to 2.

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 12. PKO BP SA ratings as at 31 December 2005

FITCH RATINGS	
Support rating	2
STANDARD AND POOR'S	
Long-term local currency liabilities rating	BBBpi
MOODY'S INVESTORS SERVICE LTD.	
Long-term deposit rating	A2 stable outlook
Short-term deposit rating	Prime-1 stable outlook
Financial strength	C stable outlook
CAPITAL INTELLIGENCE	
Long-term foreign currency liabilities rating	BBB+
Short-term foreign currency liabilities rating	A2
Local strength	BB+
Support rating	2
Outlook	stable

6. ORGANIZATIONAL AND CAPITAL RELATIONS

6.1 Investment activity

In 2005, the main changes in the capital and organizational relations within the group of related entities were as follows:

- the acquisition of 41.44% of shares in Centrum Obsługi Biznesu Sp. z o.o.,
- the repurchase from minority shareholders of shares in KREDOBANK S.A. (former Kredyt Bank (Ukraina) S.A.), representing 2.367% of the company's share capital; as a result of the above transaction, the Bank holds in total 69.018% of shares in the company's share capital, which entitle to 69.018% of votes at the Annual General Meeting;
- completion of the liquidation of PKO Towarzystwo Finansowe Sp. z o.o.;
- registration of increase in the capital of Kolej Gondolowa Jaworzyna Krynicka S.A.; the percentage of the share capital held by the Bank decreased from 38.23% to 37.83% and the percentage of votes at the Annual General Meeting decreased from 37.03% to 36.85%;
- incorporation of POMERANKA Sp. z o.o – a subsidiary of PKO Inwestycje Sp. z o.o. (which holds 100% of the company's share capital and votes at the Shareholders' Meeting);
- incorporation of UKRPOLINWESTYCJE Sp. z o.o based in Kiev – a subsidiary of PKO Inwestycje Sp. z o.o. (which holds 55% of the company's share capital and votes at the Shareholders' Meeting);
- the acquisition by PKO Inwestycje Sp. z o.o – a subsidiary of the Bank – of shares in Wilanów Investments Sp. z o.o. accounting for 49% of the company's share capital; as a result of the above transaction, PKO Inwestycje Sp. z o.o holds 100% of the company's share capital and 100% of votes at the Shareholders' Meeting;
- the acquisition by Bankowe Towarzystwo Kapitałowe S.A – a subsidiary of the Bank – of shares in FINDER Sp. z o.o. accounting for 42.31% of the company's share capital and 42.31% of votes at the Shareholders' Meeting;
- additional payment to PKO Inwestycje Sp. z o.o. in the total amount of PLN 87,500 thousand for realization of investment projects;
- registration by the National Bank of Ukraine of the change of the name of KREDOBANK S.A - former Kredyt Bank (Ukraina) S.A.,
- registration of the change of the name and scope of activities of Towarzystwo Kapitałowe S.A. – formerly Dom Maklerski BROKER S.A.; the current activities of the company are venture capital activities.



In addition, during the year 2005:

- the Bank sold its shares in Wschodni Bank Cukrownictwa S.A. (WBC S.A.). The shares, which were the subject of the transaction represented 25.1321% of the company's share capital and 25.1441% of votes at its Annual General Meeting. The assets disposed of by the Bank represented a long-term equity investment of PKO BP SA. The Bank acquired the shares in WBC S.A. in 2003 as a result of realisation of the restructuring program of WBC S.A.
- the Bank sold its shares in Łódzka Agencja Rozwoju Regionalnego S.A. The shares, which were the subject of the transaction represented 2.42% of the company's share capital and votes at its Annual General Meeting;
- the Bank made equity investments on the regulated market by making transactions within the portfolios controlled by the Equity Investment Department and BDM. The total value of the portfolios at acquisition cost as at 31 December 2005 was PLN 15.6 million and decreased by PLN 339.4 million in comparison to 31 December 2004.

Work connected with the development of the Group

In 2005, PKO BP carried on work connected with analysis of Central and Eastern European markets and an increase of control over PKO/Credit Suisse Towarzystwo Funduszy Inwestycyjnych S.A.

On 22 December 2005, the Management Board of the Bank provided the Polish Securities and Exchange Commission (KPWiG) with a notification about its intention to acquire registered shares of PKO/Credit Suisse Towarzystwo Funduszy Inwestycyjnych S.A. representing 25% of votes at its Annual General Meeting. As a result of this transaction, the Bank will hold 75% of the company's share capital and votes at the Annual General Meeting.

In the Bank's opinion, the capital and other investments planned by the Bank 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 2005, PKO BP SA provided the following services to related (affiliated) entities:

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

In addition:

- Under the cooperation agreement with Inteligo Financial Services S.A., in 2005 the Bank made payments to the company for a total amount of PLN 106.9 million; these payments were mainly related to remuneration for services arising from the company's day-to-day operating activities and the re-invoicing of the costs of Centrum Bankowości Elektronicznej Inteligo and the Call Center in Lublin;
- Under the lease agreement with Centrum Finansowe Puławska Sp. z o.o., in 2005 the Bank made payments to the company for a total amount of PLN 59.7 million; these payments were mainly related to rent and operating fees.

All significant PKO BP SA transactions with the PKO BP SA Group entities, including debts due to the Bank from these companies as at 31 December 2005, have been presented in the Additional Notes and Explanations to the financial statements of PKO BP SA for the year 2005.

Granted off-balance sheet liabilities

Off-balance sheet liabilities of a financial and guarantee nature granted to related entities as at the end of 2005 amounted to PLN 453.3 million, and decreased by PLN 259.0 million in comparison to the end of 2004.

Out of the total amount of these liabilities, PLN 328.3 million relates to liabilities granted to Bankowy Fundusz Leasingowy S.A., mainly in respect of open credit lines and issued guarantees, while PLN 81 million represents financial liabilities and open credit lines granted to Centrum Obsługi Biznesu Sp. z o.o.



All transactions with related entities were made on an arm's length basis. Maturity dates range from 1 month to 10 years.

Detailed information concerned organisational relationships is described in Note 1 of additional notes to the financial statements.

7. RISK MANAGEMENT POLICY

The risk management system is one of the most important internal process of the Bank supporting its operations. The system covers both credit risk management and market risk and operating risk management. The aim of the system is to ensure an appropriate level of security and profitability in a changing legal and economic environment.

7.1 Credit risk

The Bank's risk management system is subject to on-going improvement and adjustment to new sources and aspects of banking risk.

Assessment of credit risk related to institutional clients

The assessment of credit risk related to institutional clients is made in terms of the client and 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.

Assessment of credit risk related to individual clients

The assessment of credit risk related to individual clients is made in terms of borrowing power and credibility. The assessment of the borrowing power 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. In the third quarter of 2005, the Bank implemented behavioural scoring for revolving loans, which is used to set the limits of revolving loans for individual clients having savings-giro account (ROR) in PKO BP SA. The system covers almost 5 million accounts.

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. The amount of the Bank's loan exposure which requires the involvement of a credit committee in the lending process is uniform within the entire Bank and amounts to PLN 500 thousand.

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.

Impairment losses and provisions for credit risk

The Annual General Meeting of the Bank adopted a resolution according to which, as of 1 January 2005, the Bank would prepare both its quarterly consolidated reports and stand-alone reports in accordance with IFRS. Accordingly, in 2005 the Bank started to introduce regulations relating to identification of loan exposures subject to the risk of impairment and calculation of the amount of impairment losses in accordance with IAS 39. Internal regulations relating to classification of loan exposures and recognition of specific provisions in accordance with the decree of the Minister of



Finance on the principles of providing for risks connected with banking activities were amended as appropriate for reporting and taxation purposes.

Portfolio credit risk management methods

In 2005, the Bank continued its work aimed at fully implementing the solutions set out in the draft of the New Capital Accord (NCA) and in the European Union Directive. During that period, the Bank analysed its compliance with the requirements of NCA in the field of internal processes, IT systems and the required data. The analysis would enable the Bank to identify the areas which need to be adjusted and for which the Bank has to prepare a schedule of activities that must be undertaken in order to fulfil the NCA requirements.

The Bank continues its work connected to the development of portfolio credit risk measurement methodology and the widening of the estimated portfolio credit risk indicators. Portfolio credit risk measurement allows the Bank to account for credit risk in the price of its services, assess profitability adjusted for the risk factor, mould collateral policy application and determine the level of impairment write offs based on internal models.

In 2005, the portfolio credit risk analysis was expanded by all companies from the PKO BP SA Group.

In 2005 there was a improvement in the quality of credit portfolio. At the end of 2005, the ratio of total irregular loans calculated according to the decree of the Minister of Finance dated 10 December 2003 on the principles of providing for banking risks amounted 6.9% and decreased by 2.0 percentage points compared with the end of 2004. In accordance with IFRS, the percentage of loan exposures which fulfilled the conditions for individual impairment, representing an approximate equivalent of the share of the ratio of irregular loans to total loans, amounted to 6.3% in 2005.

7.2 Financial risk

In 2005, the Bank updated the rules and procedures concerning currency risk management, derivatives, liquidity and classification of transactions and calculation of capital requirements concerning different types of risk. The amendments to internal regulations were the result of changes in the Bank's activities, changes in macroeconomic and legislative environment, development of risk assessment methodologies and the results of analyses performed by the Bank.

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 2005, the process of implementing a specialized IT system supporting financial risk management was completed. The system will improve the operating efficiency and IT security of the financial risk management process; it will also increase the level of automation of computations and will allow for their centralization. Currently the Bank conducts post-implementation in order to adjust the IT system to current requirements of the Bank and to the changes in the macroeconomic environment in which the Bank operates.

Financial risk profile of the Bank in 2005

In 2005, as in previous periods, the Bank sustained high PLN liquidity, which throughout the year considerably exceeded the thresholds in all time horizons. In the previous year, the Bank changed PLN liquidity to foreign currency liquidity in order to finance foreign currency loans.

Interest rate risk indicators did not exceed the existing limits.

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

In 2005, the Bank verified the standing of financial institutions on a regular basis – through verification of granted credit and settlement limits.



7.3 Operational risk

Operational risk is understood in the Bank as the risk of a loss arising from non-compliance or weakness of internal processes, people and systems or 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 the operational efficiency of the Bank by reducing operating losses and costs and increasing the speed and adequacy of the Bank's response to events which are beyond the Bank's 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 2005, the Bank issued internal regulations concerning classification of operational events and the procedure for communicating operational events, and also the method of calculating economic capital for operational risk.

8. DISTRIBUTION CHANNELS

Branches

At the end of 2005, PKO BP SA had 1,251 units, of which:

- 1,168 units on the retail market, including: 12 regional retail branches, 537 independent branches, 619 subordinated branches; compared with the end of 2004, the total number of units decreased by 15,
- 83 units on the corporate market, including: 13 regional corporate branches, 13 corporate client teams and 57 corporate centres.

Agencies

Year 2005 was the period of further changes in the structure of PKO BP SA agencies. These changes resulted primarily from adjusting the rules of the Bank's cooperation with agencies to the provisions of the amended Banking Law. The Bank prepared a new template for agency contract and extended the scope of banking and actual activities outsourced by the Bank to its agents.

In 2005, the number of agencies decreased by 215 when compared with the previous year. As at 31 December 2005, the Bank cooperated with 2,510 agencies.

During the year 2005, the Bank issued approximately 53 thousand loans via its agencies, for a total amount of PLN 484 million (the amount of loans sold increased by 25.2% when compared with 2004). In addition, agencies acquired more than 50 thousand savings-giro accounts (ROR), which accounts for 7.5% of the total number of accounts acquired by the Bank.

The Bank's clients who make cash withdrawals using pay cards at POS terminals are now able to obtain information about the amount of cash available at their accounts. As at 31 December 2005, PKO BP SA agencies realised approximately 9 million cash withdrawals using cards at POS terminals, for a total amount exceeding PLN 2.8 million.

E-banking

In the area of e-banking, year 2005 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.

Throughout the year 2005, the Bank acquired 757 thousand customers with whom it signed contracts for the use of the Internet and phone services with respect to savings-giro (ROR) accounts and the Partner-type current accounts.

In the segment of customers with savings-giro (ROR) accounts, the percentage of the users of e-banking services amounts to approximately 13%, whereas in the segment of customers with Partner accounts – it amounts to approximately 28%. The total number of the users of e-banking services at the end of 2005, including the Inteligo account users, amounted to approximately 1,450 thousand, which gave the Bank the leading position in the e-banking sector in Poland.



During the year, the Bank expanded its e-banking services to include the possibility of printing out confirmations of realized transactions and sending the confirmations to the telefax number indicated by the client.

In addition, the Bank provided its Internet clients with the possibility of submitting loan requests under the Quick Credit Service facility. In the second half of 2005, the Bank expanded the range of clients using e-banking services to include housing communities holding the "Nasza Wspólnota" service package.

In the area of services for corporate client, the significant emphasis has been put on the further dissemination of *Multi Cash* electronic banking system. *Multi Cash* slowly becomes the major channel of communication between the Bank and corporate customers, at the same time being the tool for cost saving in this area.

The extensive usage confirmation of the electronic banking systems by the corporate customers is the share of electronic banking transfers in the total number of transfers, which amounted to almost 63% in second half of 2005. In comparison to 2004, in 2005 there was an increase of the number of contracts for *Multi Cash* system by almost 243%.

Self-service terminals and personnel support equipment

At the end of 2005, PKO BP SA had the largest ATM network in Poland, which accounted for 22%⁷ of all ATMs in Poland. At the end of 2005, the number of ATMs available to the Bank's clients was 1,862 (including 840 ATMs with deposit function). The PKO BP SA ATMs carried out more than 191 million transactions for a total amount exceeding PLN 46.5 billion. The percentage of transactions carried out at PKO BP SA ATMs using cards issued by other banks amounted to 5.22%. During the year 2005, the Bank accepted over 142 thousand deposit envelopes and sold 302 thousand Simplus mobile phone cards via its ATM network.

At the end of 2005, the number of self-service terminals available to customers within the PKO BP SA network amounted to 222.

At the end of 2005, the number of cash dispensers supporting the work of the PKO BP SA personnel amounted to 277.

9. INTERNAL CONSIDERATIONS

9.1 Organization of the Bank

Year 2005 was the first full financial year in which the Bank operated within the structures created as a result of the reorganisation process. The primary purpose of this reorganisation was to create appropriate conditions for the Bank's business activities development and to increase the effectiveness of the Bank's operations and control over the Bank's expenses as well as to prepare the Bank for implementation of the Integrated Information System, in particular by:

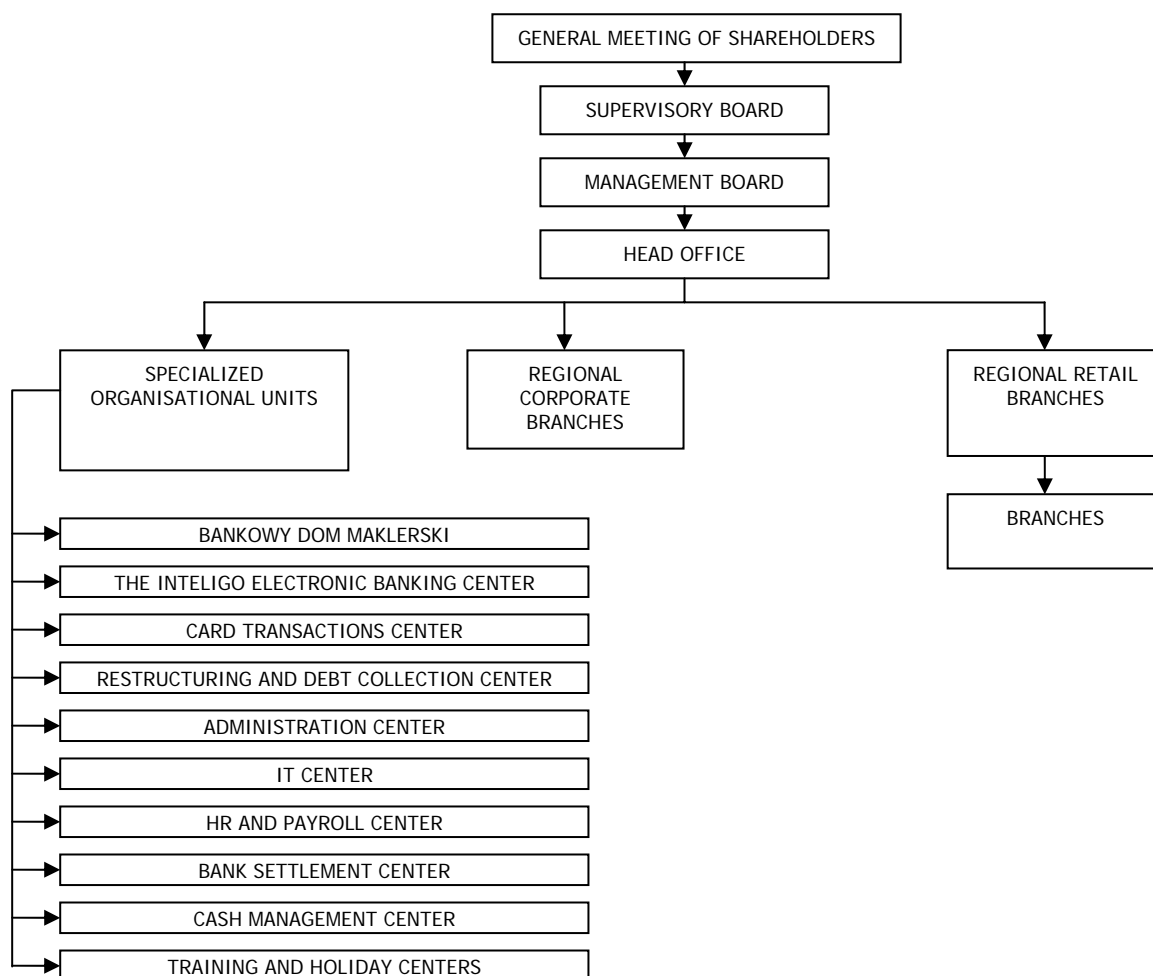
- focusing the operations of the business structures exclusively on tasks related to sales and on satisfying the requirements of the particular customer segments,
- concentrating support functions relating to the whole Bank in specialized organisational units or head office departments,
- clear assignation of responsibilities for business performance and cost optimisation,
- introducing changes to the system of internal regulations by replacing the existing instructions with principles, product certificates and procedures,
- standarisation of organisational structures for distribution network units.

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.

⁷ Data www.karty.pl – as at 16.11.2005



Organisational structure of the Bank





9.2 Management and Supervisory Boards in the reporting period

Members of Management Board in the reporting period

Starting from 19 May 2005, members of the Bank's Management Board are appointed for a common term of three years.

Table 13. Members of Management Board in the reporting period

No.	Name and surname	Function	Date of appointment
1.	Andrzej Podsiadło	President of Management Board	20.06.2002; 19.05.2005 re-appointed to another term
2.	Kazimierz Małecki	First Deputy President	04.07.2002; 19.05.2005 re-appointed to another term
3.	Danuta Demianiuk	Deputy President	02.01.2003; 16.09.2005 re-appointed to another term
4.	Sławomir Skrzypek	Deputy President	20.12.2005
5.	Piotr Kamiński	Member	10.03.2003; 16.09.2005 re-appointed to another term
6.	Jacek Obłękowski	Member	20.06.2002; 19.05.2005 re-appointed to another term
7.	Krystyna Szewczyk	Member	14.05.2004; 16.09.2005 re-appointed to another term

Other functions performed by Board members during the reporting period

Table 14. Other functions performed by Board members during the reporting period

No.	Name and surname	Assets and Capital & Liabilities Management Committee	Credit Committee	Steering Committee for the Integrated Information System	Steering Committee for Implementation of Branch Modernisation Program (set up on 15.03.2005)
1.	Kazimierz Małecki	Chairman		Chairman	
2.	Danuta Demianiuk	Vice-chairman	Chairman	Member	Vice-chairman until 19.12.2005
3.	Sławomir Skrzypek				Vice-chairman since 20.12.2005
4.	Piotr Kamiński		Vice-chairman		
5.	Jacek Obłękowski			Vice-chairman	Chairman
6.	Krystyna Szewczyk	Member		Vice-chairman	Member



Members of Supervisory Board

Table 15. Supervisory Board of the Bank in the reporting period

No.	Name and surname	Function	Date of appointment
1.	Bazyl Samojlik	Chairman Member Chairman	25.08.2003 19.05.2005 20.05.2005
2.	Urszula Pałaszek	Member Vice-chairman	19.05.2005 20.05.2005
3.	Krzysztof Zdanowski	Member Secretary	19.05.2005 23.06.2005
4.	Andrzej Giryn	Member Member	25.03.2002 19.05.2005
5.	Stanisław Kasiewicz	Member Member	25.08.2003 19.05.2005
6.	Ryszard Kokoszcyński	Vice-chairman Member	06.06.2002 19.05.2005
7.	Jerzy Osiatyński	Member Member	25.03.2002 19.05.2005
8.	Czesława Siwek	Member	19.05.2005
9.	Władysław Szymański	Member Member	25.03.2002 19.05.2005
10.	Arkadiusz Kamiński*	Secretary	25.04.2002

*The appointment of Mr Arkadiusz Kamiński expired on 29 April 2005 due to submitted resignation.

HOLDERS OF COMMERCIAL POWERS OF ATTORNEY, BOARD MEETINGS AND IMPLEMENTATION OF RESOLUTIONS OF GENERAL MEETINGS AND RECOMMENDATIONS OF THE STATE TREASURY MINISTER

As at 31 December 2004, there were 17 holders of commercial powers of attorney in PKO BP SA. During the year 2005, the Management Board of the Bank appointed 4 and dismissed 3 holders of commercial powers of attorney. As at 31 December 2005, there were 18 holders of commercial powers of attorney.

During the year 2005, the Management Board held 51 minuted meetings and took 364 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 Annual General Meeting of PKO BP SA was held on 19 May 2005.

The resolutions passed during the Annual General Meeting were implemented by PKO BP SA.

RULES FOR APPOINTING AND DISMISSING MEMBERS OF MANAGEMENT BOARD

In accordance with § 19 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 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 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.



Contracts concluded between the issuer and persons performing management functions

In accordance with the definition contained in § 1 section 2.1 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 Management Board are the persons who manage the Bank.

With each member of Management Board, the Bank concluded two contracts binding in 2005, 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 remuneration determined in the so-called "chimney law" (Act of 3 March 2000 on the remuneration of persons managing certain legal entities). (Journal of Laws No. 26, item 306 with subsequent changes)

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 46 of additional notes to the Bank's financial statements.

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

Bank's shares held by members of Management and Supervisory Boards as at 31 December 2005. The nominal value is PLN 1 per share.

Table 16. Shares held by members of Management and Supervisory Boards

No.	Name and surname	Number of shares held at the date of submitting this report
I. Management Board		
1.	Andrzej Podsiadło	450
2.	Kazimierz Małecki	2627
3.	Sławomir Skrzypek	-----
4.	Danuta Demianiuk	-----
5.	Piotr Kamiński	-----
6.	Jacek Obłękowski	512
7.	Krystyna Szewczyk	-----
II. Supervisory Board		
1.	Bazył Samojlik	-----
2.	Urszula Pałaszek	-----
3.	Krzysztof Zdanowski	-----
4.	Andrzej Giryn	-----
5.	Stanisław Kasiewicz	106
6.	Ryszard Kokoszcyński	-----
7.	Jerzy Osiatyński	-----
8.	Czesława Siwek	4000
9.	Władysław Szymański	-----

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

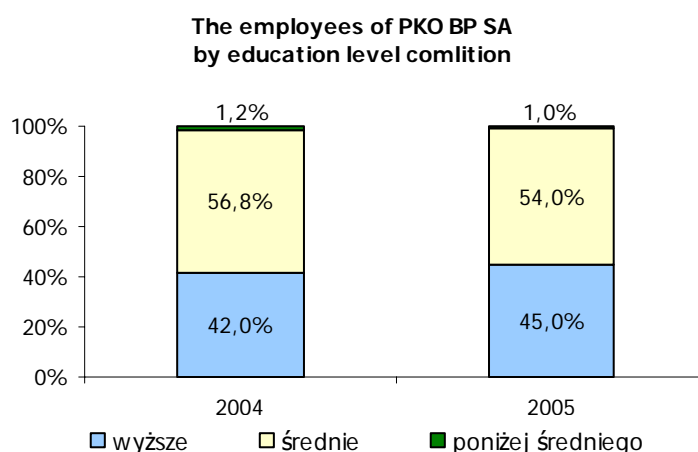


9.3 Human Resources

The number of PKO BP SA employees as at 31 December 2005 was 33,479 (in terms of full-time equivalent) and decreased by 1,907 i.e. 5.4% compared to 31 December 2004. Average number of employees in 2005 amounted to 34,522 (in terms of full-time equivalent) and decreased by 1,374 compared to 2004.

During the year 2005, the Bank continued the process of optimising employment in its organisational units by adjusting the number of employees, including specialized staff, to the tasks resulting from its strategic goals.

The activities undertaken by the Bank in 2005 were aimed at improving work effectiveness and efficiency and developing professional staff to provide clients with top quality services, face competition and market challenges and build up firm relations with the Bank's clients.



Remuneration system

The incentive systems existing in the Bank have been adjusted to the new organisational and functional structure of the Bank. They account for the specific nature of the business conducted in the retail and corporate markets and the separate activities of the specialized organisational units supporting the work of other departments.

The Bank introduced a system of bonuses aimed at intensifying business activities in the retail and corporate markets, improving work effectiveness and creating the Bank's value, including stimulating cost management skills.

Training

The main directions of training activities in 2005 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 2005, more than 107 thousand employees participated in training, of which 93% participated in in-house training conducted by internal lecturers.

The Bank's training policy focused on:

- improving employees' selling skills and pro-client attitudes,
- developing employees' specialist skills, including those connected with implementation of new services, products and technologies,
- preparing employees for implementation of new technologies.



9.4 Service promotion and image building

Promotional activities

Promotional activities of the Bank in 2005 concentrated mainly upon the following:

- building up the image of the Bank as a modern leader in the area of banking, providing a multi-channel access to products and services;
- strengthening positive and consistent image of the Bank as a patron of Polish national culture and sponsor of Polish Olympic organisations;
- maintaining the leading position of the Bank on the retail market – promotional activities were focused on carrying out promotional campaigns for the Bank's products and services, including:
 - promotional campaign of a new cash loan facility called QUICK CREDIT SERVICE,
 - the AUTO PARTNER loan,
 - mortgage loan WŁASNY KĄT ("Own flat"),
 - consolidation loan,
 - subscribed deposits,
 - credit cards, including in particular the MasterCard UEFA Champions League,
 - QUICK CREDIT LIMIT FOR BUSINESSES – a new offer for small and medium-sized enterprises,
 - in Autumn 2005, the Bank carried out an image and product campaign "E-banking leader", which finalised the 2005 campaign supporting the sales of the PKO-Inteligo e-banking services; the aim of this campaign was to strengthen the positive features of the Bank's image as a reliable and safe financial institution and, at the same time, emphasize the changes connected with innovation and improvement of the efficiency of PKO BP SA operations,
 - private and personal banking support – essential for enhancing the prestige of the PKO BP SA brand – was provided in the form of an annual program involving PR and advertising activities;
- strengthening the Bank's position in the corporate market by creating an image of the Bank as professional advisor in the market of financial services;

The Bank carried out intense promotional activities in the area of corporate banking by making an effective use of selected business events (seminars, conferences, meetings, business competitions), especially of a local nature, as well as promoting individual financial services addressed to various client segments. In doing this, the Bank referred to successful sale of its products, such as syndicated loans, municipal bonds or the European Program.

- as part of implementation of the Bank's marketing strategy for T-bonds, the Bank carried out a multimedia campaign for T-bonds using a new graphic layout of advertisements.

The Bank's sponsorship and charity activities were aimed at supporting culture, life-saving and health care. The Bank has supported almost 2,000 undertakings. In 2005, the Bank continued the long-term program "PKO Bank Polski Kulturze Narodowej" (PKO BP for National Culture), under which the Bank acted as the patron of: renovation of a replica of Michelangelo's fresco "The Last Judgment" and the ceremony of making this works available to the public, which was held at the National Museum in Cracow, ceremonial concert "V Wielki Recital" (Fifth Great Recital) held to commemorate the 85th anniversary of foundation of the Adam Mickiewicz University in Poznań, exhibition of manuscripts accompanying the Ninth Easter Ludwig van Beethoven Festival and anniversary concerts of Wanda Warska and Hanna Banaszak. The Bank continued to cooperate with the National Philharmonic, National Library and the National Museum in Warsaw (exhibition of sculptures by W. Hasior). The Bank was the general sponsor of another edition of the Polish Radio Music Festival, which commemorated the 80th anniversary of the Polish Radio, the Andrzej Drawicz Prize, the "Rawa Blues" Festival at Rawa Mazowiecka and the 48th International Festival of Contemporary Music "Warszawska Jesień" (Warsaw Autumn).

As part of the "PKO Bank Polski Blisko Ciebie" (PKO BP Close to You) program, the Bank sponsored, among others, the Stage-play Song Competition (Przegląd Piosenki Aktorskiej) in Wrocław and an international cross-country skiing event "Bieg Piastów", and subsidized the continuation and promotion of two social programs: "Cała Polska czyta dzieciom" (Whole Poland Reads to Children) and educational program "Zostańcie z nami" (Stay with Us) organised by the Foundation of the Weekly Polityka (Fundacja Tygodnika Polityka). The Bank sponsored also a few Students' Days (Juwenalia)



As part of the "PKO Bank Polski Reprezentacji Olimpijskiej" (PKO BP for the Olympic Representation) program, in 2005 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" and the sponsor of "For Wołodyjowski's Sabre Competition (Turniej o Szablę Wołodyjowskiego).

In the area of health care and health promotion, the Bank provided financing for, among others, Fundacja Rozwoju Kardiochirurgii (Foundation for Cardiosurgery Development) – to support the Polish artificial heart program, Fundacja na rzecz Przeszczepów Wątroby i Wspierania Postępu w Chirurgii Przewodu Pokarmowego (Liver Transplant Foundation), Fundacja Służby Zdrowia Samodzielnego Publicznego Wojewódzkiego Szpitala Zespołonego w Szczecinie (the Szczecin Public Hospital Foundation), Śląska Akademia Medyczna (The Silesian Medical Academy) – for the purchase of special apparatus for laparoscopic surgery, Szpital Uniwersytecki w Krakowie (The University Hospital in Cracow), Szpital Zachodni im. Jana Pawła II w Grodzisku Mazowieckim (a hospital in Grodzisk Mazowiecki), Caritas Polska and PCK Zarząd Główny (Polish Red Cross Central Management Board) – assistance for the victims of natural disasters in Asia. Additionally, the Bank made a donation for the "Różowa Konwalia" (Pink Lily of the Valley) program carried out by Polskie Towarzystwo Ginekologii Onkologicznej (Polish Oncologic Gynaecology Association), provided financing for the purchase of specialist medical equipment for Fundacja "Spełnionych Marzeń" (Dreams Fulfilled Foundation) and Stowarzyszenie Pomocy Dzieciom z Chorobami Serca i Nerek (Association for Children with Heart and Kidney Diseases).

Awards and Distinctions

In 2005, PKO BP SA received a number of awards and distinctions. The most important are listed below:

- "Debut of the Year 2004" (Debiut 2004 Roku) on the Warsaw Stock Exchange - an award granted by the Stock Exchange Newspaper PARKIET for the last-year privatisation of PKO BP SA – the biggest one in the history of the Warsaw Stock Exchange (February 2005);
- "Superbrands Polska 2004" - title granted to the Bank in recognition of the leading Polish brand in the financial sector (February 2005);
- "Employer of the Year" (Pracodawca Roku) – title awarded by a students' organisation, AIESEC (April 2005),
- "European Medal" – an award granted to the Bank in the "services" category for the "European Program" and to the Bank's subsidiary „eService" for "Authorisation of transactions carried out using pay cards" in the 10th edition of the competition organised by BCC and the European Integration Committee (April 2005);
- Europroduct – Promotional title granted Bank's products and services in the 8th Competition Edition organised by Polish Trade Association, in "service" category – for The European Program and in "product" category – for the Consolidation Loan, "Nasz Remont" Credit STUDENT credit card, and for current account SUPERKONTO with INTELIGO package;
- "Benefactor of the Year 2004" (Dobroczyńca Roku 2004) – two titles granted to PKO BP SA in annual competition organised by the Academy for the Development of Philanthropy in Poland (Akademia Rozwoju Filantropii w Polsce); in the "culture and arts" category – for supporting culture and arts institutions, including the National Philharmonic in Warsaw, and in the "health care and health promotion" category – together with Inteligo Financial Services – for providing financial assistance for the Polish Artificial Heart Program (April 2005);
- Golden Rock 2004 – prize awarded by MasterCard Europe for issuing the PKO Euro Biznes card – the first in Poland MasterCard credit card for small and medium-sized enterprises (April 2005);
- Rock Awards 2004 – an award granted to the Bank's subsidiary, „eService", for the greatest achievement in developing the network of points of sale accepting MasterCard pay cards (April 2005),
- Golden Jubilee Award – granted to the President of PKO BP SA by MasterCard Europe for a continued support of MasterCard Europe in Poland, and in particular for acting as chairman of Europay Forum Polska (April 2005);



- “Brand Worth of European Trust” (Marka Godna Europejskiego Zaufania) – title granted to the Bank by “Reader’s Digest” in the current year edition of the European market research among its readers (April 2005);
- First place in Newsweek’s ranking of “the most valuable company” (April 2005),
- “The Philharmonic’s Sponsor of the Year” (Sponsor Roku Filharmonii) – title granted to the Bank for its last-year cooperation with the National Philharmonic (June 2005);
- Diamond to the Golden Statue of the Polish Business Leader awarded by the Business Centre Club to companies that were previously awarded the Polish Business Leader statue. PKO BP SA received the Diamond award for the third time (June 2005);
- A distinction granted to PKO BP SA in the Students’ Employers Ranking KOMPAS, in the “financial institution” category (June 2005),
- First place in FORBES’s ranking (September issue) granted to PKO BP SA in the category of “quick loans” for one of the cheapest revolving loan facilities and reasonable credit card interest rates,
- Arts & Business Awards 2005 of the Commitment to Europe art & business Foundation; PKO BP SA received an award in the “Sponsor art & business” category; in addition, the Bank received a distinction in the category of “Partnership of the Year” for its long-term cooperation with Willa Decjusza in Cracow, which may serve as an example of a long-term and mutually beneficial cooperation of a commercial firm with a cultural institution (November 2005),
- “Laureate” title in the “Bank Dostępny” (Accessible Bank) competition organised by the Foundation “Otwarte Drzwi” (Open Door) and the National Bank of Poland, in two categories: Clients Award – granted to PKO BP SA for the Inteligo account, and in the “Duży Bank” (Big Bank) category – granted to the First Branch of PKO BP SA in Lwówek Śląski (December 2005).

10. INVESTORS RELATIONS

10.1 Shareholders’ holdings, directly or indirectly through subsidiaries, at least 5% of total votes at the Annual General 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 Annual General Meeting.

According to the Bank’s knowledge, the State Treasury had the following number of PKO BP SA shares as at 31 December 2005:

Table 17. Shares held by the State Treasury as at 31 December 2005

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	515 711 446	51.57%	515 711 446	51.57%

10.2 Changes in Articles of Association

During the year, the Bank’s Articles of Association were changed by two resolutions of the Ordinary Annual Meeting of PKO BP SA adopted on 19 May 2005:

- Resolution No. 29/2005 regarding amendments to the Articles of Association of PKO BP SA – the contents of § 6 of the Articles were changed; the previous registered “B” and “C” series shares were converted to bearer shares, and sections 3 and 4 were deleted from § 6 of the Articles,
- Resolution No. 30/2005 regarding amendments to the Articles of Association of PKO BP SA – the contents of § 11 section 1 were changed; in accordance with the new wording of § 11 section 1 of the Articles, Supervisory Board is appointed for a common term, other contents of § 11 section 1 did not change.

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 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

The price of the Bank's shares as at 31 December 2005 amounted to PLN 29.00 and increased by PLN 1.20 i.e. 4.3% compared to the price as at 31 December 2004.

During the year 2005, the price of the PKO BP SA shares fluctuated from PLN 25.10 as at 28 April 2005 to PLN 33.00 as at 19 September 2005. The following factors had impact on the level of the prices of the Bank's shares: trends prevailing on the Stock Exchange and the Bank's financial results.



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 AGM), 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 at all.

10.7 Employee shares

Acting at the request of the State Treasury Minister under the Act of 30 August 1996 on commercialisation and privatisation (Journal of Laws 2002 No. 171, item 1397 with subsequent amendments) and § 14 section 1 of the decree of the State Treasury Minister dated 29 January 2003 on detailed principles for dividing entitled employees into groups, determining the number of shares falling to each of those groups and the procedure for acquiring shares by entitled employees (Journal of Laws No. 35, item 303), the Bank, on 4 April 2005, notified the public of commencing the process of free-of-charge transfer of 105,000,000 "B" series PKO BP SA shares to entitled employees. As at 31 December 2005, the number of shares assigned to employees amounted to 103,763,142.

The process of a free-of-charge transfer of shares to entitled persons, including the signing of agreements for a free-of-charge transfer of shares and the issuing of deposit certificates confirming



the transfer of ownership to the entitled person, was carried out starting from 6 April 2005 at locations and dates which were determined separately for the employees entitled to acquire PKO BP SA shares free of charge and the successors of the entitled employees.

In accordance with Art. 38.3 of the Act on Commercialisation and Privatisation, in correspondence with Art. 48 of the Banking Law, employee shares which were acquired free of charge by entitled employees may not be disposed of within 2 years of the date on which the first shares according to general rules were transferred by the State Treasury, and the employee shares acquired by members of Management Board – within 3 years of the date on which the first shares according to general rules were transferred by the State Treasury.

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 515,711,446 shares which give right to 51.57% of votes at the Annual General Meeting.

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

In accordance with the provisions of the Bank's Articles of Association, the transfer of "A" series shares requires consent of the Council of Ministers in the form of resolution. The transfer of "A" series shares after acquiring such consent results in the expiry of the above restrictions.

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

During the year 2005, the Bank signed the following significant contracts:

- On 1 June 2005, the Bank signed a contract with a consulting firm for the provision of consulting services relating to preparation and implementation of a plan for optimisation of selected costs of the Bank.
- On 29 July 2005, PKO BP SA signed a Letter of Intent with Poczta Polska (Polish Mail) regarding an extension of cooperation between these two companies.
- On 28 August 2005, the Bank concluded property and civil liability insurance contracts (in total, four insurance policies). Insurance coverage was provided to the Bank by a co-insurance pool comprising: TU Allianz Polska SA (60% share in risk) and PZU SA (40% share in risk).
- On 7 October 2005, the Bank signed a contract for the sale of a portfolio of retail non-performing loans classified as "loss" (balance sheet and off-balance sheet items). The amount due under this transaction was received by the Bank into its bank account on 20 October 2005.
- During the year 2005, the Bank signed 12 significant loan agreement with one borrower, for a total amount of PLN 3,760 million.
- On 22 December 2005, the Bank signed a syndicated loan agreement with a significant borrower from the fuel industry, which consists of tranche A of EUR 250 million and tranche B of EUR 750 million (the share of the Bank amounted respectively to: EUR 22.7 million and EUR 68.2 million). The total value of services arising from long-term agreements with that borrower meets the criteria referred to in § 2 section 2 of the decree of the Minister of Finance of 19 October 2005 on current and periodic information provided by the issuers of securities.
- The Bank concluded a syndicated loan agreement with a customer from the gas fuel production and distribution industry, which consists of tranche A of EUR 600 million and tranche B of EUR 300 million, and which can be used in either EUR, USD or PLN. The share of PKO BP SA in these tranches amounts to EUR 100 million and EUR 50 million, respectively.

In 2005, the Bank did not enter into any important agreements with either the Central Bank or the supervisory bodies.

As at the date of this Report, the Bank is not aware of any agreements which might result in changes to the proportion of shares held by its current shareholders, except for the agreement between PKO



BP SA and the Ministry of State Treasury relating to the granting of shares to entitled employees in accordance with the Act of 30 August 1996 on commercialization and privatization.

12. LOANS TAKEN, AND LOAN, GUARANTEE AND SURETYSHIP AGREEMENTS

During the year 2005, the Bank did not take out any loans or advances or receive any guarantees or suretyships that were not related to its operating activity.

13. UNDERWRITING AGREEMENTS AND GUARANTEES GRANTED TO SUBSIDIARIES

In 2005, PKO BP SA did not sign any underwriting agreements with Group companies.

The guarantee granted by PKO BP SA to its subsidiary - Bankowe Towarzystwo Kapitałowe S.A. (formerly Dom Maklerski BROKER S.A.) for an amount of PLN 105 million expired on 31 January 2005. This guarantee was issued as a security for the company's payments to the Stock Exchange Transaction Settlement Guarantee Fund (*Fundusz Gwarantowania Rozliczeń Transakcji Giełdowych*).

On 6 October 2005, PKO BP SA issued a guarantee to its subsidiary – Bankowy Fundusz Leasingowy S.A. for an amount up to PLN 22 million. The guarantee provides a security for the company's repayment of the first tranche of the loan granted by the European Bank for Reconstruction and Development of London.

On 7 November 2005, PKO BP SA issued a guarantee to its subsidiary - Centrum Elektronicznych Usług Płatniczych eService S.A. for an amount up to PLN 100 thousand. The guarantee provides a security for a contract concluded with POLKOMTEL S.A. for the sale of prepaid phone card units.

As at 31 December 2005, the value of guarantee arising from the Agreement for Organisation, Conducting and Servicing of a Bond Issuance Program, concluded between PKO BP SA and its subsidiary - Bankowy Fundusz Leasingowy S.A., amounted to PLN 25 million. This guarantee relates to the closing of an issue of bonds.

14. ENFORCEABLE TITLES ISSUED BY THE BANK

During the year 2005, PKO BP SA issued 30,284 banking enforceable titles for a total amount of PLN 324,204,403.

15. SIGNIFICANT POST-BALANCE SHEET EVENTS

- On 1 January 2006, PKO BP SA introduced a new Table of Banking Fees and Commission Rates. The changes result from market conditions and an extended scope of the Bank's operations.
- On 24 January 2006, PKO BP SA concluded with Credit Suisse Asset Management Holding Europe (Luxembourg) S.A. a conditional agreement for the sale of 45,000 registered preference shares of PKO/Credit Suisse Towarzystwo Funduszy Inwestycyjnych S.A. The Bank will acquire these shares once it fulfils all the conditions specified in the agreement. The expected transfer of the shares will take place by the end of the first quarter 2006. The shares acquired by the Bank account for 25% of votes at the company's Annual General Meeting. As a result of this acquisition, PKO BP SA will hold 75% of shares in the company's share capital and votes at the Annual General Meeting. The price for the shares acquired by the Bank amounts to PLN 55 million.
- On 25 January 2006, PKO BP SA concluded an agreement with its customer for issuing banking guarantee. Under this agreement, the Bank is required to issue, at the request of the customer, a guarantee to the Customs Office in respect of an excise security amounting to 309 million. The agreement for issuing banking guarantee binds from 1 February 2006 to 31 January 2007, plus a 90-day liability period. As at the date of this agreement, the total value of all agreements signed by the Bank with that customer amounted to PLN 1,104.9 million.
- On 27 January 2006, PKO BP SA concluded a Shareholders' Agreement with the City of Sopot and NDI S.A., with the participation of Centrum Haffnera Sp. z o.o., for an investment project relating to re-vitalisation of Sopot's tourist centre.

The Bank's involvement in this project will comprise capital involvement (the Bank will take up app. 49.4% of shares in Centrum Haffnera Sp. z o.o.) and loans.



The Bank will participate in the above project upon the fulfilment of the conditions specified in the Agreement.

- On 14 February 2006, the Bank received a report from the rating agency Capital Intelligence in which the rating for the financial strength of PKO BP SA was increased from BB+ to BBB- with a stable outlook. This change was made owing to the improving quality of the Bank's loan portfolio and increasing effectiveness of its operations.
- On 8 March 2006, the Supervisory Board of the Bank made a resolution, in which it accepted the resignation of Mr Piotr Kamiński from acting function as Member of the Board from date 9 March i.e. effective date when Piotr Kamiński was appointed as a Vice-chairman of the Bank Pocztowy S.A. Board.
- On 16 March 2006 PKO BP received approval of the chairman of Office of Competition and Consumer Protection for concentration resulting from the overtake the control through PKO BP SA over PKO/Credit Suisse Towarzystwo Funduszy Inwestycyjnych. S.A.

16. 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 ending 31 December 2005, 2006 and 2007 and a review of stand-alone financial statements and consolidated financial statements for 6-month periods ending 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 1,216.3 thousand (net of VAT) for the year 2005 and PLN 875.0 thousand (net of VAT) for the year 2004.

The total amount of fees arising from contracts concluded with Ernst & Young Audit Sp. z o.o. for remaining services other than reviews and audits of financial statements was as follows: PLN 2,319.4 thousand (net of VAT) for the year 2005 and PLN 2,889.0 thousand (net of VAT) for the year 2004.

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 the assistance in IFRS implementation in 2005 and activities concerning the privatisation of the Bank in 2004.



17. 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.

The Management Board of PKO BP SA hereby represents that the entity authorised to audit financial statements which 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 2005* consists of 41 consecutively numbered pages.

President of Management Board
Andrzej Podsiadło

First Deputy President
Kazimierz Małecki

Deputy President
Danuta Demianiuk

Deputy President
Sławomir Skrzypek

Member
Jacek Obłąkowski

Member
Krystyna Szewczyk