



Independent Registered Auditor's Opinion To the General Meeting of Shareholders and the Supervisory Board of Powszechna Kasa Oszczędności Bank Polski SA

We have audited the accompanying financial statements of Powszechna Kasa Oszczędności Bank Polski SA (hereinafter called "the Bank"), with its registered office at 15 Puławska Street, in Warsaw, which comprise the statement of financial position as at 31 December 2012, showing total assets and total equity and liabilities of PLN 191,017,712 thousand; the income statement for the financial year from 1 January to 31 December 2012, showing a net profit of PLN 3,592,617 thousand; the statement of comprehensive income for the period from 1 January to 31 December 2012, showing a total comprehensive income of PLN 3,342,651 thousand; the statement of changes in equity, the statement of cash flows for the financial year and additional information on accounting policies and other relevant matters.

The Management Board of the Bank is responsible for preparing the financial statements and a Directors' Report in accordance with the applicable regulations, and for the correctness of the accounting records. The Management Board and Members of the Supervisory Board are required to ensure that the financial statements and the Director's Report meet the requirements set out in the Accounting Act of 29 September 1994 (uniform text, Journal of Laws of 2009, No. 152, item 1223 with further amendments, hereinafter referred to as "the Act").

Our responsibility was to perform an audit of the accompanying financial statements and to express an opinion on whether in all material respects the financial statements comply with the applicable accounting policies, whether they present fairly the Bank's financial position and results, and whether the accounting records constituting the basis for the preparation of the financial statements are properly maintained.

We conducted our audit in accordance with the following:

- (a) the provisions of Chapter 7 of the Act;
- (b) national auditing standards as issued by the National Chamber of Registered Auditors;
- (c) International Standards on Auditing.

Our audit was planned and performed to obtain reasonable assurance that the financial statements were free of material misstatements and omissions. The audit included examining, on a test basis, accounting documents and entries supporting the amounts and disclosures in the financial statements. The audit also included an assessment of the accounting policies applied by the Bank and significant estimates made in the preparation of the financial statements as well as an evaluation of the overall presentation thereof. We believe that our audit provides a reasonable basis for our opinion.

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**Independent Registered Auditor's Opinion
To the General Meeting of Shareholders and the Supervisory Board
of Powszechna Kasa Oszczędności Bank Polski SA (cont.)**

In our opinion, and in all material respects, the accompanying financial statements:

- (a) present fairly the Bank's financial position as at 31 December 2012 and of the results of its operations for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union;
- (b) comply in form and content with the applicable laws and the Bank's Memorandum of Association;
- (c) have been prepared on the basis of properly maintained accounting records in accordance with the applicable accounting principles (policies).

The information in the Directors' Report for the year ended 31 December 2012 has been prepared in accordance with the provisions of the Decree of the Minister of Finance of 19 February 2009 concerning the publication of current and periodic information by issuers of securities and the conditions of acceptance as equivalent information required by the laws of another state not being a member state ("*the Decree*" – Journal of Laws of 2009, No. 33, item 259) and is consistent with the information presented in the audited financial statements.

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

Antoni F. Reczek
President of the Management Board

PricewaterhouseCoopers Sp. z o.o.

Principal Registered Auditor
No. 90011

Warsaw, 27 February 2013

Powszechna Kasa Oszczędności Bank Polski SA
Independent Registered Auditor's Report on the financial
statements as at and for the year ended 31 December 2012

**Independent registered auditor's report on the financial statements
For the year ended 31 December 2012
To the General Meeting of Shareholders and the Supervisory Board
of Powszechna Kasa Oszczędności Bank Polski SA**

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Powszechna Kasa Oszczędności Bank Polski SA
Auditor's report on the financial statements
for the financial year od 1 stycznia do 31 grudnia 2012 r.

I. General information about the Bank

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

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

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

- (b) As at 31 December 2012 the Bank's registered share capital amounted to PLN 1,250,000 thousand and consisted of 1,250,000,000 ordinary shares, each of PLN 1 par value, including:
- 312,500,000 A-series registered shares;
 - 197,500,000 A-series bearer shares
 - 105,000,000 B-series bearer shares;
 - 385,000,000 C-series bearer shares;
 - 250,000,000 D-series bearer shares.

- (c) As at 31 December 2012, the Bank's shareholders were:

Shareholder's name	Number of shares held	Par value of shares held (PLN'000)	Type of shares held (ordinary /preference)	Votes (%)
State Treasury	417,406,277	417,406	ordinary	33.39
Bank Gospodarstwa Krajowego	128,102,731	128,103	ordinary	10.25
ING Otwarty Fundusz Emerytalny	64,594,448	64,594	ordinary	5.17
Other	639,896,544	639,897	ordinary	51.19
Total	1,250,000,000	1,250,000		100.00

- (d) Based on art. 111 of the Act on trading in financial instruments dated 29 July 2005, the Bank conducts brokerage activities through a separate organizational unit (a branch office) of Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna Oddział – Dom Maklerski PKO Banku Polskiego w Warszawie in Warsaw (hereinafter called “the Brokerage House of PKO BP SA”).

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

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I. General information about the Bank (cont.)

(e) In the audited year, the Bank's operations comprised:

- accepting cash deposits payable on demand or on an agreed date and maintaining accounts for such deposits;
- granting loans and cash advances;
- granting and confirming bank guarantees;
- clearing cash transactions;
- issuing cards and conducting transactions with the use of cards;
- conducting forward transactions.

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

(f) During the audited year, the Management Board of the Bank comprised:

Zbigniew Jagiełło	President of the Management Board	throughout the year
Piotr Alicki	Vice-President of the Management Board	throughout the year
Bartosz Drabikowski	Vice-President of the Management Board	throughout the year
Jarosław Myjak	Vice-President of the Management Board	throughout the year
Jacek Obłąkowski	Vice-President of the Management Board	throughout the year
Jakub Papierski	Vice-President of the Management Board	throughout the year

Andrzej Kołatkowski Vice-President of the Management Board to 13 July 2012

On 26 September 2012 the Supervisory Board of PKO Bank Polski SA appointed as of 1 January 2013 Mr Piotr Mazur to the position of the Vice-President of the Management Board of the Bank.

(g) The Bank has the following related entities:

Bankowe Towarzystwo Kapitałowe SA	- subsidiary
Bankowy Fundusz Leasingowy SA	- subsidiary
Centrum Elektronicznych Usług Płatniczych „eService” SA	- subsidiary
Inteligo Financial Services SA	- subsidiary
Kredobank SA, Ukraine	- subsidiary
PKO BP BANKOWY Powszechne Towarzystwo Emerytalne SA	- subsidiary
PKO BP Finat Sp. z o.o.	- subsidiary
PKO Finance AB, Sweden	- subsidiary
PKO Towarzystwo Funduszy Inwestycyjnych SA	- subsidiary
Fort Mokotów Inwestycje Sp. z o.o.	- subsidiary
Qualia Development Sp. z o.o.	- subsidiary
Inter-Risk Ukraina Additional Liability Company	- subsidiary
Centrum Haffnera Sp. z o.o.	- jointly controlled entity
Centrum Obsługi Biznesu Sp. z o.o.	- jointly controlled entity
Bank Pocztowy SA	- associate
Kolej Gondolowa Jaworzyna Krynicka SA	- associate
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	- associate
Agencja Inwestycyjna CORP-SA SA	- associate

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I. General information about the Bank (cont.)

and the companies that are members of the capital groups of Bankowe Towarzystwo Kapitałowe SA, Bankowy Fundusz Leasingowy SA, Qualia Development Sp. z o.o., Kredobank SA and Inter-Risk Ukraina Additional Liability Company, as well as indirect jointly controlled entities that are members of the capital group Centrum Haffnera Sp. z o.o. and indirect associates that are members of the capital group Bank Pocztowy SA.

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

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

- (i) As the Parent Company of the Group, the Bank has also prepared consolidated financial statements according to IFRS as adopted by the European Union as at 26 February 2013. To better understand the Bank's financial position and its results of operations as the Parent Company, the financial statements should be read in conjunction with the consolidated financial statements.

Powszechna Kasa Oszczędności Bank Polski SA
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II. Information about the audit

- (a) The audit of the financial statements as at and for the year ended 31 December 2012 was conducted by PricewaterhouseCoopers Sp. z o.o having its seat in Warsaw, Al. Armii Ludowej 14, registered audit firm no. 144. The audit was conducted on behalf of the registered audit firm under the supervision of the principal registered auditor Antoni F. Reczek (no. 90011).
- (b) PricewaterhouseCoopers Sp. z o.o. was appointed independent registered auditor to the Bank by Resolution No. 15/2011 of the Supervisory Board dated 28 March 2011 in accordance with paragraph 15, clause 1, item 3 of the Bank's Memorandum of Association.
- (c) PricewaterhouseCoopers Sp. z o.o. and the principal registered auditor conducting the audit are independent of the audited entity within the meaning of art. 56, clause 2-4 of the Act on registered auditors and their council, entities entitled to provide audit of financial statements and public supervision of 7 May 2009 (Journal of Laws 2009, No. 77, item 649, with subsequent amendments).
- (d) The audit was conducted in accordance with an agreement dated 14 April 2011, in the following periods:
- interim audit from 26 October to 21 December 2012;
 - final audit from 7 January to 27 February 2013.

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III. The Bank's results and financial position

The financial statements do not take account of the impact of inflation. The consumer price index (from December to December) amounted to 2.4% in the audited year (4.6% in 2011).

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

- As at 31 December 2012, total assets amounted to PLN 191,017,712 thousand and increased by PLN 2,645,022 thousand (i.e. 1%) compared with the balance as at 31 December 2011.
- This increase was mainly financed with an increase in amounts due to customers of PLN 4,709,893 thousand (i.e. 3%) – mainly as a result of an increase in retail clients' deposits and the funds raised as a result of an issue of eurobonds, accompanied by an increase in equity of PLN 1,843,684 thousand (i.e. 8%), which was offset by a decrease in the balance of amounts due to banks and debt securities in issue (a decrease of PLN 2,818,502 thousand, i.e. 53% and PLN 2,239,683 thousand, i.e. 72% respectively).
- In 2012, amounts due to customers were the main source of financing for assets (similarly to the previous year). The balance of amounts due to customers amounted to PLN 154,740,574 thousand as at the balance date and represented 81% of total liabilities and equity (an increase of 1 pp. compared with the balance as at 31 December 2011). The change in the balance of amounts due to customers was mainly the effect of an increase in amounts due to retail clients (an increase of PLN 6,703,216 thousand, i.e. 6% compared with the balance as at 31 December 2011) and in loans granted by a subsidiary, PKO Finance AB (an increase of PLN 4,695,688 thousand, i.e. 105% compared with the balance as at 31 December 2011). The loans related to the issues of bonds to international markets carried out in 2012 on behalf of the Bank by PKO Finance AB, in the amounts of USD 1,000,000 thousand, CHF 500,000 thousand and EUR 50,000 thousand. This increase was partly offset by a decrease in the balance of negotiated term deposits of corporate clients (a decrease of PLN 6,630.870 thousand, i.e. 28% compared with the balance as at 31 December 2011).
- The balance of amounts due to banks amounted to PLN 2,502.888 thousand as at the balance date (a decrease of PLN 2,818,502 thousand, i.e. 53% compared with the previous year) and comprised mainly a consortium loan received in Swiss francs, whose value in the Polish currency was PLN 1,393,048 thousand (PLN 3,443,872 thousand as at 31 December 2011 – the change in the balance resulted from the repayment of a loan of CHF 950,000 thousand and a liability of CHF 410,000 thousand being drawn in July 2012). There was also a drop in the balances of interbank deposits accepted (a decrease of PLN 366,288 thousand, i.e. 27%) and in current accounts (a decrease of PLN 350,400 thousand, i.e. 83%) (Note 12).
- As at 31 December 2012, liabilities in respect of the negative valuation of derivatives amounted to PLN 3,964,170 thousand (PLN 2,645,281 thousand as at 31 December 2011). The increase in the balance as at the balance date was mainly the result of a higher valuation of IRS transactions whose balance increased by PLN 1,258,655 thousand (i.e. 65%) compared with the balance as at 31 December 2011 (Note 4).

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

- As at 31 December 2012, the balance of debt securities in issue amounted to PLN 865,905 thousand and related to short-term bonds issued to the Polish market in the amount of PLN 497,283 thousand and structured bank securities based on stock exchange indices or commodity prices in the amount of PLN 368,622 thousand. The decrease in the balance of PLN 2,239,683 thousand (i.e. 72%) compared with the balance as at 31 December 2011 resulted mainly from a decrease in the volume of short-term bonds issued to the Polish market (a decrease of PLN 2,432,690 thousand, i.e. 83% compared with the balance as at 31 December 2011).
- The balance of subordinated liabilities amounted to PLN 1,631,256 thousand as at the balance date (PLN 1,614,377 thousand as at 31 December 2011) and related to the valuation of bonds issued by the Bank in 2012 in the nominal amount of PLN 1,600,700 thousand (Note 15).
- The value of equity amounted to PLN 24,646,059 thousand as at 31 December 2012 (PLN 22,802,375 thousand as at 31 December 2011). The increase in the balance was mainly brought about by the profit generated by the Bank in 2012 in the amount of PLN 3,592,617 thousand. At the same time, the Bank earmarked PLN 1,587,500 thousand worth of the profit for 2011 for the payment of a dividend. The remaining portion of the profit for 2011 was earmarked for increasing the reserve capital (PLN 2,300,000 thousand) and other reserves (PLN 66,122 thousand) (Note 18).
- The value of the Bank's own funds calculated on the regulatory basis amounted to PLN 19,874,725 thousand as at 31 December 2012 (PLN 17,347,921 thousand as at 31 December 2011) and was PLN 7,575,382 thousand higher than the total capital requirement (PLN 12,299,343 thousand as at the end of 2012). The capital adequacy ratio calculated as at the balance date on the basis of the banking portfolio and the trading portfolio amounted to 12.93% and increased by 1.00 pp. compared with the end of the previous year. The increase in the capital adequacy ratio resulted mainly from an increase in the Bank's own funds of PLN 2,526,804 thousand (i.e. 15%), mainly as a result of a portion of the net profit being earmarked for increasing the reserve capital, partly offset by an increase in the credit risk requirement of PLN 719,052 thousand (i.e. 7%) due to regulatory changes (an increase in the risk weights used for mortgage exposures denominated in foreign currencies).
- The higher level of financing mainly translated into an increase in the balance of amounts due from banks – an increase of PLN 1,136,193 thousand (i.e. 49%). Compared with the balance as at 31 December 2011, there was also an increase in the balance of the positive valuation of derivatives (an increase of PLN 796,307 thousand, i.e. 26%) and in the balance of tangible fixed assets (an increase of PLN 369,344 thousand, i.e. 18%).
- The increase in amounts due from banks related both to deposits with banks, which increased by PLN 531,522 thousand (i.e. 28%) compared with 31 December 2011, and to current accounts, which were PLN 309,517 thousand (i.e. 111%) higher as at the balance date compared with the end of 2011. The Bank also granted a loan to a subsidiary, Kredobank SA – the related increase in the balance amounted to PLN 144,154 thousand (i.e. 120%) as at the balance date. Other changes in the balance of amounts due from banks are presented in Note 2. The balance of amounts due from banks amounted to PLN 3,456,391 thousand as at the balance date.

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

- The increase in the positive valuation of derivative financial instruments to PLN 3,861,456 thousand resulted mainly from the valuation of interest rate swaps being higher than in the previous year (an increase of PLN 1,255,494 thousand, i.e. 52%). It was partly offset by a drop of PLN 414,615 thousand (i.e. 74%) in the valuation of currency forwards.
- The balance of tangible fixed assets in the amount of 2,382,658 thousand increased by PLN 369,344 thousand. The increase resulted mainly from the acquisition of the assets of a liquidated subsidiary, Centrum Finansowe Puławska Sp. z o.o., including the property on which the Bank's Head Office is located. The value of the acquired assets amounted to PLN 238,330 thousand as at 31 December 2012 (Note 10).
- The balance of investment securities available for sale amounted to PLN 12,061,406 thousand as at the balance date and was PLN 2,107,527 thousand (i.e. 15%) lower than the balance as at the end of 2011. The decrease related mainly to corporate bonds (a decrease of PLN 805,159 thousand, i.e. 35%) and municipal bonds (a decrease of PLN 678,144 thousand, i.e. 20%) and was mainly due to the reclassification of securities to the portfolio of loans and advances to customers. The balance of Treasury bonds was also lower than in the previous year (a decrease of PLN 690,907 thousand, i.e. 8%). The entire balance related to Polish issuers (Note 7).
- As at the balance date, loans and advances to customers amounted to PLN 142,084,858 thousand and represented 74% of total assets (no change compared with the end of 2011). The gross value of the loan portfolio as at 31 December 2012 amounted to PLN 148,313,487 thousand and increased by PLN 3,272,048 thousand (i.e. 2%) compared with the balance as at 31 December 2011. This increase resulted mainly from the reclassification of debt securities from the portfolio of investment securities available for sale in the amount of PLN 2,073,951 thousand and the portfolio of mortgage loans (an increase of PLN 1,178,803 thousand, i.e. 2%) (Note 6).
- The quality of the loan portfolio as at the balance date, measured with the ratio of impaired loans to the total balance of loans and advances to customers deteriorated compared with the end of 2011. As at 31 December 2012, the ratio of impaired loans to the total balance of loans and advances to customers increased by 1.1 pp. and amounted to 8.3%. At the same time, the coverage ratio of impairment allowances to impaired loans and advances to customers amounted to 45.4% as at 31 December 2012 and increased by 3.7 pp. compared with the end of the previous financial year.
- The structure of liquid assets changed as at the balance date. A decrease of PLN 1,028,859 thousand (i.e. 78%) in trading assets financed an increase of PLN 1,168,950 thousand (i.e. 13%) in cash and balances with the central bank.
- Trading assets amounted to PLN 282,230 thousand as at 31 December 2012. The decrease in the assets was mainly due to a decrease in the Bank's exposure to Polish Treasury bonds – between the end of 2011 and the end of 2012 the related balance dropped by PLN 1,002,548 thousand (i.e. 82%) (Note 3).
- Cash and balances with the central bank amounted to PLN 10,229,230 thousand as at the balance date. There was an increase in both the balance of cash with the central bank (of PLN 705,139 thousand, i.e. 10%) and the balance of cash in hand and in vaults (of PLN 464,033 thousand, i.e. 21%).

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

- The balance of financial assets designated upon initial recognition at fair value through profit and loss amounted to PLN 12,614,917 thousand as at the balance date. The increase in the balance (of PLN 147,716 thousand, i.e. 1%) resulted mainly from a change in the structure of the balance – the share of short-term NBP bills increased (an increase of PLN 1,401,509 thousand, i.e. 16%), and the balance of Treasury bills was lower than in the previous year (a decrease of PLN 1,139,285 thousand, i.e. 52%) (Note 5).
- The Bank's liquidity ratios of up to 1 month and up to 3 months, calculated on the basis of data on the maturities of assets and liabilities according to real term maturity dates, amounted to 2.16 and 1.98 respectively (1.90 and 1.66 as at the end of 2011). The loans to deposits ratio (L/D) amounted to 91.8% as at the end of 2012 (93.4% as at the end of 2011).
- The share of interest-bearing assets in total assets decreased by 0.9 pp. compared with the balance as at 31 December 2011 and amounted to 93.2% as at the end of 2012.
- The operating profit amounted to PLN 4,462,805 thousand in 2012 and was PLN 451,126 thousand (i.e. 9%) lower than in 2011. The operating profit comprised mainly: net interest income of PLN 7,772,436 thousand, net fee and commission income of PLN 2,804,584 thousand and net foreign exchange gains of PLN 254,153 thousand. At the same time, the operating profit was reduced by administrative expenses of PLN 4,192,757 thousand and net impairment allowance and write-downs of PLN 2,458,590 thousand.
- Net interest income amounted to PLN 7,772,436 thousand in 2012 and was PLN 267,467 thousand (i.e. 4%) higher than in 2011. The increase was mainly due to higher income on loans and advances to customers (an increase of PLN 589,607 thousand, i.e. 6%) and on securities (an increase of PLN 261,487 thousand, i.e. 22%). The increase was offset by an increase of PLN 668,438 thousand (i.e. 15%) in interest expense. In 2012, the interest margin, calculated as the ratio of net interest income to interest income, dropped by 3 pp. compared with 2011 and amounted to 61% (Note 19). The interest spread, calculated as the difference between the profitability ratio on interest-bearing assets and the cost of borrowings, amounted to 4.1% and decreased by 0.1 pp. compared with 2011.
- In 2012, net fee and commission income was lower than in 2011 and amounted to PLN 2,804,584 thousand (a drop of PLN 68,217 thousand, i.e. 2%), which was mainly due to commission expense being higher than in the previous year. Compared with 2011, fee and commission expense increased by PLN 65,987 thousand (i.e. 9%) to PLN 815,066 thousand. At the same time, there was a decrease in fee and commission income (a drop of PLN 2,230 thousand to PLN 3,619,650 thousand). The decrease related mainly to commissions on loan insurance and the maintenance of bank accounts (a decrease of PLN 100,160 thousand, i.e. 19% and PLN 38,682 thousand, i.e. 4% respectively) and was partly offset by an increase in income from payments cards (an increase of PLN 143,318 thousand, i.e. 14%) (Note 20).

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

- In 2012, administrative expenses were PLN 134,267 thousand (i.e. 3%) higher than in the previous year and amounted to PLN 4,192,757 thousand. An increase in staff costs of PLN 84,021 thousand (i.e. 4%) was accompanied by an increase in depreciation and amortization of PLN 27,294 thousand (i.e. 6%) (Note 25). The overall business effectiveness, calculated as the costs to income ratio (the C/I ratio), deteriorated in 2012 (the ratio increased by 0.1 pp. to 37.7%). The negative change in the ratio was due to costs being higher than in 2011.
- In 2012, net impairment allowance amounted to PLN 2,458,590 thousand (PLN 1,812,122 thousand in 2011). The increase in net impairment allowance (recognized in the income statement) was mainly related to corporate and mortgage loans to customers – an increase of PLN 396,023 thousand (i.e. 57%) and PLN 78,136 thousand (i.e. 21%) respectively, and it was offset by a decrease in net impairment allowance on consumer loans (a drop of PLN 96,758 thousand, i.e. 15%). At the same time, the costs of recognising provisions for off-balance sheet liabilities were PLN 68,096 thousand (i.e. 188%) higher in 2012 (Note 24). The cost of risk amounted to 1.4% in 2012 (1.2% in 2011).
- Gross profitability (calculated as the profit before income tax to total income) amounted to 26.3% in the audited year and decreased by 4.4 pp. compared with the previous year.
- In 2012, the income tax expense amounted to PLN 870,188 thousand (PLN 960,309 thousand in 2011). The effective tax rate amounted to 19.5% in 2012 and did not change compared with 2011.
- As a result, in 2012 the Bank generated a net profit of PLN 3,592,617 thousand which was PLN 361,005 thousand (i.e. 9%) lower than the net profit for 2011. Net profitability (calculated as the net profit to total income) amounted to 21.2% in 2012 (24.7% in 2011).
- The return on assets (calculated as the net profit to average total assets) amounted to 1.9% in 2012 and decreased by 0.3 pp. compared with 2011. In the audited year, the return on equity amounted to 15.1% and was 2.9 pp. lower than in 2011.

The Bank's financial statements have been prepared in accordance with the going concern principle.

Powszechna Kasa Oszczędności Bank Polski SA
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IV. Discussion of financial statement components

STATEMENT OF FINANCIAL POSITION as at 31 December 2012

ASSETS	Note	31.12.2012	31.12.2011	Change	Change	31.12.2012	31.12.2011
		PLN'000	PLN'000	PLN'000	(%)	Structure (%)	Structure (%)
Cash and balances with the central bank	1.	10,229,230	9,060,280	1,168,950	13	5	5
Amounts due from banks	2.	3,456,391	2,320,198	1,136,193	49	2	1
Trading assets	3.	282,230	1,311,089	(1,028,859)	(78)	-	1
Derivative financial instruments	4.	3,861,456	3,065,149	796,307	26	2	2
Financial assets designated upon initial recognition at fair value through profit and loss	5.	12,614,917	12,467,201	147,716	1	8	7
Loans and advances to customers	6.	142,084,858	140,058,649	2,026,209	1	74	74
Investment securities available for sale	7.	12,061,406	14,168,933	(2,107,527)	(15)	6	7
Investments in subsidiaries, jointly controlled entities and associates	8.	1,171,005	1,497,975	(326,970)	(22)	1	1
Non-current assets held for sale		20,410	20,410	-	-	-	-
Intangible assets	9.	1,681,120	1,522,568	158,552	10	1	1
Tangible fixed assets	10.	2,382,658	2,013,314	369,344	18	1	1
Deferred income tax asset	26.	369,007	384,134	(15,127)	(4)	-	-
Other assets	11.	803,024	482,790	320,234	66	-	-
Total assets		191,017,712	188,372,690	2,645,022	1	100	100

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IV. Discussion of financial statement components (cont.)

STATEMENT OF FINANCIAL POSITION as at 31 December 2012 (cont.)

LIABILITIES AND EQUITY	31.12.2012	31.12.2011	Change	Change	31.12.2012	31.12.2011
					Structure	Structure
Note	PLN'000	PLN'000	PLN'000	(%)	(%)	(%)
Amounts due to the central bank	3,128	3,454	(326)	(9)	-	-
Amounts due to banks	12. 2,502,888	5,321,390	(2,818,502)	(53)	1	3
Derivative financial instruments	4. 3,964,170	2,645,281	1,318,889	50	2	1
Amounts due to customers	13. 154,740,574	150,030,681	4,709,893	3	81	80
Debt securities in issue	14. 865,905	3,105,588	(2,239,683)	(72)	1	2
Subordinated liabilities	15. 1,631,256	1,614,377	16,879	1	1	1
Other liabilities	16. 1,799,363	2,156,523	(357,160)	(17)	1	1
Current income tax liabilities	145,274	77,532	67,742	87	-	-
Provisions	17. 719,095	615,489	103,606	17	-	-
Total liabilities	166,371,653	165,570,315	801,338	-	87	88
Share capital	1,250,000	1,250,000	-	-	1	1
Other capital	19,803,442	17,598,753	2,204,689	13	10	9
Net profit for the year	3,592,617	3,953,622	(361,005)	(9)	2	2
Total equity	18. 24,646,059	22,802,375	1,843,684	8	13	12
Total liabilities and equity	191,017,712	188,372,690	2,645,022	1	100	100

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IV. Discussion of financial statement components (cont.)

INCOME STATEMENT
for the financial year from 1 January to 31 December 2012

		2012	2011	Change	Change	2012	2011
	Note	PLN'000	PLN'000	PLN'000	(%)	Structure (%)	Structure (%)
Interest and similar income		12,753,964	11,818,059	935,905	8	75	74
Interest expense and similar charges		(4,981,528)	(4,313,090)	(668,438)	15	40	40
Net interest income	19.	7,772,436	7,504,969	267,467	4		
Fee and commission income		3,619,650	3,621,880	(2,230)	-	21	23
Fee and commission expense		(815,066)	(749,079)	(65,987)	9	6	7
Net fee and commission income	20.	2,804,584	2,872,801	(68,217)	(2)		
Dividend income	21.	93,200	94,028	(828)	(1)	1	-
Net income from financial instruments designated at fair value	22.	95,092	(78,538)	173,630	221	1	1
Gains less losses from investment securities		81,605	16,303	65,302	401	-	-
Net foreign exchange gains	23.	254,153	331,367	(77,214)	(23)	2	2
Other operating income		67,899	110,791	(42,892)	(39)	-	1
Other operating expense		(54,817)	(67,178)	12,361	(18)	-	-
Net impairment allowance and write-downs	24.	(2,458,590)	(1,812,122)	(646,468)	36	20	15
Administrative expenses	25.	(4,192,757)	(4,058,490)	(134,267)	3	34	37
Operating profit / Profit before income tax		4,462,805	4,913,931	(451,126)	(9)		
Income tax expense	26.	(870,188)	(960,309)	90,121	(9)		
Net profit		3,592,617	3,953,622	(361,005)	(9)		
Total income		16,965,563	15,992,428	973,135	6	100	100
Total expenses		(12,502,758)	(11,078,497)	(1,424,261)	13	100	100
Profit before income tax		4,462,805	4,913,931	(451,126)	(9)		

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IV. Discussion of financial statement components (cont.)

Selected ratios characterizing the Bank's financial position and results

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

	2012	2011
Profitability ratios		
Gross profitability (profit before income tax / total income)	26.3%	30.7%
Net profitability (net profit / total income)	21.2%	24.7%
ROE (net profit / average net assets) (2)	15.1%	18.0%
ROA (net profit / average total assets) (2)	1.9%	2.2%
Cost to income ratio (administrative expenses / profit on banking activities) (3)	37.7%	37.6%
Profitability ratio on interest-bearing assets (interest income / average interest-bearing assets) (2)	7.2%	7.1%
Cost of borrowings (interest expense / average interest-bearing liabilities) (2)	3.1%	2.9%
Asset quality ratios		
Interest-bearing assets to total assets (4)	93.2%	94.1%
Impaired loans to total gross loans and advances to customers	8.3%	7.2%
Coverage of impairment allowances of impaired loans advances to customers	45.4%	41.7%
Cost of risk (5)	1.4%	1.2%
Liquidity ratios		
Liquidity up to 1 month (6)	2.16	1.90
Liquidity up to 3 months (6)	1.98	1.66
Loans to deposits	91.8%	93.4%
Other ratios		
Capital adequacy ratio	12.93%	11.93%
Bank's own funds (PLN'000)	19,874,725	17,347,921
Total capital requirement (PLN'000)	12,299,343	11,635,379

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

(2) The average balances of balance sheet items were calculated on the basis of the balances of individual items at the beginning and the end of the current financial year and the prior financial year.

(3) The profit on banking activities understood as operating profit less administrative expenses and net impairment allowances.

(4) Interest-bearing assets are defined as balances with the central bank (excluding cash), amounts due from banks, loans and advances to customers, investment securities designated at fair value through profit and loss and securities held for trading.

(5) The cost of risk calculated by dividing net impairment allowances for loans and advances to customers for the period by the average balance of gross loans and advances to customers.

(6) Liquidity ratios are understood as the ratio of assets receivable to liabilities payable at the real term maturities as at the balance date.

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IV. Discussion of financial statement components (cont.)

Statement of financial position as at 31 December 2012

1. Cash and balances with the central bank

As at 31 December 2012, the balance of "Cash and balances with the central bank" amounted to PLN 10,229,230 thousand (PLN 9,060,280 thousand as at the end of 2011) and included PLN 7,550,898 thousand cash maintained by the Bank in an account with the National Bank of Poland (PLN 6,845,759 thousand as at 31 December 2011).

As at the balance date, the Bank calculated and maintained the mandatory reserve in accordance with Resolution No. 15/2004 of the Management Board of the National Bank of Poland dated 13 April 2004 on the principles and method of calculation and maintenance of the mandatory reserve by banks. As at 31 December 2012, the declared mandatory reserve to be maintained with the NBP amounted to PLN 4,999,918 thousand (PLN 4,975,268 thousand as at 31 December 2011).

2. Amounts due from banks

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

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Deposits with banks	2,445,915	1,914,393	531,522	28
Current accounts	589,139	279,622	309,517	111
Loans and advances granted	270,143	125,777	144,366	115
- including: to related entities	263,859	119,705	144,154	120
Receivables due to repurchase agreement	149,284	-	149,284	100
Receivables from unsettled transactions	29,373	32,385	(3,012)	(9)
Cash in transit	3,329	1,731	1,598	92
Total, gross	3,487,183	2,353,908	1,133,275	48
Impairment allowances	(30,792)	(33,710)	2,918	(9)
Total, net	3,456,391	2,320,198	1,136,193	49

The increase in the balance of amounts due from banks resulted mainly from an increase in the balance of deposits with banks and in current accounts (an increase of PLN 531,522 thousand, i.e. 28% and PLN 309,517 thousand, i.e. 111% respectively compared with the balances as at 31 December 2011). Additionally, there was an increase in the balance of loans granted to Kredobank SA – an increase in exposure of PLN 144,154 thousand, i.e. 120% compared with the balance as at 31 December 2011.

As at 31 December 2012, the impairment allowance for amounts due from banks amounted to PLN 30,792 thousand and was PLN 2,918 thousand (i.e. 9%) lower than the balance as at 31 December 2011. The balance mainly comprised an allowance for amounts due from banks in respect of unsettled transactions related to derivatives, declared as due and payable, in the amount of PLN 29,373 thousand (PLN 32,385 thousand as at 31 December 2011).

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IV. Discussion of financial statement components (cont.)

2. Amounts due from banks (cont.)

Amounts due denominated in foreign currencies represented an equivalent of PLN 2,878,327 thousand (i.e. 83%) of the balance of amounts due from banks as at the balance date (PLN 1,975,590 thousand, i.e. 84% of the balance as at 31 December 2011).

3. Trading assets

As at 31 December 2012, the balance of "Trading assets" with a value of PLN 282,230 thousand comprised the following items:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Treasury bonds (PLN)	216,521	1,219,069	(1,002,548)	(82)
Treasury bills	-	49,402	(49,402)	100
Other	65,709	42,618	23,091	54
Total	282,230	1,311,089	(1,028,859)	(78)

The decrease in the valuation of trading assets of PLN 1,028,859 thousand (i.e. 78%) as at the balance date was due to a decrease in the Bank's exposure to Polish Treasury bonds (a drop of PLN 1,002,548 thousand, i.e. 82%) and a decrease in the Bank's exposure to Treasury bills (a drop of PLN 49,402 thousand, there were none in the portfolio as at 31 December 2012). The said decrease was partly offset by an increase in the valuation of other securities (an increase of PLN 23,091 thousand, i.e. 54%). The portfolio of trading assets was subject to significant fluctuations as at the end of the individual months of the audited period, reaching the highest balance as at the end of August 2012 (PLN 2,750,193 thousand).

As at 31 December 2012, Polish Treasury bonds represented 77% of the balance of all trading assets.

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IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments

The balance of receivables in respect of the positive valuation of derivatives increased by PLN 796,307 thousand (i.e. 26%) compared with the end of 2011 and amounted to PLN 3,861,456 thousand as at 31 December 2012. The balance of liabilities in respect of the negative valuation of derivatives amounted to PLN 3,964,170 thousand and increased by PLN 1,318,889 thousand (i.e. 50%) compared with the end of 2011. The above amounts comprised the following items:

	31.12.2012	31.12.2012	31.12.2011	31.12.2011
	Assets	Liabilities	Assets	Liabilities
	PLN'000	PLN'000	PLN'000	PLN'000
Interest rate swaps	3,654,976	3,632,552	2,399,482	2,378,165
- including CIRS	357,675	370,043	419,640	421,039
Currency forwards	143,009	268,280	557,624	195,991
Options	63,301	61,932	106,492	70,112
Other	170	1,406	1,551	1,013
Total	3,861,456	3,964,170	3,065,149	2,645,281

The changes in the above balances as at 31 December 2012 compared with the balances as at 31 December 2011 is presented in the table below:

	Change	Change	Change	Change
	Assets	Assets	Liabilities	Liabilities
	PLN'000	%	PLN'000	%
Interest rate swaps	1,255,494	52	1,254,387	53
- including CIRS	(61,965)	(15)	(50,996)	(12)
Currency forwards	(414,615)	(74)	72,289	37
Options	(43,191)	(41)	(8,180)	(12)
Other	(1,381)	(89)	393	39
Total	796,307	26	1,318,889	50

In 2012, there was an increase in both the positive and negative valuation of derivative transactions. The most significant change related to an increase in the positive and negative valuation of interest rate transactions (IRS) (an increase in the positive valuation of PLN 1,280,968 thousand, i.e. 66% and in the negative valuation of PLN 1,258,655 thousand, i.e. 65% compared with the balances as at 31 December 2011) and was partly offset on the assets side by a decrease in the valuation of currency forwards, mainly currency swaps, of PLN 414,615 thousand (i.e. 74%).

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IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments (cont.)

As from 2009 the Bank has applied hedge accounting (a macro cash flow hedge) in accordance with IAS 39 F6.2 – F6.3. In 2012, the Bank did not establish any new hedging relationships and used the hedging relationships created in the previous years:

- a hedge of the cash flow volatility on mortgage loans denominated in CHF and negotiated deposits in PLN, as a result of the interest rate risk and the exchange risk, using CIRS transactions – due to the strategy being pursued in 2012, a net amount of PLN (350,414) thousand was recognized in the statement of comprehensive income;
- a hedge of the cash flow volatility on floating interest rate loans in EUR, as a result of the interest rate risk, using IRS transactions – due to the strategy being pursued in 2012, a net amount of PLN 27,024 thousand was recognized in the statement of comprehensive income;
- a hedge of the cash flow volatility on floating interest rate loans in PLN, as a result of the interest rate risk, using IRS transactions – due to the strategy being pursued in 2012, a net amount of PLN 15,609 thousand was recognized in the statement of comprehensive income;
- a hedge of the cash flow volatility on floating interest rate loans in CHF, as a result of the interest rate risk, using IRS transactions – due to the strategy being pursued in 2012, a net amount of PLN (2,505) thousand was recognized in the statement of comprehensive income.

In total, as a result of the application of hedge accounting the Bank recognized PLN (310,286) thousand net of deferred income tax (PLN 144,261 thousand net of deferred income tax in 2011) in the statement of comprehensive income. At the same time, the Bank recognized the ineffective portion of the cash flow volatility hedges in the amount of PLN 7,938 thousand in the income statement (PLN (64,342) thousand in 2011) (Note 22).

In 2012 PLN (1,296,830) thousand of the comprehensive income was recognized in the income statement (PLN 1,112,235 thousand in 2011) (Note 19).

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

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

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IV. Discussion of financial statement components (cont.)

4. Derivative financial instruments (cont.)

As at the balance date, the net valuation of derivative transactions designated for hedge accounting as part of two hedging relationships applied by the Bank based on these instruments amounted to PLN 273,757 thousand:

	Assets 31.12.2012 PLN'000	Liabilities 31.12.2012 PLN'000	Net 31.12.2012 PLN'000
Fair value measurement, including:	24,566	(56,038)	(31,472)
- measurement up until the date of introducing hedge accounting (net income/loss from financial instruments measured at fair value)	68,100	(82,315)	(14,215)
- measurement from the date of introducing hedge accounting (revaluation reserve)	(43,534)	26,277	(17,257)
Foreign exchange differences on the revaluation of the nominal amount (net foreign exchange gains/losses)	298,714	(185,049)	113,665
Interest accrued (net interest income)	174,850	16,714	191,564
Total	498,130	(224,373)	273,757

As at 31 December 2011, the net valuation of derivative transactions designated for hedge accounting amounted to PLN 174,327 thousand:

	Assets 31.12.2011 PLN'000	Liabilities 31.12.2011 PLN'000	Net 31.12.2011 PLN'000
Fair value measurement, including:	313,182	67,845	381,027
- measurement up until the date of introducing hedge accounting (net income/loss from financial instruments measured at fair value)	111,117	(100,373)	10,744
- measurement from the date of introducing hedge accounting (revaluation reserve)	202,065	168,218	370,283
Foreign exchange differences on the revaluation of the nominal amount (net foreign exchange gains/losses)	74,732	(453,863)	(379,131)
Interest accrued (net interest income)	129,011	43,420	172,431
Total	516,925	(342,598)	174,327

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IV. Discussion of financial statement components (cont.)

5. Financial assets designated upon initial recognition at fair value through profit and loss

The balance of "Financial assets designated upon initial recognition at fair value through profit and loss" increased by PLN 147,716 thousand (i.e. 1%) compared with the end of 2011 and amounted to PLN 12,614,917 thousand as at 31 December 2012. The portfolio comprised the following categories of securities:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
NBP bills	9,995,300	8,593,791	1,401,509	16
Treasury bonds (PLN)	1,322,226	1,318,278	3,948	-
Treasury bills	1,040,863	2,180,148	(1,139,285)	(52)
Municipal bonds (EUR)	145,343	143,973	1,370	1
Municipal bonds (PLN)	111,185	108,922	2,263	2
Treasury bonds (EUR)	-	122,089	(122,089)	(100)
Total	12,614,917	12,467,201	147,716	1

The increase in the balance of financial assets designated upon initial recognition at fair value through profit and loss resulted mainly from a change in the Bank's exposure to short-term securities – compared with the end of 2011 the balance of NBP bills increased by PLN 1,401,509 thousand (i.e. 16%) and was offset by a decrease in the Bank's exposure to Treasury bills (a decrease of PLN 1,139,285 thousand, i.e. 52%) and Treasury bonds denominated in EUR (a decrease of PLN 122,089 thousand, there were none in the portfolio as at 31 December 2012).

All of the financial assets designated upon initial recognition at fair value through profit and loss were issued by Polish entities. As at the balance date, instruments quoted on organized stock exchanges represented 11% of the balance (11% as at the end of 2011).

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IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers

In 2012, the portfolio of loans and advances to customers, measured by reference to the gross value of loans granted, increased by PLN 3,272,048 thousand (i.e. 2%) compared with the balance as at 31 December 2011, reaching PLN 148,313,487 thousand. This increase was mainly due to the reclassification, in September and December 2012, of debt securities from the portfolio of investment securities available for sale in the amount of PLN 2,073,951 thousand (there were no corporate or municipal bonds in the portfolio of loans and advances as at the end of 2011) to the portfolio of loans and advances to customers, in accordance with IAS 39.50E.

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

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

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Financial sector (excluding banks)	3,177,999	3,220,155	(42,156)	(1)
corporate loans	3,177,999	3,220,155	(42,156)	(1)
Non-financial sector	137,530,488	136,754,855	775,633	1
mortgage loans	72,059,644	70,880,841	1,178,803	2
corporate loans	42,719,131	41,625,770	1,093,361	3
consumer loans	21,848,645	24,248,244	(2,399,599)	(10)
debt securities	903,068	-	903,068	100
Public sector	7,605,000	5,066,429	2,538,571	50
corporate loans	6,429,961	5,066,429	1,363,532	27
debt securities	1,175,039	-	1,175,039	100
Total loans and advances, gross	148,313,487	145,041,439	3,272,048	2
Impairment allowance	(6,228,629)	(4,982,790)	(1,245,839)	25
Total loans and advances, net	142,084,858	140,058,649	2,026,209	1

As at the balance date, PLN 29,992,389 thousand (i.e. 20%) worth of the balance of gross loans represented amounts due in foreign currencies (PLN 33,984,423 thousand, i.e. 23% as at 31 December 2011), of which 72% related to the Swiss franc (no change compared with 31 December 2011).

After eliminating the effect of increases in foreign exchange rates, the increase in the gross loan portfolio in 2012 would amount to approx. PLN 5.7 bn (i.e. 4%), of which a drop of approx. PLN 1.4 bn (i.e. 6%) would relate to mortgage loans denominated in CHF.

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IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers (cont.)

b) The Bank's loan portfolio in terms of quality

	31.12.2012	31.12.2011	31.12.2012	31.12.2011
	PLN'000	PLN'000	Structure	Structure
			%	%
Impaired loans and advances	12,316,775	10,395,779	8,3	7,2
Not impaired loans and advances, gross	135,996,712	134,645,660	91,7	92,8
Total loans and advances, gross	148,313,487	145,041,439	100,0	100,0
Allowances on impaired loans and advances	(5,589,629)	(4,330,276)	89,7	86,9
Allowances on incurred but not identified losses (IBNI)	(639,000)	(652,514)	10,3	13,1
Total impairment allowances on loans and advances	(6,228,629)	(4,982,790)	100,0	100,0
Total loans and advances, net	142,084,858	140,058,649		

As at the end of 2012, the share of impaired loans in the total loan portfolio increased compared with the end of 2011 and amounted to 8.3% (7.2% as at 31 December 2011). At the same time, the coverage ratio of impairment allowances for impaired loans increased and amounted to 45.4% (41.7% as at 31 December 2011).

The deterioration in the quality of the loan portfolio related mainly to loans to small and medium enterprises and to corporate clients. The sale of loans is an important part of managing non-performing loans. The sales performed in 2012 (mainly in the area of consumer loans) limited the growth of the non-performing loans ratio (had there been no sales of the portfolio in 2012, the impaired loans ratio would have amounted to 8.9% as at the end of 2012).

The total gross carrying amount of loans sold was PLN 981,400 thousand (the net amount was PLN 272,969 thousand).

The share of allowances for exposures valued under the individualized method in total allowances was higher than in the previous year – as at the balance date, the said allowance amounted to PLN 2,261,663 thousand (36% of the total allowances), whereas as at 31 December 2011 it amounted to PLN 1,498,059 thousand (30% of the total allowances).

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IV. Discussion of financial statement components (cont.)

6. Loans and advances to customers (cont.)

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

The reconciliation of the change in the balance of impairment allowances on loans and advances to customers in the statement of financial position and the net impairment allowance as at 31 December 2012 is presented below (in PLN'000):

	<u>consumer loans</u>	<u>housing and developer loans</u>	<u>corporate loans and debt securities</u>	<u>Total</u>
Impairment allowances on loans and advances to customers in the statement of financial position as at 31 December 2011	(1,451,068)	(1,234,974)	(2,296,748)	(4,982,790)
Net impairment allowance on loans recognised	(565,650)	(457,175)	(1,085,972)	(2,108,797)
Other changes	(12,080)	32,690	11,219	31,829
Decrease in impairment allowances due to the derecognition of assets, not affecting the income statement	<u>611,078</u>	<u>19,598</u>	<u>200,453</u>	<u>831,129</u>
Impairment allowances on loans and advances to customers in the statement of financial position as at 31 December 2012	<u>(1,417,720)</u>	<u>(1,639,861)</u>	<u>(3,171,048)</u>	<u>(6,228,629)</u>

The item "Other changes" in the amount of PLN 31,829 thousand includes, among others, foreign exchange differences relating to impairment allowances which, in 2012, reduced the balance of impairment allowances in the statement of financial position by PLN 64,921 thousand.

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IV. Discussion of financial statement components (cont.)

7. Investment securities available for sale

As at 31 December 2012, the balance of "Investment securities available for sale" decreased by PLN 2,107,527 thousand (i.e. 15%) compared with the balance as at 31 December 2011 and amounted to PLN 12,061,406 thousand (PLN 14,168,933 thousand as at 31 December 2011).

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Treasury bonds	7,619,522	8,310,429	(690,907)	(8)
Municipal bonds	2,780,212	3,458,356	(678,144)	(20)
Corporate bonds	1,517,239	2,322,398	(805,159)	(35)
Listed equity instruments	32,498	39,357	(6,859)	(17)
Other	111,935	38,393	73,542	192
Total	12,061,406	14,168,933	(2,107,527)	(15)

The change in the balance as at the balance date was mainly due to the reclassification of corporate and municipal bonds in the amount of PLN 2,073,951 thousand to the portfolio of loans and advances to customers (Note 6), as well as a decrease in the Bank's exposure to Treasury bonds (a decrease of PLN 690,907 thousand, i.e. 8% compared with the balance as at 31 December 2011).

The balance of "Other" includes, *i.a.*, the Bank's exposure to the Marguerite Fund. This exposure amounted to PLN 103,227 thousand as at 31 December 2012 (an increase of PLN 91.743 million, i.e. 89% compared with the end of 2011).

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IV. Discussion of financial statement components (cont.)

8. Investments in subsidiaries, jointly controlled entities and associates

As at 31 December 2012, the balance of investments in subsidiaries, jointly controlled entities and associates amounted to PLN 1,171,005 thousand and was PLN 326,970 thousand (i.e. 22%) lower than the balance as at 31 December 2011.

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

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Subsidiaries	1,040,822	1,329,357	(288,535)	(22)
- value at cost	1,644,924	1,763,746	(118,822)	(7)
- impairment allowance	(604,102)	(434,389)	(169,713)	39
Jointly controlled entities	23,434	61,869	(38,435)	(62)
- value at cost	61,869	61,869	-	-
- impairment allowance	(38,435)	-	(38,435)	100
Associates	106,749	106,749	-	-
- value at cost	148,029	148,029	-	-
- impairment allowance	(41,280)	(41,280)	-	-
Shares in subsidiaries, jointly controlled entities and associates	1,171,005	1,497,975	(326,970)	(22)

The decrease in the gross amount of investments in subsidiaries, jointly controlled entities and associates of PLN 118,822 thousand was caused mainly by the liquidation of Centrum Finansowe Puławska Sp. z o.o. in liquidation and the acquisition of the company's assets by the Bank, together with the property on which the Bank's Head Office is located in Warsaw (the amount of the investment in the company amounted to PLN 167,288 thousand as at 31 December 2011). This decrease was partly offset by shares being taken up in the increased capital of Fort Mokotów Inwestycje Sp. z o.o. in the amount of PLN 29,735 thousand and shares being taken up in Inter-Risk Ukraina Spółka z dodatkową odpowiedzialnością in the amount of PLN 19,713 thousand.

The decrease in the balance of investments in subsidiaries, jointly controlled entities and associates resulted also from the impairment allowances recognized by the Bank in 2012. In 2012, the Bank recognized an impairment allowance for shares in the following subsidiaries: Kredobank SA – in the amount of PLN 150,000 thousand and Inter-Risk Ukraina – in the amount of PLN 19,713 thousand, as well as shares in a jointly controlled entity, Centrum Haffnera – in the amount of PLN 38,435 thousand.

In 2012, the Bank increased the capital of a subsidiary, BFL SA, by PLN 20,000 thousand. As at 31 December 2012, the increase in the capital had not yet been registered and is presented in "Other assets" (Note 11).

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IV. Discussion of financial statement components (cont.)

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

The Bank's key investments in subsidiaries, jointly controlled entities and associates as at 31 December 2012 are described in the table below:

	Gross value	Impairment	Net value	Structure
	PLN'000	PLN'000	PLN'000	(%)
Subsidiaries	1,644,924	(604,102)	1,040,822	89
KREDOBANK SA	935,619	(573,723)	361,896	31
PKO BP BANKOWY PTE SA	205,786	-	205,786	18
PKO Towarzystwo Funduszy Inwestycyjnych SA	186,989	-	186,989	16
other	316,530	(30,379)	286,151	24
Jointly controlled entities	61,869	(38,435)	23,434	2
Centrum Haffnera Sp. z o.o.	44,371	(38,435)	5,936	1
other	17,498	-	17,498	1
Associates	148,029	(41,280)	106,749	9
Bank Pocztowy SA	146,500	(39,780)	106,720	9
other	1,529	(1,500)	29	-
Shares in subsidiaries, jointly controlled entities and associates	1,854,822	(683,817)	1,171,005	100

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IV. Discussion of financial statement components (cont.)

9. Intangible assets

As at the balance date, the balance of intangible assets amounted to PLN 1,681,120 thousand and was PLN 158,552 thousand (i.e. 10%) higher than the balance as at 31 December 2011. An analytical breakdown of the balance is presented in the table below.

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Software	2,731,205	2,775,173	(43,968)	(2)
Other intangible assets (including capital expenditure)	280,821	130,560	150,261	115
Total, gross	3,012,026	2,905,733	106,293	4
Accumulated amortization	(1,313,752)	(1,365,148)	51,396	(4)
Impairment allowances	(17,154)	(18,017)	863	(5)
Total, net	1,681,120	1,522,568	158,552	10

As at 31 December 2012, the most significant item of intangible assets was the Integrated Information System ("ZSI") which net book value amounted to PLN 709,428 thousand (PLN 707,925 thousand as at 31 December 2011). The expenditure on the ZSI system amounted to PLN 63,448 thousand in the audited year (PLN 68,827 thousand in 2011).

In the audited year, the balance of impairment allowances did not change much compared with the balance as at 31 December 2011. The value of an allowance relating to the unused functionalities of the ZSI system did not change in the audited year and amounted to PLN 15,373 thousand as at the balance date.

The wear and tear of intangible assets measured with the ratio of accumulated amortization to gross carrying amount of the intangible assets amounted to 44% as at the balance date (47% as at 31 December 2011).

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IV. Discussion of financial statement components (cont.)

10. Tangible fixed assets

As at the balance date, the carrying amount of "Tangible fixed assets" amounted to PLN 2,382,658 thousand and increased by PLN 369,344 thousand (i.e. 18%) compared with the end of 2011.

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Land and buildings	2,488,526	2,081,141	407,385	20
Machinery and equipment	1,952,522	1,887,837	64,685	3
Fixed assets under construction	251,065	133,508	117,557	88
Means of transport	862	1,373	(511)	(37)
Investment properties	793	793	-	-
Other	438,422	385,401	53,021	14
Tangible fixed assets, gross	5,132,190	4,490,053	642,137	14
Accumulated depreciation	(2,749,498)	(2,476,596)	(272,902)	11
Impairment allowance	(34)	(143)	109	(76)
Tangible fixed assets, net	2,382,658	2,013,314	369,344	18

As at the balance date, the gross amount of tangible fixed assets increased by PLN 642,137 thousand (i.e. 14%) compared with the end of the previous year. The increase in the balance related mainly to an increase in the value of land and buildings, mainly as a result of the acquisition of the assets of a liquidated subsidiary, Centrum Finansowe Puławska Sp. z o.o., including the building at Puławska Street in Warsaw (the net amount of the acquired assets amounted to PLN 238,330 thousand as at 31 December 2012).

The wear and tear of tangible fixed assets (excluding assets under construction) measured with the ratio of accumulated depreciation to gross tangible fixed assets amounted to 56% as at the balance date (57% as at 31 December 2011).

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

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IV. Discussion of financial statement components (cont.)

11. Other assets

The value of other assets increased by PLN 320,234 thousand (i.e. 66%) and amounted to PLN 803,024 thousand as at the balance date. The balance comprised the following asset categories:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Settlements of payment cards transactions	432,047	166,051	265,996	160
Settlements of financial instruments (a)	123,077	143,845	(20,768)	(14)
Receivables from unsettled transactions related to derivatives	64,564	90,689	(26,125)	(29)
Receivables related to clients' cash in transit	59,282	26,538	32,744	123
Receivables from customers	47,955	39,237	8,718	22
Accruals and prepayments	36,582	22,862	13,720	60
Receivables and settlements of securities turnover	25,453	1,730	23,723	1,371
Unregistered capital of a subsidiary, BFL SA	20,000	-	20,000	100
Inventory related to utilization, auxiliary operations and investment	16,218	20,160	(3,942)	(20)
Receivables from the State budget due to the distribution of court fee stamps	8,412	3,350	5,062	151
Other (b)	118,982	138,979	(19,997)	(14)
Total, gross	952,572	653,441	299,131	46
Impairment allowance (c)	(149,548)	(170,651)	21,103	(12)
Total, net	803,024	482,790	320,234	66

- (a) As at the balance date, settlements of financial instruments comprised mainly the settlement of the premium paid in respect of the purchase of currency options in the amount of PLN 62,783 thousand (PLN 41,574 thousand as at 31 December 2011).
- (b) As at 31 December 2012 the item 'Other' comprised mainly receivables due to shortages and losses with a gross amount of PLN 54,879 thousand, i.e. 47% of the balance (PLN 50,356 thousand, i.e. 38% of the balance as at 31 December 2011).
- (c) The balance of other assets as at 31 December 2012 was decreased by impairment allowances of PLN 149,548 thousand (PLN 170,651 thousand as at 31 December 2011). They comprised mainly allowances for receivables from unsettled transactions related to derivatives in the amount of PLN 56,113 thousand and in respect of shortages and losses in the amount of PLN 54,879 thousand.

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IV. Discussion of financial statement components (cont.)

12. Amounts due to banks

As at 31 December 2012, the balance of amounts due to banks decreased compared with the end of 2011 (a decrease of PLN 2,818,502 thousand, i.e. 53%) and comprised the following components:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Loans and advances received	1,393,048	3,443,872	(2,050,824)	(60)
Bank deposits	1,006,347	1,372,635	(366,288)	(27)
Current accounts	71,539	421,939	(350,400)	(83)
Other money market deposits	31,954	82,944	(50,990)	(61)
Total	2,502,888	5,321,390	(2,818,502)	(53)

The decrease in loans and advances received as at 31 December 2012 resulted mainly from the repayment of the loan granted to the Bank in the amount of CHF 950,000 thousand by a consortium of Polish and foreign banks, which was partially offset by drawing another consortium loan for a three year period with a value of CHF 410,000 thousand.

Additionally, the decrease in the balance was due to a decrease in bank deposits of PLN 366,288 thousand (i.e. 27%) and a decrease in the balance of current accounts of PLN 350,400 thousand (i.e. 83%) compared with the balance as at 31 December 2011.

As at the balance date, foreign currency payables represented 83% of the balance of amounts due to banks (81% as at 31 December 2011).

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IV. Discussion of financial statement components (cont.)

13. Amounts due to customers

As at the balance date, amounts due to customers amounted to PLN 154,740,574 thousand and increased by PLN 4,709,893 (i.e. 3%) compared with the end of 2011:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Amounts due to retail clients	110,127,352	103,424,136	6,703,216	6
term deposits	62,895,895	54,897,173	7,998,722	15
current accounts and overnight deposits	47,026,306	48,054,921	(1,028,615)	(2)
Other amounts due to customers	205,151	472,042	(266,891)	(57)
Amounts due to corporate entities	41,154,325	42,784,326	(1,630,001)	(4)
term deposits	17,381,502	24,012,372	(6,630,870)	(28)
current accounts and overnight deposits	11,545,398	11,187,998	357,400	3
loans and advances received (a)	10,709,239	6,453,092	4,256,147	66
amounts due from repurchase agreement	851,416	644,005	207,411	32
Other amounts due to customers	666,770	486,859	179,911	37
Amounts due to State budget entities	3,458,897	3,822,219	(363,322)	(10)
current accounts and overnight deposits	2,870,735	2,241,309	629,426	28
term deposits	562,397	1,516,981	(954,584)	(63)
Other amounts due to customers	25,765	63,929	(38,164)	(60)
Total amounts due to customers	<u>154,740,574</u>	<u>150,030,681</u>	<u>4,709,893</u>	3

(a) The balance of loans and advances received related mainly to a loan from a subsidiary PKO Finance AB (Sweden) of USD 1,000,000 thousand, CHF 750,000 thousand and EUR 850,000 thousand as at the balance date, including accrued interest, from the issue of the Bank's eurobonds under the EMTN program earmarked for international markets.

In 2012, the Bank continued to increase its deposit base. This objective was pursued by active acquisition of new funds through products addressed to retail clients (an increase in term deposits of PLN 7,998,722 thousand, i.e. 15%).

In 2012, the structure of amounts due to customers did not changed significantly – the share of term deposits decreased by 2 pp. (52% as at 31 December 2012 compared with 54% in the previous year), and the funds in current accounts and overnight deposits represented 40% of the balance of amounts due to customers (41% as at the end of 2011).

Liabilities denominated in foreign currencies represented 13% of the balance (an increase of 1 pp. compared with the balance as at 31 December 2011).

As at 31 December 2012, the value of the loans to deposits ratio (L/D) decreased and amounted to 91.8% (93.4% as at 31 December 2011).

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IV. Discussion of financial statement components (cont.)

14. Debt securities in issue

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Financial instruments measured at amortized cost – bank bonds issued	497,283	2,929,973	(2,432,690)	(83)
Financial instruments designated at fair value through profit and loss – bank securities issued	<u>368,622</u>	<u>175,615</u>	<u>193,007</u>	<u>110</u>
Total	<u>865,905</u>	<u>3,105,588</u>	<u>(2,239,683)</u>	72

In 2012, under the Bond Issue Program (the issue limit was set at PLN 5 billion) the Bank issued three-month zero-coupon bonds denominated in PLN. As at 31 December 2012, the Bank had bond liabilities in the nominal amount of PLN 500,000 thousand, at a discount rate of 4.76%, issued in November 2012.

Moreover, in 2012 the Bank offered its customers structured bank securities based on the value of the S&P500 index, the NASDAQ100 index, a basket of shares of American companies, the price of copper and gold, and a basket of assets (oil, silver, and copper). As at 31 December 2012, the Bank's liability in respect of the securities issued amounted to PLN 368,622 thousand (PLN 175,615 thousand as at 31 December 2011). In accordance with IAS 39.11A (a) the Bank does not separate the embedded derivative from its host contract and measures the entire instrument at fair value through profit and loss.

15. Subordinated liabilities

As at 31 December 2012, the balance of subordinated liabilities in the amount of PLN 1,631,256 thousand (PLN 1,614,377 thousand as at 31 December 2011) comprised 10-year bonds issued by the Bank in 2012 with a total nominal value of PLN 1,600,700 thousand and maturing on 14 September 2022 (with an option of early redemption in 2017).

In October 2012, the Bank performed a premature redemption of subordinated bonds with a total nominal value of PLN 1,600,700 thousand, which were issued by the Bank in 2007 (the call option was exercised).

The bonds were issued on the basis of the Act on Bonds dated 29 June 1995 with a view to increasing the Bank's supplementary funds in accordance with Article 127 par. 3, clause 2b of the Banking Law, pursuant to a decision of the Polish Financial Supervision Authority dated 18 September 2012 (the supplementary funds are increased by the nominal value of the bonds).

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IV. Discussion of financial statement components (cont.)

16. Other liabilities

As at 31 December 2012, the balance of other liabilities amounted to PLN 1,799,363 thousand and dropped by PLN 357,160 thousand (i.e. 17%) compared with the end of 2011. The balance comprised the following items:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Deferred income	343,366	277,150	66,216	24
Accounts payable	318,690	241,918	76,772	32
Other liabilities relating to:	1,137,307	1,637,455	(500,148)	(31)
interbank settlements	280,633	580,998	(300,365)	(52)
liabilities relating to investment activities and internal operations	197,663	182,955	14,708	8
liabilities relating to settlements of security transactions	148,572	279,204	(130,632)	(47)
liabilities arising from social and legal transactions	95,687	141,261	(45,574)	(32)
liabilities arising from foreign currency activities	81,306	140,546	(59,240)	(42)
liabilities related to payment cards	78,248	32,972	45,276	137
financial instruments settlements	59,547	82,861	(23,314)	(28)
liabilities due to suppliers	45,222	54,794	(9,572)	(17)
liabilities relating to interest on interest temporarily redeemed by the State budget	26,599	21,764	4,835	22
liabilities due to insurance companies	19,547	24,821	(5,274)	(21)
settlement of acquisition of machines, and materials, works and services regarding the construction of tangible assets and their usage	19,236	10,265	8,971	87
liabilities due to UOKiK (the Competition and Consumer Protection Office)	16,597	16,597	-	-
liabilities arising from sale of value marks	11,816	12,626	(810)	(6)
liabilities arising from transactions with financial and non-financial institutions	8,686	10,102	(1,416)	(14)
other	47,948	45,689	2,259	5
Total	1,799,363	2,156,523	(357,160)	(17)

As at the balance date, the largest share in the balance of other liabilities had deferred income of PLN 343,366 thousand – an increase of PLN 66,216 thousand (i.e. 24%) compared with the balance as at 31 December 2011 and accounts payable in the amount of PLN 318,690 thousand – an increase of PLN 76,772 thousand (i.e. 32%) compared with the balance as at 31 December 2011.

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IV. Discussion of financial statement components (cont.)

16. Other liabilities (cont.)

The decrease in the balance as at 31 December 2012 resulted mainly from a decrease in the balance of interbank settlements of PLN 300,365 thousand (i.e. 52%) due to a smaller balance of transfers awaiting settlement, ordered by customers after the end of the session, which will be completed on the following business day.

17. Provisions

As at 31 December 2012, provisions comprised the following items:

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Provisions for anniversary bonuses and retirement benefits	429,728	426,973	2,755	1
Provisions for liabilities and guarantees granted	215,619	111,769	103,850	93
Provision for legal claims	2,254	2,254	-	-
Other provisions	71,494	74,493	(2,999)	(4)
Total	719,095	615,489	103,606	17

The increase in the balance of provisions as at the end of 2012 resulted mainly from an increase in the level of provisions for liabilities and guarantees granted of PLN 103,850 thousand (i.e. 93%). This increase resulted mainly from the revaluation of guarantees granted to corporate clients.

Provisions for anniversary bonuses and retirement benefits were based on the calculations of an independent actuary included in the report dated February 2013. The report was prepared on the basis of the balances as at the balance date.

As at 31 December 2012, the item "Other provisions" included, *inter alia*, a restructuring provision (PLN 57,655 thousand). The restructuring provision covers future liabilities in respect of compensation and severance pay to employees whose employment contracts will be terminated for reasons other than their fault. In accordance with IAS 37.72, the basis for creating this provision is the Bank's employment restructuring plan.

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IV. Discussion of financial statement components (cont.)

18. Equity

Changes in equity in the audited year are shown in the table below:

	Share capital	Reserve capital	Financial assets available for sale	Cash flow hedges	General banking risk fund	Other reserves	Unappropriated profits	Total other capital	Net profit for the period	TOTAL
	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000	PLN'000
As at 31.12.2011	1,250,000	12,898,111	(51,164)	362,185	1,070,000	3,319,621	3,953,622	21,552,375	-	22,802,375
Change in the value of instruments available for sale net of deferred income tax	-	-	60,320	-	-	-	-	60,320	-	60,320
Hedge accounting	-	-	-	(310,286)	-	-	-	(310,286)	-	(310,286)
Net profit for 2012	-	-	-	-	-	-	-	-	3,592,617	3,592,617
Appropriation of profit for 2011 to equity	-	2,300,000	-	-	-	66,122	(2,366,122)	-	-	-
Impact of the acquisition of a subsidiary's assets and liabilities by the Bank	-	-	-	-	-	-	88,533	88,533	-	88,533
Dividend paid	-	-	-	-	-	-	(1,587,500)	(1,587,500)	-	(1,587,500)
As at 31.12.2012	1,250,000	15,198,111	9,156	51,899	1,070,000	3,385,743	88,533	19,803,442	3,592,617	24,646,059

Unappropriated profits include a difference in the amount of PLN 88,533 thousand resulting from the settlement of the acquisition of the assets of a subsidiary, Centrum Finansowe Puławska Sp. z o.o. (Note 8).

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IV. Discussion of financial statement components (cont.)

18. Equity (cont.)

On 6 June 2012, the General Meeting of Shareholder of Powszechna Kasa Oszczędności Bank Polski SA passed a resolution relating to the appropriation of profit for 2011, in the amount of PLN 3,953,622 thousand, according to which PLN 2,300,000 thousand was to be transferred to reserve capital, PLN 66,122 thousand was to be transferred to other reserves and PLN 1,587,500 thousand was to be paid out as a dividend.

As at 31 December 2012, the Bank's share capital amounted to PLN 1,250,000 thousand and consisted of 1,250,000,000 ordinary shares with a nominal value of PLN 1 each, including:

- 312,500,000 series A registered shares;
- 197,500,000 series A bearer shares;
- 105,000,000 series B bearer shares;
- 385,000,000 series C bearer shares;
- 250,000,000 series D bearer shares.

The Bank's own funds, calculated in accordance with the Banking Law and Resolution No. 325/2011 of the Polish Financial Supervision Authority, amounted to PLN 19,874,725 thousand as at the balance date (PLN 17,347,921 thousand as at 31 December 2011) and were PLN 7,575,382 thousand higher than the total capital requirement (PLN 12,299,343 thousand as at the end of 2012). As at the balance date, the capital adequacy ratio calculated on the basis of the banking and trading portfolios amounted to 12.93% (11.93% as at 31 December 2011).

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IV. Discussion of financial statement components (cont.)

Income statement for the financial year ended 31 December 2012

19. Net interest income

In 2012, net interest income amounted to PLN 7,772,436 thousand and increased by PLN 267,467 thousand (i.e. 4%) compared with 2011. The net interest income comprised the following items:

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Interest income:	12,753,964	11,818,059	935,905	8
Income from loans and advances to customers	10,170,927	9,581,320	589,607	6
Income from hedging instruments	870,450	814,275	56,175	7
Income from securities designated upon initial recognition at fair value through profit and loss	729,572	561,826	167,746	30
Income from investment securities	667,074	557,750	109,324	20
Income from placements with banks	249,826	218,682	31,144	14
Income from trading assets	59,264	74,847	(15,583)	(21)
Other	6,851	9,359	(2,508)	(27)
Interest expense:	(4,981,528)	(4,313,090)	(668,438)	15
Interest expense on amounts due to customers	(4,736,087)	(4,133,424)	(602,663)	15
Interest expense on debt securities in issue	(205,435)	(130,568)	(74,867)	57
Interest expense on deposits from banks	(26,979)	(45,684)	18,705	(41)
Premium expense on debt securities available for sale	(9,911)	(1,322)	(8,589)	650
Other expenses	(3,116)	(2,092)	(1,024)	49
Net interest income	<u>7,772,436</u>	<u>7,504,969</u>	<u>267,467</u>	<u>4</u>

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IV. Discussion of financial statement components (cont.)

19. Net interest income (cont.)

The increase in interest income of PLN 935,905 thousand (i.e. 8%) in 2012 was caused mainly by interest income on loans and advances to customers which was higher than in 2011 (an increase of PLN 589,607 thousand, i.e. 6%). This was mainly due to an increase in reference interest rates (the average annual WIBOR 1M rate amounted to 4.77% in 2012 compared with 4.37% in 2011).

The growth rate of interest expense was nearly twice as high and amounted to 15%, which translated into an increase in interest expense of PLN 668,438 thousand in 2012. This was mainly the result of higher interest expense on amounts due to customers and the higher costs of issuing own debt securities (an increase of PLN 602,663 thousand, i.e. 15% and of PLN 74,867 thousand, i.e. 57% respectively). This increase resulted mainly from the increase in the balance of amounts due to customers (an increase of PLN 4,709,893 thousand, i.e. 3% in 2012 (Note 13)).

As a result, the interest margin calculated as the ratio of the net interest income to interest income dropped by 3 pp. in 2012 and amounted to 61%. The interest spread, calculated as the difference between the ratio of interest income to interest-bearing assets and the cost of borrowings, amounted to 4.1% and did not change much (a drop of 0.1 p.p.) compared with 2011.

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IV. Discussion of financial statement components (cont.)

20. Net fee and commission income

In 2012, net fee and commission income amounted to PLN 2,804,584 thousand and dropped by PLN 68,217 thousand (i.e. 2%) compared with 2011. The net fee and commission income comprised the following items:

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Fee and commission income	3,619,650	3,621,880	(2,230)	-
Income from payment cards	1,163,918	1,020,600	143,318	14
Income from maintenance of bank accounts	865,290	903,972	(38,682)	(4)
Income from loans and advances	567,904	574,044	(6,140)	(1)
Income from loan insurance	415,339	515,499	(100,160)	(19)
Income from maintenance of investment funds (including management fees)	177,221	187,566	(10,345)	(6)
Income from cash transactions	122,841	148,325	(25,484)	(17)
Income from securities transactions	82,794	70,295	12,499	18
Income from servicing foreign mass transactions	48,785	47,966	819	2
Income from performing the role of an agent for the issue of Treasury bonds	39,295	29,669	9,626	32
Income from sale and distribution of court fee stamps	25,624	18,625	6,999	38
Income from fiduciary activities	3,699	2,806	893	32
Other	106,940	102,513	4,427	4
Fee and commission expense	(815,066)	(749,079)	(65,987)	9
Expenses on payment cards	(492,947)	(373,697)	(119,250)	32
Expenses on loan insurance	(111,320)	(133,488)	22,168	(17)
Expenses on acquisition services	(94,636)	(117,603)	22,967	(20)
Expenses on settlement services	(24,053)	(20,971)	(3,082)	15
Expenses on fee and commissions for operating services rendered by banks	(9,994)	(11,340)	1,346	(12)
Other	(82,116)	(91,980)	9,864	(11)
Net fee and commission income	2,804,584	2,872,801	(68,217)	(2)

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IV. Discussion of financial statement components (cont.)

20. Net fee and commission income (cont.)

In 2012, fee and commission income decreased slightly by PLN 2,230 thousand. This drop resulted mainly from a decrease of PLN 100,160 thousand (i.e. 19%) in income from loan insurance and a decrease of PLN 38,682 thousand (i.e. 4%) in income from maintenance of bank accounts, partly offset by an increase of PLN 143,318 thousand (i.e. 14%) in income from payment cards. The drop in the income from loan insurance resulted mainly from a decrease in the volume of consumer loans granted (a drop in the volume of consumer loans of PLN 2,399,599 thousand, i.e. 10% (Note 6)) and the reimbursement of commissions to customers due to the early repayment of loans or the renouncement of insurance. The drop in income from maintenance of bank accounts and cash transactions (of PLN 38,682 thousand, i.e. 4% and PLN 25,484 thousand, i.e. 17% respectively) resulted from the introduction of a new offer intended for retail clients; whereas the increase in income from credit cards resulted mainly from an increase in the number of payment card transactions compared with the previous year (a 2% increase compared with 2011) and an increase in the average transaction value (a 9% increase compared with the previous year).

In 2012, the balance of fee and commission expense increased by PLN 65,987 thousand (i.e. 9%) compared with 2011. This increase was caused mainly by expenses on payment cards being PLN 119,250 thousand (i.e. 32%) higher. This increase was partly offset by a decrease in commission expenses on loan insurance (a drop of PLN 22,168 thousand, i.e. 17%) and in expenses on acquisition services (a drop of PLN 22,967 thousand, i.e. 20%) as a result of a decrease in the volume of products sold through this channel and the rates of commissions received by agents and intermediaries being lowered.

21. Dividend income

In 2012, dividend income amounted to PLN 93,200 thousand and was PLN 828 thousand (i.e. 1%) lower than in 2011. This amount comprised mainly the dividends paid by PKO Towarzystwo Funduszy Inwestycyjnych SA – PLN 37,884 thousand (PLN 48,200 thousand in 2011), Inteligo Financial Services SA – PLN 19,898 thousand (PLN 16,716 thousand in 2011), Centrum Finansowe Puławska Sp. z o.o. – PLN 16,119 thousand (no dividend paid in 2011) and Centrum Elektronicznych Usług Płatniczych “eService” SA – PLN 10,000 thousand (PLN 22,200 thousand in 2011).

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IV. Discussion of financial statement components (cont.)

22. Net income from financial instruments designated at fair value through profit and loss

In 2012, the gain on financial instruments designated at fair value through profit and loss amounted to PLN 95,092 thousand (a loss of PLN 78,538 thousand in the previous year):

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Debt instruments	103,534	7,003	96,531	1,378
Derivative instruments	3,899	(88,585)	92,484	104
Structured Bank securities at fair value through profit and loss	(11,306)	3,630	(14,936)	(411)
Equity instruments	(1,035)	(612)	(423)	69
Other	-	26	(26)	(100)
Total	95,092	(78,538)	173,630	221

The item "Derivative instruments" includes the net realized income and the measurement of derivative instruments with the exception of foreign currency transactions the value of which is recognized in net foreign exchange gains (losses) (Note 23).

The net income from derivative instruments also includes the ineffective portion of cash flow hedges recognized in the income statement in the amount of PLN 7,938 thousand ((PLN 64,342) thousand in 2011) (Note 4).

23. Net foreign exchange gains

In 2012, net foreign exchange gains amounted to PLN 254,153 thousand (PLN 331,367 thousand in 2011) and included gains and losses on revaluation and on transactions in assets and liabilities in foreign currencies, and the fair value measurement of foreign exchange derivatives (FX forward, FX swap, CIRS and currency options). Compared with 2011, net foreign exchange gains dropped by PLN 77,214 thousand (i.e. 23%).

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IV. Discussion of financial statement components (cont.)

24. Net impairment allowance and write-downs

In 2012, the net impairment allowance and write-downs were negative (an excess of allowances and write-downs recognized over those reversed) and amounted to PLN 2,458,590 thousand (an increase in the negative balance of PLN 646,468 thousand compared with 2011).

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Loans and advances to customers	(2,108,797)	(1,731,396)	(377,401)	22
Investments in subsidiaries, jointly controlled entities and associates	(208,148)	(24,707)	(183,441)	742
Provisions for off-balance sheet liabilities	(104,367)	(36,271)	(68,096)	188
Investment securities available for sale	(14,988)	(1,924)	(13,064)	679
Intangible assets	(3,695)	-	(3,695)	100
Tangible fixed assets	(3,257)	984	(4,241)	(431)
Amounts due from banks	(174)	2,815	(2,989)	(106)
Other	(15,164)	(21,623)	6,459	(30)
Net impairment allowance and write-downs	<u>(2,458,590)</u>	<u>(1,812,122)</u>	<u>(646,468)</u>	36

The increase in net impairment allowances for corporate loans of PLN 396,023 thousand (i.e. 57%) contributed significantly to the change in the balance in 2012, mainly in connection with the deterioration in the quality of the portfolio of loans to small and medium enterprises and mortgage loans – an increase of PLN 78,136 thousand (i.e. 21%), which was offset by a drop in net impairment allowances for consumer loans (a drop of PLN 96,758 thousand, i.e. 15%). The cost of risk amounted to 1.4% in 2012 and was 0.2 pp. higher than in the previous year. Detailed information on the quality of the loan portfolio is presented in Note 6.

Additionally, in 2012 the Bank set up provisions for off-balance sheet liabilities in the amount of PLN 104,367 thousand and recognized an impairment allowance for its shares in Kredobank (PLN 150,000 thousand), Centrum Haffnera (PLN 38,435 thousand) and Inter-Risk Ukraina (PLN 19,713 thousand) (Note 8).

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IV. Discussion of financial statement components (cont.)

25. Administrative expenses

Administrative expenses incurred by the Bank in 2012 amounted to PLN 4,192,757 thousand and were PLN 134,267 thousand (i.e. 3%) higher than the expenses incurred in 2011:

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Staff costs	(2,308,061)	(2,224,040)	(84,021)	4
Overheads	(1,199,405)	(1,184,695)	(14,710)	1
Depreciation and amortization	(479,992)	(452,698)	(27,294)	6
Taxes and fees	(61,311)	(60,320)	(991)	2
Contribution and payments to the Bank Guarantee Fund	(143,988)	(136,737)	(7,251)	5
Total	(4,192,757)	(4,058,490)	(134,267)	3

The increase in administrative expenses in 2012 resulted mainly from an increase in staff costs which comprised mainly an increase in wages and salaries of PLN 43,097 thousand (i.e. 2%), which amounted to PLN 1,928,946 thousand in 2012 (PLN 1,885,849 thousand in 2011).

The increase in overheads in 2012 comprised mainly an increase of PLN 21,316 thousand (i.e. 9%) in administrative activity costs, which amounted to PLN 261,224 thousand in 2012 and an increase of PLN 5,989 thousand (i.e. 2%) in the costs of maintenance and rental of non-current assets, which amounted to PLN 351,515 thousand in 2012. This increase was partly offset by a decrease in promotion and advertising costs which amounted to PLN 134,644 thousand in 2012 (PLN 155,555 thousand in 2011).

The increase in administrative expenses was also caused by an increase in depreciation and amortization expense (an increase of PLN 27,294 thousand, i.e. 6%) and an increase in fees paid to the Bank Guarantee Fund (an increase of PLN 7,251 thousand, i.e. 5%).

The Bank's effectiveness ratios in the audited year were as follows:

	2012	2011
	PLN'000	PLN'000
Administrative expenses	(4,192,757)	(4,058,490)
Average annual number of employees	26,044	26,444
Administrative expenses per employee	(161)	(153)
Net profit per employee	138	150

The cost to income ratio for the audited year amounted to 37.7% (37.6% for 2011). The deterioration in the C/I ratio was mainly caused by an increase in costs. At the same time, the net profit per employee decreased (a drop of 8% compared with 2011). Administrative expenses per employee increased mainly as a result of a drop in the number of employees of 400 (the annual average).

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IV. Discussion of financial statement components (cont.)

26. Income tax expense

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

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Deferred income tax (a)	(73,763)	(50,194)	(23,569)	47
Current income tax expense (b)	(796,425)	(910,115)	113,690	(12)
Income tax expense recognized in the income statement	(870,188)	(960,309)	90,121	(9)
Income tax expense recognized in other comprehensive income	58,636	(28,595)	87,231	(305)
Total	(811,552)	(988,904)	177,352	(18)

The effective tax rate amounted to 19.5% in 2012 and did not change compared with the previous year.

(a) Deferred income tax

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

	Statement of financial position 31.12.2012	Statement of financial position 31.12.2011	Income statement
	PLN'000	PLN'000	PLN'000
Deferred income tax provision			
Interest accrued on receivables	193,308	176,076	17,232
Interest capitalized on "pass" mortgage loans	169,830	190,844	(21,014)
Interest on securities	14,567	58,187	(43,620)
Valuation of derivatives, including:	18,450	94,471	x
- recognized in the income statement	6,276	9,514	(3,238)
- recognized in other comprehensive income	12,174	84,957	x
Valuation of securities, including:	6,037	16,414	x
- recognized in the income statement	3,889	15,443	(11,554)
- recognized in other comprehensive income	2,148	971	x
Difference between the carrying values of tangible fixed assets and their tax bases	333,554	293,318	40,236
Gross deferred income tax provision	735,746	829,310	x
- recognized in the income statement	721,424	743,382	(21,958)
- recognized in other comprehensive income	14,322	85,928	x

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IV. Discussion of financial statement components (cont.)

26. Income tax expense (cont.)

(a) Deferred income tax (cont.)

	Statement of financial position 31.12.2012	Statement of financial position 31.12.2011	Income statement
	PLN'000	PLN'000	PLN'000
Deferred income tax assets:			
Interest accrued on liabilities	235,244	391,527	(156,283)
Valuation of derivative instruments	10,661	16,093	(5,432)
Valuation of securities, including:	-	24,550	x
- recognized in the income statement	-	11,580	(11,580)
- recognized in other comprehensive income	-	12,970	x
Provisions for anniversary bonuses and retirement benefits, and other employee benefits	131,770	126,714	5,056
Impairment allowances	494,933	414,558	80,375
Adjustment to ESP valuation	187,166	211,011	(23,845)
Other	44,979	28,991	15,988
Gross deferred income tax assets	1,104,753	1,213,444	x
- recognized in the income statement	1,104,753	1,200,474	(95,721)
- recognized in other comprehensive income	-	12,970	x
Net impact of the deferred income tax on the income statement	-	-	(73,763)

Due to the fact that the Bank recognized net deductible differences as at the end of 2012, it recognized a deferred income tax asset of PLN 369,007 thousand (PLN 384,134 thousand as at the end of 2011).

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IV. Discussion of financial statement components (cont.)

26. Income tax expense (cont.)

(b) Current income tax

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

	2012	2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Profit before income tax	4,462,805	4,913,931	(451,126)	(9)
Current tax at 19%	(847,933)	(933,647)	85,714	(9)
Permanent differences between profit/loss before income tax and taxable income, including:	(75,151)	(28,613)	(46,538)	163
Allowances reversed/(recognized) and positive revaluation which do not constitute taxable income/tax-deductible costs	(42,388)	(36,356)	(6,032)	17
Impact of recognition of an allowance which does not constitute tax-deductible costs (Kredobank SA)	(28,500)	-	(28,500)	100
Other non-deductible costs	(22,029)	(10,309)	(11,720)	114
Dividend income	17,708	17,859	(151)	(1)
Other	58	193	(135)	(70)
Other differences, including donations	52,896	1,951	50,945	2,611
Corporate income tax recognized in the income statement	(870,188)	(960,309)	90,121	(9)
Effective tax rate	19.5%	19.5%	-	-
Temporary difference resulting from deferred tax recognized in the income statement	(73,763)	(50,194)	(23,569)	47
Total current income tax expense	(796,425)	(910,115)	113,690	(12)

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IV. Discussion of financial statement components (cont.)

27. Off-balance sheet items

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

	31.12.2012	31.12.2011	Change	Change
	PLN'000	PLN'000	PLN'000	(%)
Off-balance sheet liabilities granted, including:	44,029,485	38,075,797	5,953,688	16
Financing granted	32,476,929	30,671,744	1,805,185	6
Guarantees and warranties granted – nominal value	11,552,556	7,404,053	4,148,503	56
Off-balance sheet liabilities received, including:	2,963,532	2,280,636	682,896	30
Guarantees and warranties received	1,707,143	1,905,208	(198,065)	(10)
Financing received	1,256,389	375,428	880,961	235

The increase in off-balance sheet liabilities granted of PLN 5,953,688 thousand was caused by an increase in the nominal value of guarantees and warranties granted of PLN 4,148,503 thousand (i.e. 56%) and an increase in off-balance sheet liabilities related to financing of PLN 1,805,185 thousand (i.e. 6%).

Off-balance sheet liabilities received increased by PLN 682,896 thousand (i.e. 30%) in 2012.

The item “Guarantees and warranties received” relates mainly to guarantees of loan repayment received, including PLN 1,380,228 thousand relating to a State Treasury guarantee of repayment of mortgage loans of the so-called “old portfolio” in accordance with the Act of 29 November 2000 on the State Treasury guaranteeing the repayment of specific mortgage loans (PLN 1,609,472 thousand as at 31 December 2011).

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V. Statements of the independent registered auditor

- (a) The Management Board of the Bank provided all the information, explanations, and representations required by us in the course of the audit and provided us with a representation letter confirming the completeness of the information included in the accounting records and the disclosure of all contingent liabilities and subsequent events which occurred up to the date on which that letter was signed.
- (b) The scope of the audit was not limited.
- (c) The Bank has up-to-date documentation of its accounting policies, approved by the Management Board. The Bank's accounting policies were tailored to its needs and ensured the recognition of all events with a material effect on the assessment of its financial position and results, taking into consideration the prudence principle. There were no changes to the accounting policies compared with the previous year.
- (d) The closing balances as at the end of the previous year were correctly brought forward as the opening balances of the current financial year in all material respects.
- (e) The counts of assets and liabilities were carried out and reconciled in accordance with the Accounting Act, and the results were included in the accounting records for the audited year.
- (f) The financial statements of the Bank as at and for the year ended 31 December 2011 were approved by Resolution No. 3/2012 passed by the General Meeting of Shareholder on 6 June 2012 filed with the National Court Register in Warsaw on 15 June 2012 and published in *Monitor Polski B* No. 2405 on 8 October 2012.
- (g) On 6 June 2012, the General Meeting of Shareholders of Powszechna Kasa Oszczędności Bank Polski SA passed a resolution relating to the appropriation of profit for 2011, in the amount of PLN 3,953,622 thousand, according to which PLN 2,300,000 thousand was to be transferred to reserve capital, PLN 66,122 thousand was to be transferred to other reserves and PLN 1,587,500 thousand was to be paid out as a dividend.
- (h) The financial statements for the previous year were audited by PricewaterhouseCoopers Sp. z o.o. The registered auditor issued an unqualified opinion.
- (i) We have assessed the operation of the accounting system. Our assessment covered in particular:
 - the accuracy of the documentation relating to business transactions;
 - the fairness, accuracy and verifiability of the books of account, including computerized books of account;
 - the methods used for controlling access to data and the computerized data processing system;
 - the safeguarding of the accounting documentation, books of account, and financial statements.

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

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V. Statements of the independent registered auditor (cont.)

- (j) We determined the materiality levels at the planning stage. Materiality levels specify the limits up to which identified irregularities may be left unadjusted without any detriment to the quality of the financial statements and to the correctness of the underlying books of account, since failing to make such adjustments will not be misleading for the readers of the financial statements. Materiality measures both the quantity and quality of audited items and that is why it varies for different statement of financial position and income statement items. Due to the complexity and quantity of the materiality levels adopted for audit purposes, they are included in the audit documentation.
- (k) The notes to the financial statements present all significant information required by IFRS as adopted by the European Union.
- (l) The information in the Directors' Report for the year ended 31 December 2012 has been prepared in accordance with the provisions of the Decree of the Minister of Finance dated 19 February 2009 concerning the publication of current and periodic information by issuers of securities and the conditions of acceptance as equal information required by the law of other state, which is not a member state (Journal of Laws No. 33, item 259 with subsequent amendments) and is consistent with the information presented in the audited financial statements.
- (m) The total capital requirement, together with the requirement concerning the risk of excessive capital exposure, amounted to PLN 12,299,343 thousand as at the balance date. The capital adequacy ratio as at 31 December 2012 amounted to 12.93%. As at the balance date, the Bank complied with the prudence principle in all material respects.



VI. Final information and comments

This report has been prepared in connection with our audit of the financial statements of Powszechna Kasa Oszczędności Bank Polski SA with its registered office in Warsaw, 15 Puławska Street. The financial statements were signed by the Banks's Management Board and the person entrusted with maintaining the books of account on 26 February 2013.

This report should be read in conjunction with the Independent Registered Auditor's unqualified Opinion to the General Meeting of Shareholders and the Supervisory Board of Powszechna Kasa Oszczędności Bank Polski SA dated 27 February 2013, concerning the said financial statements. The opinion on the financial statements expresses a general conclusion drawn from the audit and involves assessing the materiality of individual audit findings rather than being a sum of all the evaluations of individual financial statement components. This assessment takes account of the impact of the facts noted on the truth and fairness of the financial statements as a whole.

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

Antoni F. Reczek
President of the Management Board

PricewaterhouseCoopers Sp. z o.o.

Principal Registered Auditor
No. 90011

Warsaw, 27 February 2013