

## INTRODUCTION

### **1. General information concerning the activities of the Capital Group of Bank Handlowy w Warszawie SA (the “Bank’s Capital Group”)**

#### **1.1. Activities of the parent entity – Bank Handlowy w Warszawie SA (the “Bank”)**

Bank Handlowy w Warszawie S.A. (“the Bank”) has its registered seat in Warsaw, at ul. Senatorska 16, 00-923 Warszawa. The Bank was founded on the strength of a Notarial Deed of 13 April 1870. The Bank is registered in the Register of Entrepreneurs in the National Court Register maintained by the District Court for Warsaw, XIX Commercial Department in Warsaw, under KRS number 0000001538.

Under the Polish Classification of Economic Activity (PKD), the principal business of the Bank is “other banking activity”. According to the classification followed by the regulated market Warsaw Stock Exchange, the business of the Bank is “finance – banks”.

The Bank operates on the basis of applicable regulations and its Articles of Association.

The business of the Bank is the performance of domestic and foreign banking operations and all other activity related to banking operations as permitted by law.

Pursuant to the Bank’s Articles of Association, the Bank performs the following banking operations:

- accepting deposits payable on request or on a given date and account operation for such deposits,
- operation of other bank accounts,
- performing cash settlements in all forms accepted in domestic and international banking operations,
- extending credits and cash loans,
- conducting operations which involve checks, bills of exchange and warrants,
- issuing and confirming sureties,
- issuing and confirming bank guarantees and open letters of credit,
- performing FX operations,
- provision of agency services in money transfers abroad by residents and settlements with non-residents in Poland,
- issuing of banking securities,
- commissioned operations related to issue of securities,
- safe-keeping of valuable objects and securities and safe-box services,
- issuing of payment cards and processing of operations executed with use of such cards,
- purchase and sale of receivables,
- processing of forward transactions.

The Bank may also:

- take up or purchase shares and rights attached to shares, shares of other legal entities and investment fund units,
- organize and service financial lease projects,
- render factoring services,
- trade in securities on its own account and act as an agency in securities trading,
- operate securities accounts,
- render financial consulting and advisory services,
- undertake commitments related to issue of securities,
- perform the function of a representative bank within the meaning of the Bonds Act,
- purchase and sell real estate, and perpetual usufruct rights,
- perform settlements for trading in securities, property rights and derivative financial instruments,
- exchange debt for assets belonging to the debtor, on terms agreed on with such a debtor,
- purchase and sell derivative financial instruments at the Bank's own account and act as an agency in trading therein,
- render financial services, including soliciting customers within the meaning of the Act on the organization and operations of pension funds,
- accept orders to purchase, sell or subscribe for participation units and investment certificates of investment funds,
- render insurance agency services,
- act as depository for pension funds,
- act as depository for investment funds.

For the purpose of conducting its business, the Bank has the right to hold foreign currencies and trade therein.

## **1.2. Operations of entities of the Group**

Other segments of business of subsidiary undertakings included in the Group and other subordinated (joint-venture and associated) undertakings are as follows:

- banking operations,
- brokerage operations,
- provision of financial, lease, and factoring services,
- investment operations,
- insurance operations (undertaking under liquidation),
- industrial production with differentiated profile of final products (exclusively undertakings to be resold).

## 2. Time limits for the operation of the Bank and of the entities forming the Bank's Capital Group

The Bank's Capital Group does not include any undertakings with a limited time of operations.

### 3. Financial data presentation periods

These consolidated financial statements refer to the period of 1 January 2004 to 31 December 2004. Comparable financial data refers to the period of 1 January 2003 to 31 December 2003.

#### 4. Bank's Management Board and Supervisory Board

As of 31 December 2004, the Management Board of the Bank consisted of the following members:

Slawomir Sikora	President of the Bank's Management Board
Sunil Sreenivasan	Vice-President of the Bank's Management Board
Philip Vincent King	Vice-President of the Bank's Management Board
David J. Smith	Vice-President of the Bank's Management Board
Lidia Jabłonowska-Luba	Member of the Bank's Management Board
Michał H. Mrozek	Member of the Bank's Management Board.

The following changes of the Bank's Management Board occurred in 2004:

- |                 |                     |
|-----------------|---------------------|
| – resigned on:  |                     |
| 30 March 2004   | Wiesław Kalinowski, |
| – appointed on: |                     |
| 25 May 2004     | Michał H. Mrozek    |

On 7 December 2004, the Supervisory Board of the Bank appointed Mr. Reza Ghaffari to the position of Vice-President of the Bank's Management Board. The resolution became effective on 3 February 2005, after Mr. Reza Ghaffari fulfilled the condition of obtaining the required work permit.

On 3 February 2004, Mr. David J. Smith resigned from the position of the Bank's Vice-President and his mandate as a Member of the Management Board expired.

On 31 March 2005, Mr. Sunil Sreenivasan resigned from the position of the Bank's Vice-President, and his mandate as a Member of the Management Board expired.

As of 31 December 2004, the Supervisory Board of the Bank consisted of the following members:

Stanisław Sołtysiński	President,
Shirish Apte	Vice-President,
Göran Collert	Member,
Susan Helena Dean	Member,
Mirosław Gryszka	Member,
Rupert Hubbard	Member,
Edward Kuczera	Member,
Stephen H. Long	Member.

Jarosław Myjak	Member,
Andrzej Olechowski	Member,
Aneta M. Popławska	Member,
Frederick F. Seegers	Member.

The following changes of the Bank's Supervisory Board took place in 2004:

the following were not appointed for the subsequent term of office:

24 June 2004	Andrzej Gdula,
24 June 2004	Allan J. Hirst,
24 June 2004	Edward T. Walsh.

In the letter dated 3 May 2004 Mr. Krzysztof Opawski offered to the President of the Supervisory Board of the Bank his resignation from the function of the Member of the Bank's Supervisory Board

The Bank was informed about the resignation of Mr. Krzysztof Opawski on 25 May 2004.

– in addition the following resigned on:

4 August 2004	Jean Paul Votron
25 November 2004	Atif Aslam Bajwa
25 November 2004	Carlos Urrutia

– the following were appointed on:

24 June 2004	Atif Aslam Bajwa,
24 June 2004	Susan Helena Dean,
24 June 2004	Jarosław Myjak,
24 June 2004	Aneta M. Popławska.
7 December 2004	Rupert Hubbard
7 December 2004	Stephen H. Long
7 December 2004	Frederick F. Seegers

## 5. Internal organizational units of the Bank and of entities of the Group

The consolidated financial statements of the Bank for 2004 and comparable financial data for 2003 contain the financial data of all of the Bank's organisational units and entities of the Group through which their operations are performed. The internal organisational units of the Bank do not prepare separate financial statements

## 6. Business combinations

In 2004 and 2003, no business combinations occurred.

## 7. Continuation of business activities

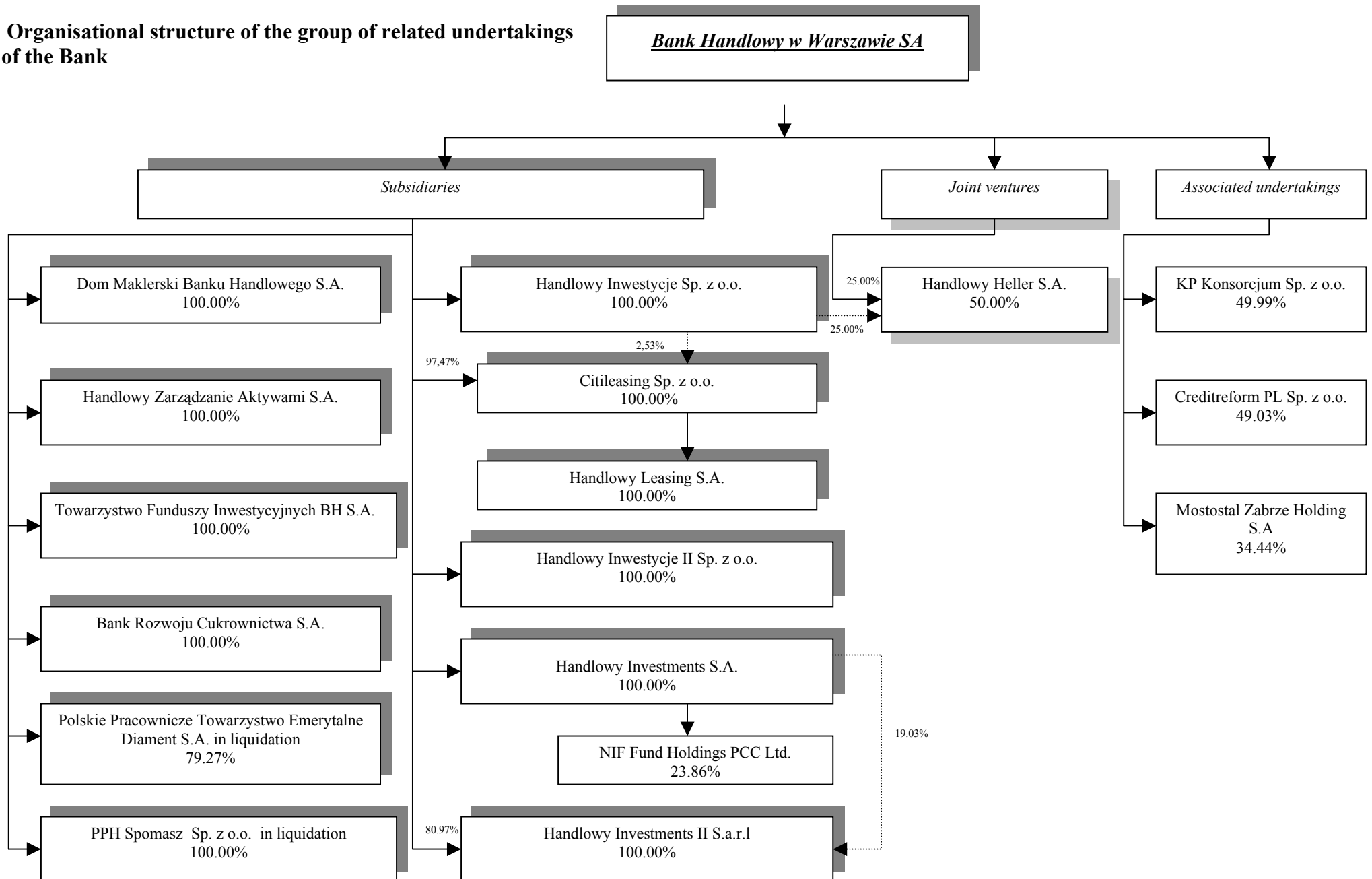
The consolidated financial statements for the year 2004 were prepared on the assumption that the Bank and the entities of the Bank's Capital Group would continue their business activity in the foreseeable future, and that there are no circumstances which threaten the continuation of their activity, with the exception of subsidiaries put into liquidation: Polskie Towarzystwo Emerytalne DIAMENT S.A. as of 23 June 2003, and PPH Spomasz Sp. z o.o. as of 3 November 2000.

Among the remaining subordinated entities of the Bank, there is a threat to the continuation of activity of the associated entity Mostostal Zabrze Holding S.A. ("MZH").

On 6 April 2005, pursuant to MZH Management Board's information included in the current report, the Extraordinary General Assembly of Stockholders adopted a resolution regarding further existence of the company. The Extraordinary General Assembly of Stockholders shares the opinion of the Company's Management Board that within the bankruptcy proceedings conducted with the possibility of reaching an

agreement, utilizing the instrument of conversion of debt into stocks, and considering the good will of crediting banks and of other entities secured on the Company's assets, the continuation of activities of MZH is possible. As at the day of signing of this report the Bank holds 9.84% of the stock capital of MZH and as many votes at the general assembly of the company. The reduction of the Bank's participation in the share capital of MZH from 34.44% to 9.84% was the result of transactions concluded in January and March 2005 presented in the Additional Explanatory Note 28.

## 8. Organisational structure of the group of related undertakings of the Bank



## 9. The Group (subsidiary undertakings) and other subordinated undertakings

### 9.1. Subsidiary undertakings of the Group

#### 9.1.1. Consolidated financial subsidiary undertakings included in the Bank's Capital Group (consolidated in full)

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
Dom Maklerski Banku Handlowego S.A.	Warsaw	Brokerage activity	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000002963	-	100	100

The value of shares purchased, amounting to PLN 70,950 thousand, is eliminated against shareholder's equity. In the Consolidated Annual Financial Statements of the Bank for 2003, this undertaking was fully consolidated.

#### 9.1.2. Non-consolidated financial subsidiary undertakings included in the Group (not consolidated in full), accounted for by the equity method

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
Citileasing Sp. z o.o.	Warsaw	Lease operations	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000057370	184,253	100	100
Handlowy Leasing S.A.	Warsaw	Lease operations	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000031640	23,921	100	100
Handlowy Inwestycje Sp. z o.o.	Warsaw	Investment activity	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000038928	8,296	100	100
Handlowy Inwestycje II Sp. z o.o.	Warsaw	Investment activity	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000033180	4,061	100	100
Handlowy Investments S.A.	Luxembourg	Investment activity	District Court for and in Luxembourg, Trade and Company Registry Section: B, No. 57746	-	100	100
Handlowy Investments II S.a.r.l.	Luxembourg	Investment activity	District Court for and in Luxembourg, Trade and Company Registry Section: B, No. 61343	20,249	100	100

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
Handlowy Zarządzanie Aktywami S.A.	Warsaw	Brokerage activity	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000034423	4,366	100	100
Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A. in liquidation	Warsaw	Insurance	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000081054	186	79.27	79.27
Towarzystwo Funduszy Inwestycyjnych BH S.A.	Warsaw	Investment activity	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000001538	22,843	100	100
Bank Rozwoju Cukrownictwa S.A.	Poznań	Banking	District Court in Poznań, XIX Commercial Department of KRS KRS registry number 0000007876	40,255	100	100

In the Bank's annual consolidated financial statements for the year 2003, these undertakings were accounted for under the equity method.

#### 9.1.2.1. Justification for non-consolidation

The non-consolidated financial subsidiary undertakings disclosed in note 9.1.2 were not subject to full consolidation on the basis of Article 58 of the Act of 29 September 1994 on Accounting (Journal of Laws of 2002 No. 76, item 694 with subsequent amendments). The remaining entities are minor in comparison to the Bank and immaterial with respect to the true and fair presentation of the financial results of the Group.

The table below presents the financial data of the undertakings excluded from consolidation

Company name	Balance sheet total	Interest income from banking activity or net income from sale of goods and products and financial operations	Shareholders' equity, including::						Fixed assets	Average employment in 2004
				Authorised share capital	Equity reserves	Other shareholders' equity, including:				
	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	Net retained profit/ loss	Net profit/ loss	in PLN thousand	in full time job equivalents
Citileasing Sp. z o.o.	189,273	3,220	167,410	123,120	28,739	15,551	1,329	3,580	19,516	20
Handlowy Leasing S.A.	755,202	52,790	25,671	3,125	626	21,920	-	21,920	440,370	41
Handlowy Inwestycje Sp. z o.o.	15,307	0	9,253	4	-	9,249	(6,263)	706	11,644	-
Handlowy Inwestycje II Sp. z o.o.	4,100	-	4,074	4	10,080	(6,010)	(6,185)	175	309	-
Handlowy Investments S.A.	120,151	0	(67,698)	38,515	-	(106,213)	(91,484))	(15,101)	68,906	-
Handlowy Investments II S.a.r.l.	34,069	0	18,591	53,138	-	(34,547)	(42,745)	1,239	12,195	-
Handlowy Zarządzanie Aktywami S.A.	6,352	6,266	4,567	5,000	5	(438)	(26)	(412)	117	14
Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A. in liquidation	399	-	235	100	1,223	(1,088)	(302)	(13)	-	1
Towarzystwo Funduszy Inwestycyjnych BH S.A.	26,839	23,530	23,446	13,000	29,000	(18,554)	(24,869)	6,315	1,715	6
Bank Rozwoju Cukrownictwa S.A.	43,927	2,690	40,559	25,064	9,745	5,750	-	1,877	1,796	6

**9.1.3. Non-financial subsidiary undertakings included in the Group, not accounted for by the equity method**

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
PPH Spomasz Sp. z o.o. in liquidation	Warsaw	Production of catering and trade equipment	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 3035	9,443	100.00	100.00

In the Bank's annual consolidated financial statements for the year 2003, the undertaking was not consolidated by the full method or accounted for by the equity method. The undertaking was valued at cost adjusted by write-offs for permanent diminution in value.

**9.1.3.1. Rationale for exclusion from equity method**

The non-financial subsidiary disclosed in note 9.1.3 was not consolidated using the equity method of accounting on the basis of Article 58 of the Act of 29 September 1994 on Accounting (Journal of Laws of 2002 No. 76, item 694 with subsequent amendments). The entity is insignificant compared to the Bank and is immaterial with respect to the true and fair presentation of the financial results of the Group. The entity was valued at purchase price including write-offs for permanent diminution in value.

**9.1.4. Changes in the structure of Bank's Capital Group**

In the year 2004, the structure of Bank's Capital Group did not change.

## 9.2. Other subordinated (joint-venture and associated) undertakings

### 9.2.1. Joint-venture and associated undertakings accounted for by the equity method

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
Handlowy Heller S.A.	Warsaw	Factoring	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000005577	13,342	50.00	50.00
KP Konsorcjum Sp. z o.o.	Warsaw	Investment funds management	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000044147	11,500	49.99	49.99

In the Consolidated Annual Financial Statements of the Bank for 2003, the undertakings were accounted for by the equity method.

### 9.2.2. Associated undertakings not accounted for by the equity method

Company name	Registered office	Core business	Registration Authority	Balance sheet value of shares in PLN thousand	Percent of authorised share capital held	Share in the total number of votes at the General Meeting of Shareholders
Mostostal Zabrze Holding S.A.	Zabrze	Production – service construction works	District Court in Gliwice, XIX Commercial Department of KRS KRS registry number 0000049844	-	34.44	34.44
NIF Fund Holdings PCC Ltd.	Guernsey	Investment activity	No data	18,116	23.86	23.86
Creditreform PL. Sp. z o.o.	Warsaw	Economic enquiry	District Court for Warsaw, XIX Commercial Department of KRS KRS registry number 0000164993	329	49.03	49.03

In the Consolidated Annual Financial Statements of the Bank for 2003, the undertakings were not accounted for by the equity method. The undertakings were valued at the acquisition price, taking into account write-downs for permanent loss in value.

### 9.2.2.1. Rationale for not applying the equity method of accounting

The non-financial affiliates listed were not subject to valuation using the equity method of accounting on the basis of Article 58 of the Act of 29 September 1994 on Accounting (Journal of Laws of 2002 No. 76, item 694 with subsequent amendments). The entities are insignificant compared to the Bank and they are immaterial with respect to the true and fair presentation of the financial results of the Group. The entity was valued at the purchase price including write-offs for permanent diminution in value.

The table below presents the financial data of the undertakings

Company name	Balance sheet total          in PLN thousand	Interest income from banking activity or net income from sale of goods and products and financial operations          in PLN thousand	Shareholders' equity, including:						Fixed assets          in PLN thousand	Mean employment in 2004          in full time job equivalents
				Authorised share capital          in PLN thousand	Equity reserves          in PLN thousand	Other shareholders' equity, including::				
							Net retained profit/ loss          in PLN thousand	Net profit/ loss          in PLN thousand		
Mostostal Zabrze Holding S.A.	217,995	98,386	(102,895)	20,327	5,630	(128,852)	(122,233)	(12,298)	85,622	2,227
NIF Fund Holdings PCC Ltd.	No data available									
Creditreform PL. Sp. z o.o.	627	4 958	308	670	11	(373)	(505)	132	131	37

**9.2.3. Changes in the structure of other subordinated undertakings (joint-ventures and associated) undertakings**

In 2004, the structure of joint - ventures and associated undertakings changed as follows:

- sale of the entire holding of shares in Polimex Cekop S.A. held by the subsidiary Handlowy Investments S.A. which represented 36.64% of the share capital and as many votes at the general assembly of the entity,
- redemption of some of the shares in the capital of the associated undertaking NIF Fund Holdings PCC Ltd. owned by the subsidiary Handlowy Investments S.A. The redeemed shares represented in total 10.19% of the entity's capital. The Bank's stake in the capital of the entity and the number of votes at the General Meeting of shareholders of this enterprise did not change and amounted to 23.86%;
- sale of some of the shares of the associated undertaking Pia Piasecki S.A. The shareholding sold represented a 17.40% stake in the capital of the entity. As a result of this transaction, the Bank holds a 19.12% stake in capital and the same number of votes at the General Meeting of shareholders of this enterprise;
- sale of some of the shares of the associated undertaking IPC JV Sp. z o.o. representing a 31.00% stake in the capital of the entity and the same number of votes at the general meeting of shareholders of this enterprise;
- sale of some of the shares of the associated undertaking Elektromontaż Poznań S.A. The shareholding sold represented a 5.42% stake in the capital of the entity. As a result of this transaction, the Bank holds a 19.88% stake in capital and the same number of votes at the General Meeting of shareholders of this enterprise;

## **10. Reclassification and presentation of financial data for 2003**

In order to maintain comparability of financial data in the current period, the comparable data presented for the year 2003 has been subject to appropriate restatement as compared to the data previously published in the annual consolidated report for the year 2003. The restatement is the result of the change introduced regarding the accounting practice of sell-buy-back/ buy-sell-back securities transactions and the changes in presentation of financial data in the balance sheet Explanatory Note 2A, 17A and 21A.

The differences resulting from the restatement and the financial impact of the changes introduced are presented in the additional explanatory notes (see Additional Explanatory Notes 32 and 33).

## **11. Opinion issued by the certified auditor on examination of Consolidated Financial Statements for the previous period**

The certified auditor KPMG Audyt Sp. z o.o (until 9 May 2004 named KPMG Polska Audyt Sp. z o.o.) performed an examination of the Bank's financial statements as of 31 December 2003. The auditor issued an unqualified opinion.

## **12. Accounting principles**

### *General information*

The Bank's annual financial statements for 2004 were prepared in accordance with the following regulations:

- Regulation of the Council of Ministers dated 16 October 2001 concerning current and periodical information reported by issuers of securities (Journal of Laws no. 139, item 1569, as amended),
- Regulation of the Council of Ministers dated 11 August 2004, concerning specific conditions that should be met by issuers of the prospectus and the abbreviated prospectus (Journal of Laws no. 186, item 1921),

and in accordance with the provisions of the following:

- The Act of 29 September 1994 on Accounting (Journal of Laws No. 76, item 694 with subsequent amendments),
- Decree of the Finance Minister of 10 December 2001 concerning banks' detailed accounting practice (Journal of Laws No. 149, item 1673 with subsequent amendments),
- Decree of the Finance Minister of 12 December 2001 concerning the principles of banks' consolidated finance reports and of finance holding consolidated finance reports preparation (Journal of Laws No. 152, item 1728),
- Decree of the Finance Minister of 12 December 2001 concerning detailed principles of financial instruments' recognition, pricing method, the degree of disclosure and the manner of presentation (Journal of Laws No. 149, item 1673 with subsequent amendments),
- Decree of the Finance Minister of 10 December 2003 concerning the principles of creating provisions with regard to banking activity risk (Journal of Laws No. 218, item 2147).

## 12.1. Accounty standards adopted by the Bank's Capital Group

The accounting standards adopted by the Bank are consistent with the Accounting Act of 29 September 1994 (Journal of Laws of 2002 No. 74, item 694, as amended) and enforcement regulations issued on its basis, taking into account the specific standards for accounting by banks.

The accounting standards adopted by the fully consolidated subsidiary undertaking and by the domestic undertakings accounted for by the equity method are materially consistent with the standards adopted by the Bank.

The accounting standards adopted by the foreign undertakings accounted for by the equity method are consistent with the accounting standards valid in the countries where these undertakings are based. In spite of the fact that these undertakings do not apply uniform accounting standards, the differences arising from the differences in these standards do not have a significant effect on the Consolidated Financial Statements of the Bank.

### 12.1.1. The basis of including subordinated undertakings in the Consolidated Financial Statements of the Bank

#### *Basis of accounty for undertakings subject to consolidation*

Pursuant to the Accounting Act and the Regulation of the Minister of Finance of 12 December 2001, the Bank is obliged to consolidate subsidiary undertakings which are banks and financial institutions, with the possibility to use exclusions from consolidation and additional exemptions from consolidation set forth in Article 57 item 1 and Article 58 of the Act.

In previous periods and as of 31 December 2004, the subsidiary undertaking Dom Maklerski Banku Handlowego SA is subject to consolidation by the full method. The financial statements of subsidiary undertaking Dom Maklerski Banku Handlowego w Warszawie SA ("DM BH") was included for the first time in the consolidated financial statement of the Bank for the first half of 2001, with the use of the full consolidation method. Balance sheets, profit and loss accounts, and cash flow statements were consolidated by adding the respective items in the balance sheets, profit and loss accounts, and cash flow statements of the Bank and DM BH, taking into account adjustments and consolidation eliminations. The balance sheet and the profit and loss account of DM BH were appropriately modified and adjusted to grouping and presentation of the balance sheet and profit and loss account of the Bank, before being included into consolidation.

The following are excluded from the Consolidated Financial Statements:

- authorised share capital of the consolidated subsidiary undertaking,
- cost of acquisition of interests in the consolidated subsidiary undertaking,
- mutual receivables and liabilities of the consolidated undertakings,
- income and expenses corresponding to operations performed between consolidated undertakings,
- unrealised profits and losses arising from operations performed between consolidated undertakings, included in the value of non-consolidated assets,
- dividends due or paid by the undertaking to consolidated undertakings.

The data of the remaining subsidiary financial undertakings are included in the Consolidated Financial Statements by the equity method (see 9).

*Principles of accounty for other subordinated undertakings*

Interests in other (non-consolidated) subordinated undertakings constituting significant items of fixed assets of the Bank are included in the Consolidated Financial Statements by the equity method, except for undertakings intended for sale. Interests in these undertakings are disclosed in the Balance Sheet at acquisition price, taking into account write-downs for permanent loss in value. The list of other subordinated undertakings, other than subordinated financial undertakings, together with the indication of the valuation method used, is presented in item 9.

Valuation of subordinated undertakings by the equity method is made in the financial statements of the Bank by disclosing the Bank's share in the profits or losses of such undertakings. The value of interests in the undertakings accounted for by the equity method is determined and disclosed in the consolidated balance sheet pro rata to the percent share of the parent entity in the shareholders' equity of the undertaking as of the balance sheet day of the parent entity, taking into account consolidation adjustments.

Changes in value of subordinated undertakings accounted for by the equity method as of the valuation date are disclosed in the consolidated profit and loss account as "Share in net profits (losses) of subordinated undertakings accounted for by the equity method".

*Changes in consolidation principles*

In 2004 and 2003, the principles of consolidation of subordinated entities in the Bank's consolidated financial report did not undergo any changes.

*Determination of equity*

Equity and own funds are disclosed at par value, except for the part of the revaluation fund corresponding to the results of valuation of financial assets available for sale which is disclosed on the net basis. Consolidated shareholders' equity and funds include shareholders' equity and funds of the Bank and share in the change of equity of the consolidated undertaking or undertaking accounted for by the equity method, attributable to the Bank, which occurred during the whole consolidated period or period covered by valuation by the equity method, and by dividends received from the consolidated undertaking

*Determination of the profit/loss*

The financial profit/loss is determined with the use of conservative valuation principle as well as the accrual principle and income and expense matching principle. The financial profit or loss includes total income earned and the expenses corresponding to such income, applicable to the specific reporting period, irrespectively of the date of their payment. The consolidated profit or loss includes the adjusted profit or loss of the parent entity and the share in profits/losses of consolidated undertakings or undertakings accounted for by the equity method, attributable to the parent entity. Consolidation adjustments of the financial profit/loss of the parent entity refer to the elimination of dividends and interest received from consolidated undertakings or undertakings accounted for by the equity method.

*Goodwill and negative goodwill of subordinated undertakings*

As at 31 December 2004 and 31 December 2003, no goodwill and negative goodwill of subordinated undertakings exists.

*Income tax*

Corporate income tax includes the current tax liability of the Bank and DM BH (consolidated by the full method) arising from income earned and deferred tax (see item 12.2.).

**12.2. Accounting principles of the parent entity***Tangible and intangible fixed assets*

Tangible and intangible fixed assets are recognized at their purchase price less accumulated depreciation, and after charges for permanent diminution in value at the end of the period. Depreciation is calculated using the straight-line method at rates defined in the approved depreciation schedule for 2004.

Annual depreciation rates employed by the Bank are as follows:

Buildings and structures	1.5 %	-	4.5 %
Motor vehicles	14.0 %	-	20.0 %
Computers		34.0 %	
Office equipment		20.0 %	
Other tangible fixed assets	7.0 %	-	20.0 %
Computer software and licenses (except the main operating system, which is depreciated at the rate of 20%)		34.0 %	
Goodwill		5.0%	
Other intangible fixed assets		20.0%	

Assets with original cost less than PLN 3,500 are expensed as they are brought into use.

Fixed assets also include rights of perpetual usufruct of land received free of charge in previous years following applicable regulations in force at that time.

Historically, fixed assets were periodically subjected to value adjustments with the indices published by the President of the Central Statistical Office. The results of revaluation were reflected in the revaluation reserve in the Bank's equity. It should be noted that no revaluation based on the indices published by the Central Statistical Office has taken place since 31 December 1995.

Fixed assets under construction are represented by direct expenses incurred in connection with unfinished construction, assembly or improvement of fixed asset, including write-downs for permanent diminution in value.

*Foreign currencies*

Balance sheet and off-balance sheet items denominated in foreign currencies are translated at the average exchange rate at the balance sheet date as published by the President of the National Bank of Poland ("NBP").

Foreign exchange differences arising on the revaluation of balance sheet foreign currency positions are recognized in the profit and loss account as foreign exchange gains/losses.

Exchange rates for the major foreign currencies used for the translation of foreign currency balances are as follows:

		in PLN	
		31 December 2004	31 December 2003
1	USD	2.9904	3.7405
1	CHF	2.6421	3.0281
1	EUR	4.0790	4.7170

*Equity investments – interests in subordinated undertakings*

Investments in subordinated undertakings, comprising subsidiaries, joint venture and associated entities, are classified as "financial assets available for sale".

Material interests in subordinated undertakings are accounted for under the equity method. Changes in their value are recognized in the profit and loss account as a participation in net profits/(losses) of subordinated entities accounted for under the equity method.

Investments in subordinated undertakings are recognized in the balance sheet at their purchase price including write-downs for permanent diminution in value.

*Equity investments – interests in other entities*

Interests in entities other than subordinated undertakings are classified as "financial assets available for sale". They are recognized in the balance sheet at cost net of provisions for any permanent diminution in value.

*Outstanding loans and other receivables*

Amounts due from financial institutions, non-financial sector and government sector are presented in the balance sheet as the difference between the sum of their nominal value and interest accrued, and the value of specific provisions created for credit risk.

Purchased receivables are presented in the balance sheet as the difference between the sum of their nominal value and, unsettled discount, and the value of specific provisions created for credit risk.

The Bank makes specific provisions, prescribed by the Regulation of the Ministry of Finance dated 10 December 2003 on the principles of creating provisions for the risks related to the operations of banks (Journal of Laws no. 218, item 2147). The specific provisions for possible credit losses have been calculated in accordance with the risk classification of particular balance sheet and off-balance sheet exposures. The following minimum provision percentages have been applied to provisions for particular risk categories:

Normal (only consumer loans) and watch loans	1.5 %
Substandard loans	20 %
Doubtful loans	50 %
Lost loans	100 %

Certain collateral, specified in the Regulation of the Ministry of Finance dated 10 December 2003 on the principles of creating provisions for the risks related to the operations of banks, is taken into account in the calculation of provisions necessary for problem loans. Moreover, pursuant to the provisions of the Regulation, the required level of provisions for normal loans (cash lending and consumer loans) and watch loans is reduced by an amount equivalent to 25% of the general risk provision.

Impaired loans where there is no possibility of collection are written-off against the specific provisions.

### *Debt securities*

Debt securities are classified in the trading portfolio as available for sale or held until maturity.

Debt securities classified in the trading portfolio or available for sale are recorded in the balance sheet at their fair value. Changes in the fair value of debt securities held in the trading portfolio are recognized as income or expense on financial operations. Changes in the fair value of debt securities available for sale are recognized in a revaluation reserve. They are recognized in the profit and loss account only when realized.

Debt securities held until maturity are recorded at cost net of provisions against any permanent diminution in value.

Interest, discount and premium on all types of debt securities are accrued/amortized to profit and loss account on a straight line basis. Adjustments to fair value or for permanent diminution in value are made in relation to the value of the securities as described above.

### *Repo/ reverse repo transactions*

The Bank enters into repo/reverse repo transactions of the sell-buy-back ("SBB") and buy-sell-back ("BSB") type on securities. Securities sold with the promise to buyback (SBB) are presented in balance sheet assets and concurrently are disclosed as liabilities arising from the agreement to repurchase. In the case of BSB type transactions the securities acquired are presented as a receivable arising from the repurchase clause.

### *Repossessioned assets in lieu of bad debts*

Assets repossessioned in lieu of debts are recognized at fair value. A specific provision is established for the difference between the outstanding debt and the repossessioned assets or a revaluation write down for the assets is made.

### *Provisions, write-downs for permanent diminution in value*

Specific provisions and write-downs for permanent diminution in value are established according to the principles set out in the Accounting Act, the Regulation of the Minister of Finance of 10 December 2001 on the particular accounting principles of banks, and the Regulation of the Minister of Finance of 10 December 2003 on the principles of creating provisions for the risks related to the operations of banks.

Specific provisions are made based on the assessed risk arising on any particular asset or off-balance sheet commitment.

Specific provisions held against amounts due from the financial sector, non-financial sector and the State Budget sector and specific provisions against any permanent diminution in the value of securities and other assets are deducted from the carrying value of the related assets in the balance sheet. Provisions held against off-balance items are disclosed in "Other provisions" in liabilities.

According to the law dated 29 August 1997, - the Banking Law (Journal of Laws of 2002, no. 72, item 665, as amended), in prior years the Bank has established a general risk provision, to cover the potential risk tied to banking activity. The general risk provision is created by a charge against earnings, and included in "Other provisions" in liabilities.

### *Prepayments and accruals*

In order to allocate the expenses to reporting periods to which they apply, the Bank recognizes and accounts for expenses on an accrual basis. This applies, in particular, to the general expenses of the Bank.

### *Equity*

Capital and own equity are stated at nominal value, except for the revaluation fund which, to the extent it includes the results of valuation of financial assets available for sale, is disclosed at the net amount.

### *Derivative instruments*

Derivative instruments are recognized as financial assets and liabilities held for trading purposes. Derivatives are valued at their market value. The effects of changes in market value are included in the profit and loss account as income or expense on financial operations.

To date, the Bank has not adopted hedge accounting.

### *Calculating the net result*

The net result is calculated in compliance with the concept of prudence, accrual accounting and the matching concept. The net result reflects all income and relevant expenses set off against income within a particular reporting period, irrespective of the day on which these are received or paid.

### *Interest income and expenses*

Interest income includes received or accrued interest on interbank placement, loans and securities. Interest income and discount accrued on receivables classified as normal and watch are recognized in the profit and loss account on an accrual basis. Any prepayments are recognized in the profit and loss account in the respective reporting period. Interest expense on liabilities for the given reporting period is also recognized on an accrual basis.

### *Fee and commission income and expenses*

Fees and commissions are mainly comprised of amounts other than interest income on loans, guarantees and letters of credit, as well as the fees for maintenance of current accounts, banking operations and servicing of credit cards.

Bank fees and commissions not related to single closed transactions are amortized on a straight-line basis to the profit and loss account for the period of the transaction they are related to, excluding Consumer Banking loans, which are paid in equal installments. Bank fees and commissions related to these loans are amortized according to a method similar to the effective interest rate method - the so called the sum of digits method or 78 method.

*Bonuses, retirement benefits and Jubilee Awards*

Depending on their professional grade, Bank employees may be awarded bonuses from the incentive fund, bonuses under the bonus scheme applicable in a given area, or an annual discretionary incentive award as approved within internal regulations of employees' salaries.

Bonuses are awarded after the end of the period in which performance is assessed.

Bank employees may also be awarded bonuses in the form of management options. A provision is established for future payments, which is reviewed and revalued until the options are exercised. The provision is included under liabilities in "Accruals and deferred income".

Within its salary scheme, the Bank guarantees its employees retirement benefits which are dependent on the years of service with the Bank and with Citigroup entities directly prior to eligibility date. Moreover, the Bank's employees who were hired under the provisions set in the Company's Labor Contract have the right to jubilee payments. In case of employees hired in the Bank prior to 1 March 2001 the retirement and jubilee payments are calculated based on numbers of years of employment defined according to the provisions of the Company's Labor Contract that was in force from 1 January 1997. The provision for future payments is included in "Accruals and deferred income".

*Other operating income/ expenses*

Other operating income/expenses are comprised of income and expenses that are not directly related to banking activity. These include income and expenses due to sale or liquidation of fixed assets and repossessed assets, compensation, penalties and fines.

*Corporate income tax*

Corporate income tax includes the Bank's current tax liability arising from income earned and deferred tax.

Deferred tax is calculated using the balance-sheet method, taking into account both assets and liabilities expected to be subject to corporate income tax in future tax periods and the deferred corporate income tax assets, and is shown in the profit and loss account or the revaluation reserve (fund). The provision and the deferred corporate income tax assets are presented in the balance sheet together.

In relation to the Act on the European Union Guarantee Fund which came into effect on 16 April 2004 (Journal of Laws no. 121, item 1262), introducing Article 38a to the Act on Corporate Income Tax, the Bank recognized in the Balance Sheet and in the Profit and Loss Account the receivable from the State Budget arising from the right to reduce the tax liability in the years 2007 to 2009.

**13. EUR/Zloty rates**

The following rates of exchange of PLN against EUR, as set by the NBP, were used in periods covered by the financial statements and the comparable financial data:

in PLN

	31 December 2004	31 December 2003
Exchange rate as at the reporting date:	4.0790	4.7170
Average rate, computed as the arithmetical mean of the rates in force on the last day of each month in the reporting period	4.5182	4.4474
The highest rate for the last day in the month in the period	4.8746	4.7170
The lowest rate for the last day in the month in the period	4.0790	4.1286

#### **14. Major items of the balance sheet, profit and loss statement and cash flow statement converted into EUR terms**

The major items of the balance sheet and the cash flow statement are converted into EUR at average rates of exchange announced by the National Bank of Poland, in force on the last day of the periods presented.

The major items of the profit and loss account were converted into EUR at rates being the arithmetical mean of the average PLN/EUR rates of exchange announced by the National Bank of Poland, in force on the last day of the periods presented.

Net profit per ordinary share and diluted profit per ordinary share were converted into EUR at rates being the arithmetical mean of the average PLN/EUR rates of exchange announced by the National Bank of Poland, in force on the last day of each month of the reported periods.

**EUR M****CONSOLIDATED BALANCE SHEET****31 December 2004 31 December 2003**

Cash, and due from Central Bank	206,206	251,540
Due from financial sector	1,950,345	1,698,051
Due from non-financial sector	2,381,747	2,810,041
Due from budget sector	405	687
Receivables due to sell-buy-back securities purchased	71,883	61,183
Debt securities	1,790,459	829,439
Due from subordinated undertakings accounted for by the equity method	183,499	168,766
Interests subordinated undertakings accounted for by the equity method	74,205	54,980
Interests in other undertakings	9,238	8,635
Other securities and financial assets	1,006,412	768,477
Tangible and intangible fixed assets	478,136	436,646
Other assets	170,114	126,941
<b>Total assets</b>	<b>8,322,649</b>	<b>7,215,386</b>

**EUR M**

Due to NBP	176	8,723
Due to financial sector	970,804	759,435
Due to non-financial sector	4,116,589	3,828,795
Due to public sector	130,682	98,803
Liabilities in respect of securities subject to sale and repurchase agreements	100,162	99,810
Liabilities arising on financial instruments	1,028,264	774,050
Due to subordinated undertakings accounted for by the equity method	97,513	47,640
Other liabilities	316,166	242,426
Negative goodwill	-	-
Provisions	53,209	94,834
Equity	1,509,084	1,260,870
<b>Total liabilities</b>	<b>8,322,649</b>	<b>7,215,386</b>

in EUR M

<b>CONSOLIDATED PROFIT AND LOSS ACCOUNT</b>	<b>12 months to 31 December</b>	
	<b>2004</b>	<b>2003</b>
Net interest income	200,150	167,618
Net fees and commissions income	139,905	123,073
Income from shares, other securities and floating-rate financial instruments	3,658	14,559
Net gains on financial operations	11,632	29,914
FX gains	79,755	108,234
Profit on banking activity	435,099	443,399
Operating profit	110,534	103,231
Profit (loss) before taxation	110,534	103,231
Share in net profits (losses) of subordinated undertakings accounted for by the equity method	9,477	6,595
<b>Net profit (loss)</b>	<b>92,101</b>	<b>66,681</b>

EUR M

<b>MAJOR ITEMS OF THE CONSOLIDATED CASH FLOW STATEMENT</b>	<b>12 months till 31 December</b>	
	<b>2004</b>	<b>2003</b>
Net cash flow from operating activities– indirect method	43,154	29,536
Net cash flow from investing activities	(24,740)	66,156
Net cash flow from financing activities	(77,184)	(52,611)
Net cash flow, total	(58,771)	43,081
<b>Change in net cash</b>	<b>(58,771)</b>	<b>43,081</b>
Cash at beginning of period	297,102	213,837
Cash at end of period	238,332	256,918

## 15. Main differences between Polish and International Accounting Standards

From 1 January 2005 the Bank is obliged to prepare stand alone and consolidated financial statements in accordance with International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related interpretations issued as Commission Regulations, hereinafter called IAS, referred to in Art.no.2.item3. of the Polish Accounting Act of 29 September 1994.

There are differences between Polish Accounting Standards (PAS), adopted in the following financial statement, and International Accounting Standards.

Thereinafter, there are presented differences in value of revealed net assets between the Bank's consolidated financial statements dated 31 December 2004 in accordance with PAS and unsurveyed financial statements, which would be adopted as of that day in accordance with IAS:

	<b>In PLN thousand</b>
<b>Net assets in accordance with Polish Accounting Standards</b>	<b>6,155,553</b>
Adjustments, including:	
- reversing the goodwill amortization	72,445
- change of assessment of the financial assets impairment	19,232
- change of direct acquisition costs of credit	(22,137)
- positive valuation of properties recognized as an investment properties	6,320
- consolidation differences	10,912
<b>Net assets in accordance with International Standards of Accounting</b>	<b>6,242,325</b>

Comments on occurred differences between Polish Accounting Standards adopted in the following financial statement, and International Accounting Standards.

- in accordance with PAS, the Group presents purchased goodwill as the difference between cost and the value of net assets acquired and amortizes it by the straight-line method. On the other hand, IFRS requires the Bank to perform an annual impairment review instead of amortization write-downs. In relations to this, the Group made adjustment of the goodwill amortization in 2004.
- In accordance with IFRS, interest, selected commissions, and the direct acquisition costs of financial instruments should be measured with the use of the effective interest rate. In 2005, the Bank implemented this procedure in one of the IT systems used in the Corporate Banking Sector. Before that, fees and commissions, which did not refer to ended write-off transactions, were accounted for through profit and loss account by the straight-line method. From 2002, in Consumer Banking Sector, the Group has been applying so called the sum of digits method or 78 method, which is approximation of effective interest rate method.
- IAS 39 allows calculating in time only costs of credits acquisition, which were not incurred, if loan was not granted. So far, the Group also has calculated in time part of internal costs related to specified activities within credit process, such as valuation of financial condition, collaterals, settlements to banking agreements, etc. From 1 January 2005, the Group diminished value of direct costs of credits acquisition remaining to calculation as of that day in accordance with IAS.
- in the financial statements prepared in accordance with PSR, the level of write-down of credit exposure arises from the classification of the receivable to the specific risk category specified in the Regulation of the Minister of Finance of 10 December 2003, on the principles of creating provisions for the risks related to the operations of banks. In accordance with IFRS, specific provisions are recorded based on the difference between the balance sheet value of credit exposure and the present value of expected future cash flows, discounted with the use of the effective interest rate of the specific instrument. The level of the write-down created in accordance with IFRS reflects the probability of recovering both the principal as well as the interest, eliminating the recording of deferred interest in suspense as a separate component of liabilities of the Bank. After revaluation of the financial asset, interest income is recognized on the basis of the effective interest rate applied for the purposes of valuation of the present value of the instrument,

- in accordance with PAS, in previous years the Bank created a provision for general risk intended for coverage of the unidentified risk related to the conduct of banking activity. IFRS does not allow the possibility to create provisions in the situation where no objective evidence for impairment in value or non-recoverability of a financial asset exists;
- in accordance with PAS, properties included in tangible fixed assets are shown in balance sheet in accordance with purchase price diminished by redemption accounted for by straight-line method (excluding land not amortized) and eventually by write-downs for permanent diminution in value. Repossessed properties are shown at their fair market value. The Group made review of properties (own and repossessed) in order to verify with principles of IAS 40 and consequently separated investment properties, valued at their fair market value. As of 1 January 2005, capital adjustment was recognized as surplus of market value over net value of these properties.
- Additionally, the Bank as parent equity expanded its scope of consolidation on entities, which so far did not take part in consolidation process.