

## INTRODUCTION

### **1. Basic information about the core business of the Bank Handlowy w Warszawie S.A. Group (“the Group”)**

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

Bank Handlowy w Warszawie SA (“the Bank”) has its registered office 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 relations,
- extending loans and cash advances in Poland and abroad, as well as consumer loans and credits as defined in the provisions of a separate Act,
- conducting operations which involve cheques and bills of exchange,
- 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,
- organise 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 relating to the issue of securities,
- perform the function of a representative bank within the meaning of the Bonds Act,
- purchase and sale of real estate,
- 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,
- accept orders to purchase, sell or subscribe for participation units and investment certificates of investment funds,
- render insurance agency services,
- act as a depository for pension funds,
- act as a 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 entities of the Group**

The Group does not include any undertakings with a limited time of operations.



In the first half of 2004, the following changes in the Supervisory Board took place:

- 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.

- 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.

As of the date of signing of the Consolidated Semi-Annual Financial Statements of the Bank for 2004, the Supervisory Board members changed as a result of the resignation of Mr Jean Paul Votron from the function of a Member of the Supervisory Board of the Bank on 4 August 2004.

## **5. Internal organisational units of the Bank and of entities of the Group**

The Consolidated Semi-Annual Financial Statements of the Bank for 2004 and comparable financial data for the reporting periods of 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 and of entities of the Group encompassed by the consolidated financial statements do not prepare separate financial statements.

## **6. Business combinations**

In the first half of 2004 and in the presented reporting periods of 2003 no business combinations occurred.

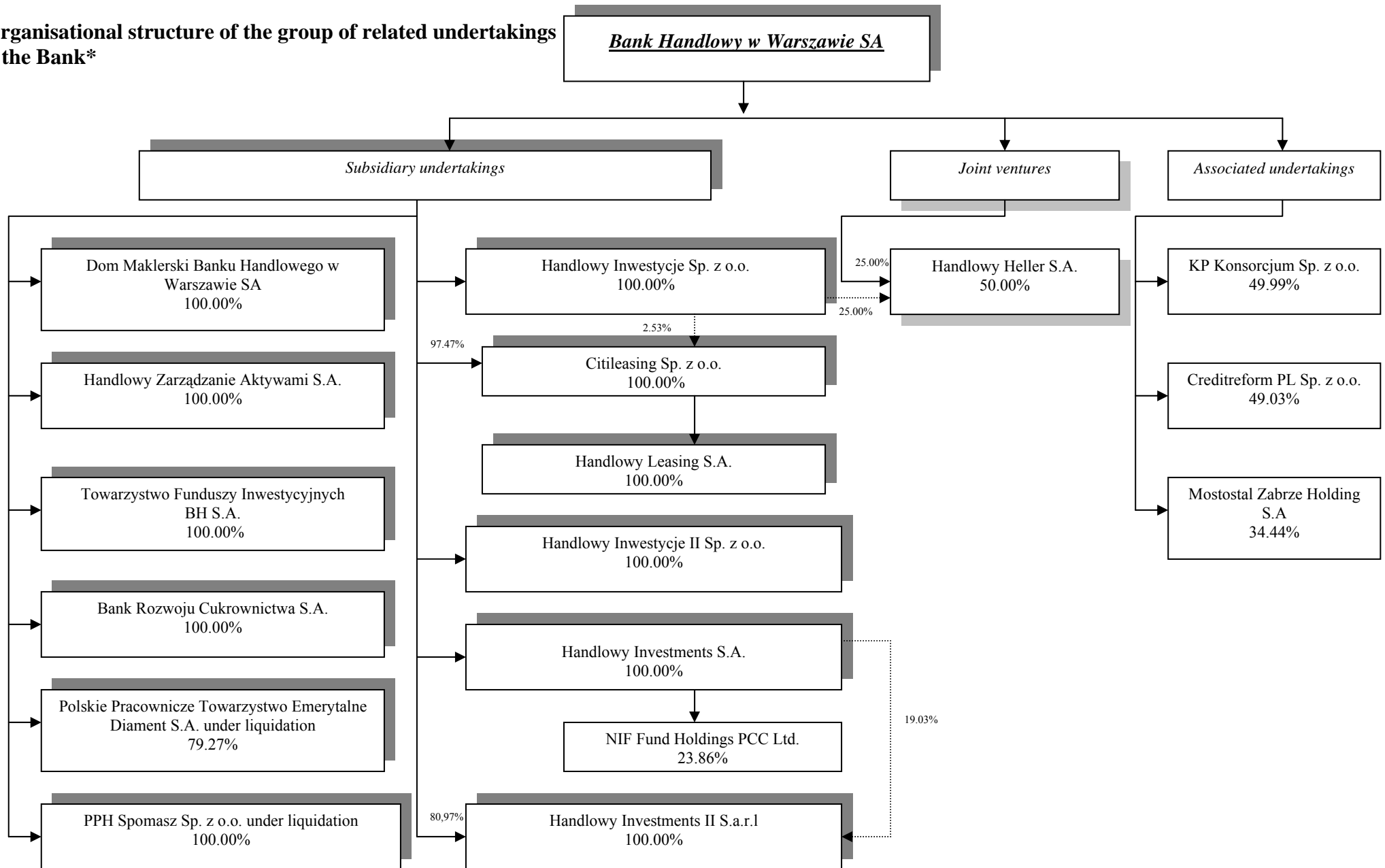
## **7. Going concern**

The Consolidated Semi-Annual Financial Statements for the first half of 2004 have been prepared under the assumption of continued operation of the Bank and of entities of the Group in the foreseeable future with no circumstances directly indicating any threat to such continued operation, except for the subsidiary undertakings Polskie Towarzystwo Emerytalne DIAMENT S.A. under liquidation as of 23 June 2003 and PPH Spomasz Sp. z o.o. under liquidation as of 3 November 2000.

Among the remaining subordinated undertakings of the Bank, there is a threat to continued operations of the associated undertaking Mostostal Zabrze Holding S.A.

According to the standpoint of the Management Board of Mostostal Zabrze Holding S.A. contained in the extended quarterly report for the second quarter of 2004, on 24 June 2004 Mostostal Zabrze Holding S.A. filed with the District Court in Gliwice a petition in bankruptcy with the possibility of arrangement with creditors and establishment of an independent administration for the Company and a petition for securing the assets of Mostostal Zabrze Holding S.A. (including for suspension of enforcement proceedings in progress and rescinding of seizures made). The court accepted the petition for consideration and is now conducting bankruptcy proceedings.

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



\* subordinated undertakings - direct and indirect via subsidiary

## 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 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 SA	Warsaw	Brokerage activity	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 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 and in the Consolidated Semi-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
Citleasing Sp. z o.o.	Warsaw	Lease operations	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000057370	174,944	100	100
Handlowy Leasing S.A.	Warsaw	Lease operations	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000031640	10,681	100	100
Handlowy Inwestycje Sp. z o.o.	Warsaw	Investment activity	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000038928	7,193	100	100
Handlowy Inwestycje II Sp. z o.o.	Warsaw	Investment activity	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000033180	3,999	100	100
Handlowy Investments S.A.	Luxembourg	Investment activity	District Court for and in Luxembourg, Commercial and Company Register Section: B, No. 57746	-	100	100
Handlowy Investments II S.a.r.l.	Luxembourg	Investment activity	District Court for and in Luxembourg, Commercial and Company Register Section: B, No. 61343	17,331	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 Zarządanie Aktywami S.A.	Warsaw	Brokerage activity	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000034423	4,526	100	100
Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A. w likwidacji	Warsaw	Insurance	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000081054	245	79.27	79.27
Towarzystwo Funduszy Inwestycyjnych BH S.A.	Warsaw	Investment activity	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000001538	20,012	100	100
Bank Rozwoju Cukrownictwa S.A.	Poznań	Banking	District Court in Poznań, XXI Business Department of the National Court Register Register No.: KRS 0000007876	38,921	100	100

In the Consolidated Annual Financial Statements of the Bank for 2003 and in the Consolidated Semi-Annual Financial Statements of the Bank for 2003, these undertakings were accounted for under the equity method.

#### 9.1.2.1. Justification for non-consolidation

The non-consolidated financial subsidiary undertakings listed in 9.1.2 were not consolidated (by full method) pursuant to Article 57 item 1 and Article 58 item 1 of the Accountancy Act of 29 September 1994 (Journal of Laws of 2002, No. 76, item 694, as amended). Bank Rozwoju Cukrownictwa S.A. is intended for sale and Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A. is intended for liquidation. The financial data of the remaining undertakings are minor in comparison to the financial data of the Bank – parent entity, and immaterial with respect to the true and fair presentation of the financial result of the Group.

The table below presents the financial data of the undertakings.

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 1 <sup>st</sup> half of 2004
				Authorised share capital	Equity reserves	Other shareholders' equity, including:				
							Net financial profit/loss of previous years	Net financial profit/loss		
	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand	in PLN thousand
Citileasing Sp. z o.o.	222,710	2,949	174,944	123,120	24,480	27,344	16,229	11,115	70,595	12
Handlowy Leasing S.A.	1,076,133	45,146	10,681	3,125	239	7,317	(15,782)	23,099	892,975	41
Handlowy Inwestycje Sp. z o.o.	13,951	14	7,193	4	8,066	(877)	(6,263)	(7)	9,662	-
Handlowy Inwestycje II Sp. z o.o.	4,004	127	3,999	4	10,080	(6,085)	(6,185)	99	31	-
Handlowy Investments S.A.	141,307	-	(61,229)	42,889	-	(104,118)	(101,873)	(2,660)	131,768	-
Handlowy Investments II S.a.r.l.	33,087	-	17,331	59,172	-	(41,841)	(47,620)	(579)	24,971	-
Handlowy Zarządzanie Aktywami S.A.	5,256	2,133	4,526	5,000	5	(479)	95	(573)	153	14
Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A. under liquidation	354	-	309	100	1,223	(1,014)	170	(37)	1	1
Towarzystwo Funduszy Inwestycyjnych BH S.A.	21,434	8,773	20,012	13,000	29,000	(21,988)	(24,870)	2,882	51	5
Bank Rozwoju Cukrownictwa S.A.	42,439	777	38,921	25,064	8,711	5,146	1,035	239	2,259	7



**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. under liquidation	Warsaw	Production of catering and trade equipment	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 3035	9,443	100.00	100.00

In the Consolidated Annual Financial Statements of the Bank for 2003 and in the Consolidated Semi-Annual Financial Statements of the Bank for 2003, the undertaking was not accounted for by the equity method. It was carried at cost adjusted for permanent diminution in value.

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

The non-consolidated subsidiary undertaking listed in 9.1.3 was not consolidated by the equity method pursuant to Article 57 item 1 of the Accounting Act of 29 September 1994 (Journal of Laws of 2002, No. 76, item 694, as amended). The undertaking is intended for liquidation. It is valued at cost, taking into account write-downs for permanent loss in value.

**9.1.4. Changes in the structure of the Group**

In the first half of 2004, the composition of the 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 the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000005577	11,374	50.00	50.00
KP Konsorcjum Sp. z o.o.	Warsaw	Management of investment funds	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000044147	12,839	49.99	49.99

In the Consolidated Annual Financial Statements of the Bank for 2003 and in the Consolidated Semi-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 and service construction industry	Registration Court in Gliwice, X Business Department of the National Court Register Register No.: KRS 0000049844	-	34.44	34.44
NIF Fund Holdings PCC Ltd.	Guernsey	Investment activity	N.D.	30,416	23.86	23.86
Creditreform PL. Sp. z o.o.	Warsaw	Business intelligence agency	District Court for the capital city of Warsaw, XIX Business Department of the National Court Register Register No.: KRS 0000164993	328	49.03	49.03

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

**9.2.2.1. Rationale for exclusion from valuation by equity method**

The above-mentioned non-financial associated undertakings excluded from equity method accounting pursuant to Article 57 item 1 of the Accounting Act of 29 September 1994 (Journal of Laws No. 121, item 591 as amended). The above-mentioned undertakings are intended for sale. They are valued at cost, taking into account write-downs for permanent loss 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 2003          in full time job equivalents
				Authorised share capital          in PLN thousand	Equity reserves          in PLN thousand	Other shareholders' equity, including:				
							Net financial profit/loss of previous years          in PLN thousand	Net financial profit/loss          in PLN thousand		
Mostostal Zabrze Holding S.A.	163,791	48,685	(72,033)	20,327	101	(92,461)	(93,787)	(2,749)	62,589	292
NIF Fund Holdings PCC Ltd.	No data available									
Creditreform PL. Sp. z o.o.	766	2,556	334	670	11	(347)	(505)	158	121	39

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

The following resulted in changes in the structure of associated joint-venture and associated undertakings in the first half of 2004:

- sale by the subsidiary Handlowy Investments S.A. of the whole shareholding in Polimex Cekop S.A. representing a 36.64% stake in capital and the same number of votes at the general meeting of shareholders of this undertaking,
- redemption of some of the shares in capital of the associated enterprise NIF Fund Holdings PCC Ltd. The redeemed shares represented a 2.37% stake in the capital of the entity. The Bank's stake in capital and the number of votes at the general meeting of shareholders of this undertaking did not change and amounted to 23.86%,
- sale of some of the shares of the associated enterprise 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 undertaking,
- sale of some of the shares of the associated enterprise IPC JV Sp. z o.o. The shareholding sold represented a 11.12% 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 undertaking,
- sale of some of the shares of the associated enterprise 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 undertaking.

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

In order to maintain comparability of financial data with the disclosures for the current period, the data presented for the reporting periods of 2003 were subject to adjustment with respect to the previously published data in consolidated periodic reports. These adjustments arise from the introduction of a change in principle of recording repo and reverse repo transactions of the sell-buy-back ("SBB") and buy-sell-back ("BSB") type on securities and the changes in the presentation of financial data in explanatory Note to balance sheet no. 17A, 2I, 3I, 21E and 22G.

The list of differences arising from the reclassification made and financial effects of the changes introduced in the principles of recording repo and reverse repo transactions on securities introduced into the consolidated financial statements for the first half of 2004 have been presented in Additional Explanatory Notes (see: Additional Explanatory Notes, sections 32 and 33).

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

The Consolidated Financial Statements of the Bank as of 30 June 2003 were reviewed by the certified auditor and no qualifications were made in the report on the review performed by the chartered auditor KPMG Audyt Sp. z o.o. (until 9 May 2004 named KPMG Polska Audyt Sp. z o.o.). The Bank's consolidated financial statements as of 31 December 2003 were audited by the chartered auditor KPMG Polska Audyt Sp. z o.o. which issued an unqualified opinion.

## 12. Accounting principles

### *General information*

The Bank's semi-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 16 October 2001 concerning the specific principles that should be met by issuers of securities (Journal of Laws No 139, item 1568, as amended),

and with the provisions of:

- the Accounting Act of 29 September 1994 (Journal of Laws of 2002, No. 76, item 964, as amended),
- Regulation of the Ministry of Finance dated 10 December 2001 on specific accounting principles for banks (Journal of Laws No. 149, item 1673, as amended),
- Regulation of the Ministry of Finance dated 12 December 2001 on the specific principles of preparing consolidated financial statements of banks and consolidated financial statements of a financial holding (Journal of Laws No. 152, item 1728),
- Regulation of the Ministry of Finance dated 12 December 2001 on specific principles for recognition, valuation and presentation of financial instruments (Journal of Laws No. 149, item 1674, as amended),
- 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).

## 12.1. Accounting standards adopted by the 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. Rules of including in the Consolidated Financial Statements of the Bank the data of subordinated undertakings

#### *Rules of accounting for consolidated undertakings*

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 30 June 2004, the subsidiary undertaking Dom Maklerski Banku Handlowego S.A. is subject to consolidation by the full method. The financial statements of subsidiary undertaking Dom Maklerski Banku Handlowego w Warszawie S.A. ("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 subsidiary 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 accounting 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 cost, 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 – parent entity 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 the first half of 2004 and in the presented reporting periods of 2003, principles of accounting for subordinated undertakings in the consolidated financial statements of the Bank did not change.

*Determination of equity*

Equity and own funds are disclosed at par value, except for the revaluation fund which includes the results of valuation of financial assets available for sale that are 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 financial 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 obtained and the expenses corresponding to such income, applicable to the specific reporting period, irrespective 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 and 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 of 30 June 2004 and in the presented reporting periods of 2003, no goodwill and negative goodwill of subordinated undertakings exists.

*Income tax*

Corporate income tax is disclosed in respect of the current tax liability of the Bank and DM BH (consolidated by the full method) for the income received and the 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 recognised at cost less accumulated depreciation, and less provisions 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 main operating system which is depreciated at the rate of 20%)	34.0 %
Goodwill	5.0%
Other intangible fixed assets	20.0%

Assets with unit original value less than PLN 3,500 are expensed on a one-off basis as of the date they are brought into use.

Fixed assets also include rights of perpetual usufruct of land received for free in previous years following applicable regulations being in power 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 directly 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 uncompleted 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 recognised as foreign exchange gains/losses.

Exchange rates for the major foreign currencies used in the preparation of these financial statements are as follows:

in PLN

		30 June 2004	31 December 2003	30 June 2003
1	USD	3.7470	3.7405	3.8966
1	GBP	6.7749	6.6686	6.4240
1	EUR	4.5422	4.7170	4.4570

### *Equity investments – interests in subordinated undertakings*

Investments in subordinated undertakings, comprising subsidiaries, joint venture and associated undertakings, 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 recognised in the profit and loss account as a participation in net profits/(losses) of subordinated undertakings accounted for under the equity method.

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

### *Equity investments – interests in other undertakings*

Interests in entities other than subordinated undertakings are classified as “financial assets available for sale”. They are recognised 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 reduced by the 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 risk 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 said 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 recognised as income or expense on financial operations. Changes in the fair value of debt securities available for sale are recognised in a revaluation reserve. They are recognised in the profit and loss account only when realised.

Debt securities held until maturity are recorded at cost net of write-downs for permanent diminution in value.

Interest, discount and premium on all types of debt securities are accrued/amortised 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 resold with the promised buyback clause (SBB) are presented in balance sheet assets and concurrently are disclosed on the liabilities side as liabilities arising from granted promise of repurchase. In the case of BSB type transactions the securities acquired are presented as a receivable arising from the repurchase clause.

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

Assets reposessed in lieu of debts are recognized at fair value. A specific provision is established for the difference between the outstanding debt and the reposessed 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 in accordance with 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 of the balance sheet.

In compliance with the Banking Act dated 29 August 1997 (Journal of Laws of 2002, No. 72, item 665, as amended), the Bank has established a general risk provision to cover potential risk inherent in banking

activity. The general risk provision is created by a charge against earnings and carried on the balance sheet as "Other provisions" in liabilities.

### *Prepayments and accruals*

Expenses are recognised and accounted for by the Bank on an accrual basis. In particular, this includes the general expenses of the Bank.

### *Derivative instruments*

Derivative instruments are recognised 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 as income or expense from financial operations, respectively.

To date, the Bank has not adopted hedge accounting.

### *Interest income and expense*

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 recognised in the profit and loss account on an accrual basis. Any prepayments are recognised in the profit and loss account in the respective reporting period. Interest expense for the current period is also recognised in the profit and loss account on an accrual basis.

### *Commission income and expense, bank fees*

Bank fees and commissions are mainly comprised of amounts other than interest received on loans, guarantees, letters of credit, and fees for maintenance of bank accounts, performance of banking operations, and servicing of credit cards.

Bank fees and commissions not related to single closed transactions are amortised on a straight-line basis to the profit and loss account for the period of the transaction they are related to.

### *Bonuses, retirement 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 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 Labour 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 Labour Contract that was in force from 1 January 1997. The provision for future payments is included in liabilities, 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 recognised 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, thereby reducing the charge to the net profit (loss) as of 30 June 2004.

## **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 consolidated financial statements and the comparable financial data for 2003:

**in PLN**

	<b>30 June 2004</b>	<b>31 December 2003</b>	<b>30 June 2003</b>
Exchange rate as at the reporting date	4.5422	4.7170	4.4570
Average rate, computed as the arithmetical mean of the rates in force on the last day of each month in the reporting period	4.7311	4.4474	4.3110
Average rate, computed as the arithmetical mean of the rates in force on the last day of each month of subsequent 12 months preceding the reporting date	4.6574	4.4474	4.1739
The highest rate for the last day in the month in the period	4.8746	4.7170	4.4570
The lowest rate for the last day in the month in the period	4.5422	4.1286	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 consolidated balance sheet and the consolidated cash flow statement concerning these financial statements and consolidated comparatives are converted into the 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 consolidated profit and loss account, net profit per ordinary share and diluted profit per ordinary share are converted into EUR at rates being the arithmetical mean of the average zloty/EUR rates of exchange announced by the National Bank of Poland, in force on the last day of each month of the respective periods presented.

Net profit per ordinary share and diluted profit per ordinary share are converted into EUR at rates being the arithmetical mean of the average zloty/EUR rates of exchange announced by the National Bank of Poland, in force on the last day of each month of 12 months preceding the reporting date.

	in EUR thousand		
<b>CONSOLIDATED BALANCE SHEET</b>	<b>30 June 2004</b>	<b>31 December 2003</b>	<b>30 June 2003</b>
Cash and due from Central Bank	178,104	251,540	253,991
Due from financial sector	1,116,036	1,698,051	990,158
Due from non-financial sector	2,751,356	2,810,041	3,214,534
Due from budget sector	152	687	1,541
Receivables subject to securities sale and repurchase agreements	82,098	61,183	3,599
Debt securities	2,123,932	829,439	1,038,236
Due from subordinated undertakings accounted for by the equity method	180,708	168,766	185,947
Interests in subordinated undertakings accounted for by the equity method	61,923	54,980	68,372
Interests in other undertakings	8,268	8,635	12,448
Other securities and financial assets	656,377	768,477	904,255
Tangible and intangible fixed assets	439,181	436,646	474,221
Other assets	138,029	126,941	177,808
<b>Total assets</b>	<b>7,736,164</b>	<b>7,215,386</b>	<b>7,325,110</b>

in EUR thousand

**CONSOLIDATED BALANCE SHEET****30 June 2004 31 December 2003****30 June 2003**

Due to the Central Bank	373	8,723	18,764
Due to financial sector	966,618	759,435	737,338
Due to non-financial sector	3,934,841	3,828,795	3,669,443
Due to budget sector	130,348	98,803	113,173
Liabilities in respect of securities subject to sale and repurchase agreements	122,858	99,810	10,376
Liabilities arising on financial instruments	731,251	774,050	877,983
Due to subordinated undertakings accounted for by the equity method	81,736	47,640	45,429
Other liabilities	421,885	242,426	448,308
Negative goodwill of subordinated undertakings	-	-	-
Provisions	61,590	94,834	100,212
Shareholders' equity	1,284,664	1,260,870	1,304,084
<b>Total liabilities</b>	<b>7,736,164</b>	<b>7,215,386</b>	<b>7,325,110</b>

in EUR thousand

**MAJOR ITEMS OF THE CONSOLIDATED  
PROFIT AND LOSS ACCOUNT****6 months to 30 June**

	<b>2004</b>	<b>2003</b>
Net interest income	90,001	84,972
Net fees and commissions income	66,540	59,794
Income from shares, other securities and floating-rate financial instruments	3,282	121
Net gains on financial operations	(5,990)	22,829
FX gains	51,348	45,064
Profit on banking activity	205,182	212,780
Operating profit	54,915	31,439
Profit (loss) before taxation	54,915	31,439
Share in net profits (losses) of subordinated undertakings accounted for by the equity method	4,523	4,003
<b>Net profit (loss)</b>	<b>47,519</b>	<b>22,377</b>

MAJOR ITEMS OF THE CONSOLIDATED CASH FLOW STATMENT	in EUR thousand	
	6 months to 30 June	
	2004	2003
Net cash flow from operating activities– indirect method	(5,675)	15,804
Net cash flow from investing activities	(7,672)	43,527
Net cash flow from financing activities	(10,841)	687
Net cash flow, total	(24,189)	60,018
<b>Change in net cash</b>	<b>(24,189)</b>	<b>60,018</b>
Cash at beginning of period	266,805	226,311
Cash at end of period	242,616	286,329

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

From 1 January 2005, the Bank must prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) and thus is now engaged in a significant effort to confirm the methodology to be used and implementation of system solutions *inter alia* in valuation of financial instruments with the use of the effective interest rate.

Due to the fact that currently this process is not yet complete, the respective quantitative data at the disposal of the Bank may change, and thus in the light of the provisions of the Regulation of the Council of Ministers of 11 August 2004 concerning the detailed conditions for the issue prospectus and the abbreviated issue prospectus, only the main differences between Polish and International Standards are stated below, without their quantification:

- 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 2002, the Bank implemented this procedure in one of the IT systems used in the Consumer Banking Sector, which keeps records of consumer loans and credit cards. In the remaining areas, the Bank currently accounts for the commissions and direct costs of instrument acquisition by the straight-line method. The Bank is in the process of implementing a system, which will enable the full application of IFRS-consistent valuation.
- in accordance with IFRS, all entities controlled by the Bank are to be consolidated. So far the Bank has excluded from consolidation some entities due to the fact that the financial data of these entities are immaterial in comparison with the financial data of the Bank – parent entity and insignificant for the true and fair presentation of the financial position and the financial result of the Capital Group. The Bank plans to broaden the scope of consolidation on entities which have not been consolidated so far.
- in the financial statements prepared in accordance with Polish Accounting Standards (PSR), the level of write-down of credit exposure arises from classification of the receivable to the specific risk category specified in the Regulation of the Minister of Finance of 10 December 2003. 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 interest in suspense as a separate component of liabilities of the Bank. After revaluation of the financial asset, interest income is recognised on the basis of the effective interest rate applied for the purposes of valuation of the present value of the instrument.

- in accordance with PSR, the Bank created in previous years 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 PSR, the Bank presents goodwill as the difference between the cost of the entity and the net assets acquired and amortises it by the straight-line method. On the other hand, IFRS impose on the Bank the obligation of annual revision of goodwill in order to disclose its potential permanent impairment in value and does not allow amortisation write-downs.
- the Bank is conducting a review of real estate (both owned as well as repossessed) in order to verify it against IAS 40 requirements. In accordance with the Polish standards, real estate classified as tangible assets is disclosed in the balance sheet at cost less depreciation calculated by the straight-line method (except for land which is not depreciated) and by potential permanent impairment write-downs. Real estate repossessed is disclosed at fair value. In light of international standards, for all real estate meeting the conditions described in IAS 40, the Bank should disclose a reliable estimate of the fair value.
- the Bank is also currently in the process of reviewing of long-term assets in light of provisions of IFRS 5 which imposes on the Bank the obligation to estimate the fair value of long-term assets held for sale and meeting the particular conditions of IFRS 5.