Financial Statement
of Bank Millennium S.A.
prepared in accordance with the Polish Accounting Standards for the year 2005

MAIN FINANCIAL DATA

	Amount '000 PLN		Amount '000 EUR	
	period from 1.01.2005 - 31.12.2005	period from 1.01.2004 - 31.12.2004	period from 1.01.2005 - 31.12.2005	period from 1.01.2004 - 31.12.2004
I. Interest income	1 117 880	839 254	277 852	185 751
II. Commission income	238 364	234 505	59 247	51 903
III. Operating income	892 069	854 997	221 728	189 235
IV. Operating profit / (loss)	413 552	-79 095	102 790	-17 506
V. Profit before taxes (loss)	413 552	-79 095	102 790	-17 506
VI. Net profit (loss)	542 119	237 544	134 746	52 575
VII. Net cash flows from operating activities	540 600	2 615 787	134 367	578 944
VIII. Net cash flows from investing activities	409 664	-2 388 208	101 823	-528 575
IX. Net cash flows from financing activities	-1 300 437	-150 964	-323 226	-33 413
X. Net cash flows, total	-350 173	76 615	-87 037	16 957
XI. Total assets	23 065 023	21 529 095	5 975 704	5 278 033
XII. Amounts due to Central Bank	0	1	0	0
XIII. Amounts due to financial sector	1 829 949	1 979 583	474 105	485 311
XIV. Amounts due to non-financial sector and public sector	13 322 159	14 203 277	3 451 515	3 482 049
XV. Total equity	2 346 317	1 986 840	607 886	487 090
XVI. Share capital	849 182	849 182	220 007	208 184
XVII. Number of shares	849 181 744	849 181 744	849 181 744	849 181 744
XVIII. Book value per share (in PLN/EUR)	2,76	2,34	0,72	0,57
XIX. Diluted book value per share (in PLN/EUR)	2,76	2,34	0,72	0,57
XX. Capital adequacy ratio	10,67%	17,35%	10,67%	17,35%
XXI. Earnings (losses) per ordinary share (in PLN/EUR)	0,64	0,28	0,16	0,06
XXII. Diluted earnings (losses) per ordinary share (in PLN/EUR)	0,64	0,28	0,16	0,06
XXIII. Pledged or paid dividend per share (in PLN/EUR)	0,28		0,06	

ANNUAL REPORT 2005 – CHAIRMAN'S LETTER

Dear Sirs,

As regards the year 2005 I have only good news to bring to you. Our net profit of PLN 567.1 million was the highest in the 16-year history of Bank Millennium. Hardly surprising therefore that the price of the Bank's shares quoted on the Warsaw Stock Exchange grew 56% in the course of the year, markedly surpassing the Banks' index as well as WIG 20.

Our good performance is attributable first of all to the consistent implementation of the development strategy. It assumes systematic growth of the bank's share in the market of banking services in Poland thanks to growth of the network and distribution channels, improvement of the quality of Customer service, development of services and products characteristic of a universal bank, at the same time particularly focusing on selected markets. It is on them that the Bank wants to reach and is in fact reaching a share, which puts it in leading positions of national rankings of best financial institutions.

The main pillar of the Bank's activity in 2005 was retail transactions done on the basis of its branch network as well as alternative distribution channels. Increasingly significant among them are transactions done online and the co-operation with specialised external operators.
Having improved the sales system and introduced new products, which Customers were very much looking forward to, we had excellent performance in sales of mortgage loans – in 2005 we granted PLN 2.4 billion mortgages reaching a market share of over 10% in new production. 82% was the volume increase of credit cards issued by the Bank, exceeding 124,000, and the value of consumer loans granted to Customers increased 39%. Our share in the market of leasing services was also growing steadily, approaching 7% thanks to a 17% increase of the value of signed contracts.
We recorded a significant growth of Customer funds, i.a. thanks to the attractive offer of mutual funds, which had the annual rate of return in excess of 250% and managed to double their market share. Also the number of Online Banking Customers doubled – from 115 000 to 275 000. It was the growth of sales that significantly increased last year's net commission income – by 17.9% - and net interest income – up by 3.7% (data for the Group) - with the cross-selling ratio per Customer growing to 2.75 products.
At the same time last year the Bank continued to focus great attention on appropriate risk management, thanks to which the NPL ratio in the Bank's loan portfolio fell last year to the lowest level in many years of below 10%
Despite strong expenditure on upgrading sales channels and developing new products the Bank had close control over costs of activity, which did not grow in 2005 over the preceding year.
In 2005 the Bank also concluded the two-stage sale of the 10% block of PZU shares purchased in 1999. Final settlement of this transaction ended with net profit of PLN 337 million.

The good results of recurrent business supported by one-off gains resulting from the PZU shares sale as well as the high solvency ratio of 19.1% (data for the Group) permitted the Management Board to propose to the General Shareholders Meeting the payment of dividend in the amount of PLN 458.6 million, which constitutes 81% of 2005 consolidated net profit and gives PLN 0.54 per share.

The Bank is starting another year of operation with a good financial standing and new plans. Desiring to increase availability of its offer Bank Millennium intends to open 160 new branches in the coming three years and to modernise its offer targeted at the segment of Small and Medium Enterprises as well as affluent individual Customers. Qualitative changes as regards services and products shall be accompanied by the introduction of a new set of graphic standards, new corporate colours, a new logo of the Bank and their accompanying motto, which is the motto of our activity. "Life Inspires Us" – is a universal message underscoring the relationship between the Bank and its Customers, their life and needs; it will stay with us in this and future years of our activity.

Regards,
Bogusław Kott

Chairman of the Management Board

INDRODUCTION (PREAMBLE) TO THE FINANCIAL REPORT AND COMPARABLE FINANCIAL DATA

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1. INFORMATION ON THE ISSUER

Name (firm) and seat: Bank Millennium S.A., Warszawa, Al. Jerozolimskie 123 a

Court of registration and register number: 19th Economic Division, National Court Register, Local Court for the Capital City of Warsaw, no. 0000010186

Core business of the issuer: banking and other financial intermediation, except for insurance and pension funds,

2. TIME LIMIT OF THE ISSUER'S OPERATION, IF DEFINED

Bank Millennium S.A. is not a company of limited time of operation.

3. PERIODS COVERED BY THE FINANCIAL REPORT AND COMPARABLE FINANCIAL DATA

The financial report covers the period between 1 Jan 2005 – 31 Dec 2005, and the comparable data – 1 Jan 2004 – 31 Dec 2004.

4. COMPOSITION OF THE MANAGEMENT AND SUPERVISORY BOARDS OF THE ISSUER

Management Board of Bank Millennium S.A. as at 31 Dec 2005:

1. Bogusław Kott – Chairman of the Management Board of the Bank,
2. Luis Pereira Coutinho – Deputy Chairman of the Management Board of the Bank,
3. Fernando Bicho - Member of the Management Board of the Bank,
4. Julianna Boniuk - Gorzelańczyk – Member of the Management Board of the Bank,
5. Wojciech Haase - Member of the Management Board of the Bank,
6. Wiesław Kalinowski – Member of the Management Board of the Bank,
7. Zbigniew Kudaś – Member of the Management Board of the Bank,
8. Rui Manuel Teixeira - Member of the Management Board of the Bank.

Composition of the Supervisory Board of Bank Millennium S.A. as at 31 Dec 2005:

1. Maciej Bednarkiewicz – Chairman of the Supervisory Board of the Bank,
2. Ryszard Pospieszyński – Deputy Chairman of the Supervisory Board of the Bank,
3. Christopher de Beck – Member of the Supervisory Board of the Bank,
4. Dimitrios Contominas - Member of the Supervisory Board of the Bank,
5. Jorge Manuel Jardim Goncalves - Member of the Supervisory Board of the Bank,
6. Andrzej Koźmiński - Member of the Supervisory Board of the Bank,
7. Francisco de Lacerda - Member of the Supervisory Board of the Bank,
8. Vasco Maria Guimaraes Jose de Mello - Member of the Supervisory Board of the Bank,
9. Paulo Teixeira Pinto - Member of the Supervisory Board of the Bank,
10. Marek Rocki - Member of the Supervisory Board of the Bank,
11. Dariusz Rosati - Member of the Supervisory Board of the Bank,
12. Zbigniew Sobolewski - Member of the Supervisory Board of the Bank.

Mr. Gijbert J. Swalef resigned from the function of the Bank Supervisory Board Member, as of 8 March 2005.

The Ordinary General Meeting of the Bank held at March 8 adopted a resolution in the matter of increasing the number of the Supervisory Board Members from 10 to 12. The following new Supervisory Board Members were appointed:

Mr. Dimitrios Contominas
Mr. Vasco Maria Guimaraes Jose de Mello
Mr. Paulo Teixeira Pinto

5. INDICATION IF THE FINANCIAL REPORT AND THE COMPARABLE FINANCIAL DATA CONTAIN JOINT DATA

There are no internal organisational units within Bank Millennium S.A. that would issue solo their separate financial reports.

6. INDICATION IF THE ISSUER IS A DOMINANT UNIT, OR A SIGNIFICANT INVESTOR, OF IF IT ISSUES CONSOLIDATED FINANCIAL REPORTS

Bank Millennium S.A. is the dominant entity of the Bank Millennium Capital Group and issues consolidated financial reports.

The consolidated financial report of the Bank Millennium Capital Group was prepared under requirements of the International Financial Reporting Standards (the IFRS), as approved by the European Community, and – wherever not regulated by the IFRS – pursuant to the provisions of the Accounting Act, dated 29 September 1994 (Journal of Laws from 2002, no. 76, item 694, as amended), and its consequent executive acts, as well as to the requirements applicable to issuers of securities allowed, or under application for allowance to the official stock exchange trading.

7. FOR FINANCIAL REPORT FOR A PERIOD COVERING A MERGER – INDICATION THAT THIS FINANCIAL REPORT WAS PREPARED AFTER THE MERGER, AND SPECIFICATION OF THE MERGER SETTLEMENT METHOD APPLIED

Between 1 January and 31 December 2005 no merger occurred that would involve Bank Millennium.

8. INDICATION IF THE FINANCIAL REPORT WAS PREPARED WITH THE ASSUMPTION THAT THE ISSUER WOULD CONTINUE ITS OPERATION

The financial report was prepared with the assumption that the issuer would continue its operation, and there are no circumstances that would indicate any threat for the operation continuation.

9. INDICATION IF THE FINANCIAL REPORT HAS BEEN SUBJECT TO CONVERSION TO ENSURE DATA COMPARABILITY

In result of a change in the way the interest margin components resulting from derivative instruments are presented; starting 2005 the result on such transactions has been presented at its net value in the income on financial operations (before the income and expense used to be recognised separately in the interest margin).

More, what have been modified since 2005 are the rules for recognizing the provision for short-term employee benefits.

The above issues have been presented in detail in item 11 (Description of adopted accounting principles/policies).

Consequent to the aforementioned changes, the financial report prepared as at 31 Dec 2004 has been modified in order to ensure that the data are comparable, as quantified in item 32 of the *Additional explanatory notes*.

10. INDICATION IF THE PRESENTED FINANCIAL REPORT OR THE COMPARABLE FINANCIAL DATA HAS BEEN ADJUSTED DUE TO RESERVATIONS CONTAINED IN OPINIONS OF AUDITING ENTITIES

No such reservations have been made.

11. DESCRIPTION OF ADOPTED ACCOUNTING PRICIPLES (POLICIES)

1) Financial report presentation principles

The financial report was prepared in line with the below principles:

- Principle of continuity,
- Principle of operation continuation,
- Principle of adequacy,
- Principle of prudent valuation,
- Principle of accrual.

The financial report was prepared pursuant to:

- Accounting Act, dated 29 September 1994, as amended
- Banking Law Act, dated 29 August 1997, as amended,
- Ordinance of the Minister for Finance, dated 26 October 2005, in the matter of specific conditions to be met by the information memorandum referred to in art. 39 sec. 1 and art. 42 sec. 1 of the Act On Public Offering, Conditions For Launching Financial Instruments In Organised Trading System And Public Companies,
- Ordinance of the Minister for Finance, dated 19 October 2005, in the matter of current and periodic information to be reported by securities issuers,
- Ordinance of the Minister for Finance, dated 10 December 2001, in the matter of specific rules for banking accountancy, as amended,
- Ordinance of the Minister for Finance, dated 10 December 2003, in the matter of creating provisions for generic risk of banks' operations,
- Ordinance of the Minister for Finance, dated 12 December 2001, in the matter of specific rules for recognition, valuation methodology, extent of disclosure, and financial instruments presentation method, as amended,
- Ordinance of the Minister for Finance, dated 18 October 2005, in the matter of the scope of information reported in financial reports and consolidated financial reports, required in an issue prospectus for issuers seated in the Republic of Poland, subject to the Polish accounting principles.

In matters not regulated by the Accounting Act, dated 29 September 1994 (as amended) the Bank applies national accounting standards, issued by the Accounting Standards Committee that has been adequately empowered by the Act, and – wherever there is no national standard – the International Financial Reporting Standards, as approved by the European Union.

2) Accounting principles applied when preparing this financial report

- **IMPLEMENTATION OF THE EFFECTIVE INTEREST RATE METHODOLOGY**

In 2005 the Bank changed the adopted accounting principles by starting to apply the effective interest rate method (the EIR) for some financial instruments subject to valuation at its depreciated cost. This was driven by provisions of the Ordinance of the Minister for Finance, dated 10 December 2001, in the matter of specific rules for banking accountancy, as amended.

The effective interest rate method is a method applied to calculation of depreciated initial value of financial assets of liabilities and allocation of cost/income on interest and some commissions to their corresponding periods. The effective interest rate is a rate for which any discounted future money payments or receivables shall be equal to the current net balance sheet value of the given financial asset or liability. While calculating the effective interest rate, the Bank estimates cash flows, taking into account any possible contractual terms and conditions for the given financial asset, however not including in the equation potential future losses on unpaid loans. The calculation includes any fees paid or received between the parties to the agreement, which are an integral part of the effective interest rate, and any costs of the transaction, as well as other premiums and discounts.

The implementation of the EIR methodology (effective interest rate methodology) for financial instruments as of January 1, 2005, entailed changes in the following areas (the discount and premium on debt securities had already been settled using the exponential method):

(i) Settling commissions on loan-making activity

Until the end of 2004 the commission had been recognised in the profit and loss account of the Bank on a cash basis when charged (with the exception of specific commissions, settled over time using the straight-line method). Since the switch onto the EIR, certain specifically-defined commissions have been recognised in the profit and loss account throughout the term of a loan agreement. Such depreciation over time applies to loan-related commissions that due to their nature are substitutes of the interest income. Unsettled part of the commission is presented in the balance sheet as adjustment to the credit exposure value, while the settled part is the interest income (or commission income for commissions charged on instruments with undefined repayment schedule). Depending on given commissions nature, the Bank spreads them over time using the straight-line, sum of digits, or EIR method. In result, the equities of the Bank reduced on the day of conversion to the EIR (opening balance adjustment driven by separating from previous years' profits part of commissions on active loan agreements that would be settled over time). The quantification of the opening balance adjustments has been presented further herein. The following items are also subject to settlement over time:

- Defined, specific-type commissions charged on payment cards, depreciated at straight-line method, recognised as commissions income,
- Own costs incurred by the Bank, directly related to loan agreement making, such as commissions payable to external and in-house agents for making mortgage loan agreement, and real estate appraisal costs related to this type of agreement.

(ii) Single agreement

In previous years the Bank made a structured long-term agreement with a single partner. The agreement effected simultaneously in the Bank taking a loan and purchasing zero-coupon securities of the partner, and the Bank making a pre-payment of (discounted) interest for the loan for 10 last years upfront. Following the agreement, till 31 December 2004 the pre-payment made had not been recognised in the profit and loss account, current loan interest had been subject to linear accrual, and the securities discount had been settled by the exponential method.

Such a contractual construct lead to a significant adjustment (increase) of the opening balance in equities at the moment of applying the valuation at depreciated cost and effective interest rate, due to, inter alia, applying one single effective interest rate to the entire structure, and settling pre-paid costs over time following the effective interest rate methodology.

(iii) Introducing the EIR methodology in a subsidiary

Moreover, in EIR calculations made by a subsidiary conducting leasing activity, the scope of costs used as the EIR calculation component was increased, while any commissions charged to customers for leasing agreement making were taken into equation (thus impacting the net assets of the Bank, since the Bank uses the equity method valuation for shares and stock in subsidiaries).

When implementing, as of January 1 2005, the principle of valuating some financial instruments at their depreciated cost and effective interest rate, following the provisions of the accounting laws binding in Poland and the IAS 39 regulations, the Bank did not covert the 2004 comparable data.

However, for the data comparability and the ability to correctly assess the financial condition, the Bank prepared the 2004 pro forma financial reports (less detailed), following the EIR requirements. The reports were used exclusively for managerial purposes, and formed the basis for the information on the Bank's activity in 2005, that was presented in the Management Board's Descriptive Report, constituting an integral section of this report.

The adjustments to the Bank's equity, as at 1 January 2005, resulting from the EIR adaptation are as follows (numbers in column headers correspond to the above-presented description):

Data in PLN thousands

	(1) Financial instruments valuation at depreciated costs and EIR – commissions	(2) Single agreement valuation at depreciated costs and EIR	(3) Financial instruments valuation at depreciated costs and EIR – subsidiary	TOTAL
Gross adjustment	-39 671	+101 881	- 1 866	+ 60 344
Net adjustment (after the deferred tax effect)	-32 133	+82 524	- 1 511	+ 48 880

q CHANGE OF ACCOUNTING PRINCIPLES IN THE AREA OF EMPLOYEE BENEFITS

Due to the adoption of International Financial Reporting Standards in the Bank's capital Group, as of 1 January 2005 the Bank changed the accounting principles concerning the method of recognising costs of short-term employee benefits on account of bonus for senior management of the Bank, based on provisions of IAS 19.

Under former accounting principles these costs were recognised in the year, in which the benefits to the employees were incurred by the Bank, under a decision of the Bank's Supervisory Board, after approval of the Bank's annual financial statements by the General Meeting of Shareholders.

According to IAS 19 costs concerning short-term employee benefits on account of bonus should be recognised in the period, in which the employees had performed the related work.

The effect of this change was reflected retrospectively in the financial statement, by restating comparable data (which has been presented in point 32 of "Additional Explanatory Notes").

- **C**HANGE IN THE ACCOUNTING PRINCIPLES CONCERNING PRESENTATION OF INTEREST ON DERIVATIVES

Since January 1 2005 the Bank has been recognizing interest on FX SWAP and CIRS operations in result on financial operations for transactions made for non-speculative purposes, i.e. to ensure liquidity in foreign currencies for FX loans made by the Bank. These are instruments concluded for non-speculative, hedging purposes, for which the Bank does not apply hedge accounting, hence they are automatically qualified to the portfolio of trading financial instruments. According to IAS 39.9 (the Bank under the delegation from the Accounting Act employs the IFRS in the case of issues not regulated by domestic provisions) all derivatives for which the Bank does not apply hedge accounting regardless of the purpose (derivatives made for speculative purposes, and these made to hedge, however not subject to hedge accounting) should be qualified as trading financial instruments, while the total change in fair value (accrued swap points plus the adjustment to fair value) should be shown in the same line of profit and loss account (in this case in result on trading activities).

It is the Bank's opinion that the interest income on FX SWAP and CIRS transactions made to ensure liquidity in foreign currencies (i.e. accrued swap points on FX swap transactions plus interest accrued on CIRS transactions) is a component of the economic interest margin, as it allows adjusting interest income on FX loans (based on EURIBOR, LIBOR) to the position financing costs (interest on PLN deposits based on WIBOR).

In the light of the above, the Bank has been consulting the option of returning to the solution applied previously also for the report made under IFRS.

A suitable adjustment which has been made for 2004 data comparability is quantified in item 32 of the Additional Explanatory Notes.

- **OTHER ACCOUNTING STANDARDS APPLIED**

Receivables and liabilities

- Receivables and liabilities are recognised at the price to be paid, including any interest accrued,
  Under strictly-defined circumstances, the Bank shall write off credit exposures against created specific provisions, following the provisions of the Ordinance of Minister for Finance, dated 2 December 2003, amending the Ordinance on specific provisions for banking accounting.
  In particular the write-off against specific provision shall be applied to loans that:
  - have been moved to the *lost* category, under the criteria defined by the Minister for Finance in the Ordinance, dated 10 December 2001, in the matter of creating provisions for the risk related with banking activities (Journal of Laws 01.149, item 1672, as amended),
  - are not material collaterals-backed, the process of collaterals liquidation have been already closed, and the created specific provision is 100% of due principal,
  - for which the related tax loss have been concluded to be unavoidable, in particular when: the Bank initiated the execution proceeding, the debtor died or the company was removed from

the business activity register, or the company is under liquidation, bankruptcy, or the debtor's whereabouts is unknown and his/her assets remain undisclosed.

The process of writing off is preceded by an individual assessment of receivables collection prospects. Any income on recoveries previously written off against provisions are posted in the profit and loss account as other operating income.

- In financial reports the receivables are presented at net amounts, i.e. minus any specific provisions created under the binding regulations, and net of the unsettled part of credit commissions resulting from using the valuation under the EIR method (as discussed above, in the section dedicated to accounting regulations changes),
- For any off-balance irrevocable liabilities, bearing the risk of irregular condition of the customer, specific provisions are opened, as required by the binding regulations.

Securities

- **Debt securities**

Debt securities are assigned at the day of purchase to one of the following categories:

- For trading

  These are securities purchased for the gain resulting from short-term price fluctuations. As at the balance sheet date, securities for trading are subject to valuation at their fair value, with the valuation outcome posted in the result on financial operations.
- Kept till maturity

  This group contains debt securities purchased with intention to keep till maturity. Securities from this portfolio are subject to valuation at the depreciated cost, with impairment write-offs.
- Available for sale

  The *Available for sale* category comprises debt securities not included in categories *For trading* and *Kept till maturity*. These securities are subject to valuation at their fair value, with the overestimation gap recognised in the revaluation capital. At the date when the entire financial asset, or its part, is taken out of the books (the sale), the to-date valuation is taken out of the capitals and moved to the profit and loss account.

Debt securities that has been classified to a category using the fair value valuation method, for which the fair value cannot be reliably determined, shall be valued at their depreciation cost.

The impairment of debt securities *kept till maturity* and *available for sale* shall be written off against profit and loss account (in case of impairment of instruments with unrealised positive valuation posted to the revaluation capital, first the result of the valuation is offset).

The discount on debt securities is settled over time using the exponential method.

- **Shares**

The shares are classified to the following categories:

- For trading,
- Available for sale,

The criteria applied to the classification, as well as the methodology for shares and stock valuation are analogous to those used for same categories of debt securities (with the exception of shares and stock in subsidiaries), as described above.

Investments in shares and stock of subsidiaries are valued in the Bank's solo report using the equity method, based on guidelines of art. 63 of the Accounting Act, and on the following assumptions:

- Any profits or losses on intra-group transactions are set off in proportion to the shareholding of the Bank (Group) in the given entity. Regardless of whether such profits/losses are prepared at the higher rank (by the dominant entity), or by the lower rank (by the subsidiary), the resulting adjustments are recognised in the profit and loss account's category *Share in profits/losses of subsidiaries*, and in the balance sheet as the *Change in the value of shares and stock in subsidiaries*,
- Should the value of shares and stock in a subsidiary be negative in result of posting the valuation effect, the report shall show the total value of adjustment (i.e. also the part of the adjustment in excess of the purchase price) in relation to the Bank's profit and loss account. In the balance sheet, the part of the adjustment over the purchase price shall be presented in liabilities as the *Provision on subsidiaries valuation at equity method*,
- in order to conduct valuation of shares and stock of entitles not held directly in the Bank's portfolio, however members of the Capital Group of Bank Millennium (i.e. entities controlled by the Bank through other entities) the two-tier procedure is applied: entities directly subordinated to the Bank perform equity method valuation of shares/stock held in companies of the Capital Group, and only then, such adjusted net assets of the entities are used in the shares and stock calculations in the Bank,

Shares and stock in subsidiaries not valued at the equity method (of insignificant scale of operations) are recognised in the balance sheet at their purchase price, including any impairment provisions created.

Derivative and other financial instruments

Derivative instruments are classified as assets or liabilities for trading and valued at their fair value. Embedded derivative instruments are posted and valued separately from the major agreement, should all the following conditional occur jointly:

§ the financial instrument is not recognised in assets for trading, whose valuation results are shown in the profit and loss account,

§ the nature of the embedded instrument and the related risks are not closely linked to the nature of the major agreement and its related risks,

§ the derivative instrument's fair value can be reliably determined.

Derivative instruments whose fair value at the balance sheet date is positive are presented in the assets as *Other securities and financial assets*, and in liabilities under *Other liabilities on financial instruments*, if their overall result is negative. In the profit and loss account, the fair value adjustment is posted under *Result on financial operations* or *Result on FX position*.

In case of fair value hedging transactions, the profits or losses on the derivative valuation set off in the profit and loss account, respectively, corresponding effects of changes in the hedged instruments' fair value.

The Bank holds the following derivative instruments:

1) FX forward

   The basis amounts of open FX forward transactions (currencies purchased and currencies sold) are recognised in off-balance items, presented under *Liabilities related to buy/sell transactions*. Amounts in foreign currencies are converted at the NBP average rate as at the balance sheet date. Forward transactions are valued using the fair value, based on the method of discounting future cash flows at the end of each month. The fair value is posted in other assets/liabilities in correspondence with the Result on FX position.

2) FX SWAP

   The basis amounts of open FX SWAP transactions (currencies purchased and currencies sold) are recognised in off-balance items, presented under *Liabilities related to buy/sell transactions*. Amounts in foreign currencies are converted at the NBP average rate as at the balance sheet date. At the end of each month FX SWAP transactions are valued using the fair value, based on the method of discounting future cash flows. The fair value is posted in *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations* and the *Result on foreign exchange*

3) Interest Rate SWAP (IRS)

   The basis amounts of open IRS transactions (currencies purchased and currencies sold) are recognised in off-balance items, presented under *Other off-balance items*. At the end of each month IRS transactions are valued using the fair value, based on the method of discounting future cash flows. The adjustment is posted under *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations*.

4) Cross – Currency Swap transactions (CCS)

   The basis amounts of open CCS transactions (currencies purchased and currencies sold) are recognised in off-balance items, presented under *Liabilities related to buy/sell operations*. Amounts in foreign currencies are converted at the NBP average rate as at the balance sheet date. At the end of each month CCS transactions are valued using the fair value, based on the method of discounting future cash flows. The adjustment is posted under *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations*.

5) Equity SWAP, Volatility Swap, Swap with embedded FX option

   The basis amounts of open swap transactions (currencies purchased and currencies sold) are recognised in off-balance items, presented under *Other off-balance items*. At the end of each month swap transactions are valued using the fair value, based on the method of discounting future cash flows. The adjustment is posted under *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations*.

6) FX options

   The basis amounts of open option transactions (only foreign currency), converted at the NBP average rate as at the balance sheet date, are recognised in off-balance items, presented under *Other off-balance items*. At the end of each month option transactions are valued at their fair value. The adjustment to the fair value is done by adjusting the premium paid/received. The fair value is posted under *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations*.

7) Forward Rate Agreement Transactions (FRA)

   Kwoty kapitału wynikające z zawartych transakcji są wykazywane w pozycjach pozabilansowych i prezentowane w pozycji „Pozostałe pozycje pozabilansowe". Transakcje FRA są wyceniane do wartości godziwej na koniec każdego miesiąca, a wycena prezentowana jest w pozycji „pozostałe papiery wartościowe i inne aktywa finansowe"/„inne zobowiązania z tytułu instrumentów finansowych" w korespondencji z wynikiem na operacjach finansowych.

   The amounts of principal on made transactions are recognised in off-balance items, and presented under *Other off-balance items*. At the end of each month FRA transactions are valued at their fair value, and the valuation is presented under *Other securities and other financial assets* / *Other liabilities on financial instruments* in correspondence with the *Result on financial operations*.

8) Investment certificates and fund units held in the Bank's portfolio, that were purchased with the intention to be sold shortly, or to gain margins, are contained in the portfolio for trading, and valued at their fair value. The outcome of the valuation is posted to the profit and loss account. These instruments are recognised under the balance sheet item *Other securities and other financial assets*.

The Bank presents in the balance sheet any financial assets sold with the buy back clause (the Sell-Buy-Back transactions, SBB), posting at the same time in liabilities the liability resulting from the buy-back promise given. The solution can only be applied if the Bank still has the risks and benefits on the given asset, despite its transfer. In case of Buy-Sell-Back transactions (BSB), any financial assets held are presented as receivables under the sell-back clause. The SBB and BSB transactions are valued at depreciated costs, while the securities under an SBB transaction are not removed from the balance sheet, and are valued using the methodology accepted for the particular securities portfolio.

Fixed and intangible assets

The accounting of fixed and intangible assets is kept at purchase or production prices, or (in case of fixed assets) at the value determined by revaluation minus depreciation charges (redemption) and impairment write-offs. The impairment is recognised when there is high probability that the Bank's fixed or intangible asset shall not generate the expected economic benefits. If this is the case, the Bank creates a revaluation write-off against the profit and loss account, equal to the difference between the balance sheet value and net sale price (or the fair value determined in any other way) of the impaired asset.

The adopted depreciation rates are derived based on the expected period of economic productivity of fixed assets. The depreciation is performed using the straight line method.

Depreciation rates used by Bank Millennium SA:

Selected fixed assets groups:	
Bank's buildings	2,5%
Investments in external premises	for the term of the lease agreement
Computer sets	30,0%
Network equipment	30,0%
Means of transport	20,0%
Telecommunication devices:	
- wired	10,0%
- wireless	20,0%
Intangible assets (software):	
Main applications (systems)	10,0%

rates used for the other computer software are not higher than 50%, depending on the planned life cycle.

The Bank regularly reviews the adopted assumptions regarding periods of economic productivity of fixed and intangible assets. Conclusions of such analysis form the grounds for a possible modification in depreciation periods, recognised prospectively as of the date of adjustment.

Fixed assets under construction are reported at their purchase price or production cost, and are not subject to depreciation.

Adaptation and modernisation of purchased of leased fixed asset premises is considered to be a component of fixed assets under construction, and has been reported in the balance sheet.

Assets taken over for sale

Assets arrested for debts are shown at the price equal to the amount of debt for which the asset was arrested, minus revaluation write-offs created up to the amount of the gap between the amount of the debt and the realistic net sale price for the arrested assets.

Assets and liabilities in foreign currencies

Assets and liabilities posted as balance sheet and off-balance FX positions are recognised after conversion to PLN at an average FX rate for each of the currencies set by the NBP President as at the balance sheet day. FX differences resulting from the conversion of balance sheet assets and liabilities are reported in the profit and loss account.

Description of selected profit and loss account items

- **Interest income**

Interest receivables are accrued to-date till the last day of the financial period. The profit and loss account shall not contain due interest, matured and not matured, and capitalised interest on receivables at risk. Such interest shall be considered interest income when received; till then it is shown in the balance sheet as suspended income. Discount interest on purchased receivables are recorded at settlement accounts as income received upfront and settled over time at accrual basis against the profit and loss account. Commissions settled over time on scheduled loans valued at depreciated costs using the EIR method are recognised as interest income. More, the interest margin includes own costs of the Bank settled over time and directly related to loan agreement making, such as commissions paid to external and in-house agents for loan agreement execution, and expenses on real estate appraisal related to this type of agreements (the issue has been discussed in the section dedicated to account changes implemented in 2005).

- **Interest expense**

Interest liabilities are accrued to-date till the last day of the reporting period. Any liabilities accrued, related to the current reporting period shall be considered costs and posted in the profit and loss account.

- **Banking fees and commissions received/ paid**

Income / costs on fees and commissions are reported in the profit and loss account at the cash method, i.e. at the moment of payment, except for these commissions that due to their nature are settled over time (the issue has been discussed in the section dedicated to account changes implemented in 2005).

- **Income on dividends**

Dividend income is recognised in the Bank's profit and loss account on the date when the divided is declared.

- **Other operating costs / income**

Other operating costs and income covers costs and income not related directly to banking activity. These in particular contain income (sale price) and costs (net value at the moment of sale) on selling or liquidating fixed assets, income on received compensations, penalties, and pains, as well as income on any recovered receivables that had been previously written off against provisions.

3) Provisions for irregular receivables and for general risk

Credit exposures are subject to classification and specific provisioning based on individual assessment of transactions, following the rules provided in the Ordinance of the Minister for Finance, dated 10 December 2003, in the matter of creating provisions for general risk related to banking activity.

The general risk provision is opened against the costs of the current period in order to cover risks related to banking activity.

4) Employee benefits

- **Short-term employee benefits**

Short-term employee benefits of the Bank include: remunerations, bonuses, paid days off, and premiums contributing to social security.

The Bank posts the expected not discounted value of short-term employee benefits as costs in the period when the employees delivered the related work, in correspondence with the cost accruals in the balance sheet liabilities.

The amount of short-term employee benefits on unused holidays due to the Bank employees is determined as the sum of unused holidays due to individual employees of the Bank.

- **Long-term employee benefits**

The Bank's liabilities on long-term employee benefits are the total of future benefits to be received by employees in return for provision of their services in the current and previous periods. Pursuant to the Bank Employees Remuneration Bylaws, and to the Labour Code, having reached certain seniority and age, employees earn the right to severance pay. Provision for severance pays is determined using actuarial method as present value of future liabilities of the Bank towards employees based on employment level and salaries as at the revaluation date. Provision for severance pays is subject to revaluation annually, and is posted under cost accruals in the balance sheet liabilities.

5) Corporate Income Tax and the deferred income tax provision and assets

Income tax is determined based on the gross accounting result adjusted by revenues that – following tax regulations – are not taxable income, and by costs not considered by the tax regulations as cost of income. Moreover, for the calculation of current tax liabilities, the gross accounting result is adjusted by costs and revenues of previous years realised for taxation reasons in the given reporting period, and by income deductions on donations, and by tax losses of previous years settled against the income of the current year.

At the end of each month, balance sheet costs and revenues that are permanently not a cost or income from taxation standpoint (permanent gaps), are identified respectively, as well as the income and costs considered taxable income and cost of income, however in a different reporting period. The difference is caused by the discrepancy between the Accounting Act and tax regulations in the moment of recognising income as obtained or cost as incurred. The Bank creates a provision for interim gap in income tax to be paid in the following reporting period. Positive gap is considered a charge of net financial result as a provision for income tax. Negative gap is posted in *accruals and prepayments*, as long as it is probable that it would be settled over the following reporting period.

Permanent gaps include, inter alia, the following:

- Contributions to the National Fund of Rehabilitation of the Disabled, made pursuant to other regulations,
- Expenses in favour of shareholders,
- Depreciation write-offs on cars in their part applicable to the value of EUR 20 thousand,
- Premiums for cars insurance, in the amount exceeding their part set in proportion of the EUR 20 thousand,
- Costs incurred in the current year but related to the income of previous years,
- Costs incurred in relation to investments in external fixed assets not used any more by the unit,
- Membership contributions towards voluntary membership organisations,
- Donations,
- Result of valuation of shares and stock in subsidiaries, valued using the equity method,
- Dividends received.

Interim gaps include, inter alia, the following:

- Interest accrued, settled discount on securities, which at the date of accrual create the gross result, while being a cost or income at the date of realisation, according to the CIT Act,
- Changes to the fair value of securities and financial instruments,
- Provisions created for receivables on granted loans, and provisions for loss on securities which will likely become cost of income,
- Differences between depreciation of fixed and intangible assets for the accounting and taxation purposes,
- Provisions for costs to be incurred,
- Losses of previous years which will likely be settled in future periods.

In the process of determination of value of the deferred tax assets, the Bank individually assesses probabilities if a given specific provision (and to what extent) is likely to become a future cost of income.

The deferred income tax provision and assets are presented in the balance sheet separately. Tax loss is shown as the deferred tax asset, as long as it is likely to be settled in future reporting periods.

Pursuant to art. 38 of the CIT Act, Bank Millennium posts discounted receivables from the Tax Office at 8% of total value of specific provisions for the risk on receivables and loans qualified by the Bank as *Doubtful* or *Lost*, that at Dec 31, 2002 were not considered cost of income. In consequence of eliminating the provisions, the Bank conducts revaluation of the receivables from the Tax Office, recording the revalution result in the profit and loss account.

6) Value Added Tax (VAT)

According to binding regulations, banking transactions are not subject to VAT taxation. Bank Millennium SA does not deduct the accrued from the due VAT, except for purchases related to the sale subject to due VAT taxation.

7) Net profit per share

The Bank's net profit per share was determined by dividing net profit for the term between 1 Jan.– 31 Dec. 2005 (annualized profit) by the weighted average number of the Bank's shares in the period.

12. INDICATION OF AVERAGE PLN FX RATES IN PERIODS COVERED BY THE FINANCIAL REPORTS AND THE COMPARABLE FINANCIAL DATA, AGAINST EUR, PROVIDED BY THE NATIONAL BANK OF POLAND

	1.01.05 – 31.12.05	1.01.04 – 31.12.04
FX rate at the last day of the period	3.8598	4.0790
Avg FX rate in the period (arithmetic average of rates as at the last day of each month in the period)	4.0233	4.5182
FX rate in the period (as at month-ends):		
- maximum	4.2756	4.8746
- minimum	3.8598	4.0790

13. INDICATION OF AT LEAST KEY POSITIONS OF THE BALANCE SHEET, PROFIT AND LOSS ACCOUNT, AND CASH FLOWS ACCOUNT FROM THE FINANCIAL REPORT AND THE COMPARABLE FINANCIAL DATA, CONVERTED TO EUR

KEY FINANCIAL DATA (in EUR thousands)

	1.01.05 – 31.12.05	**1.01.04 – 31.12.04**
Interest income	277 852	185 751
Commissions income	59 247	51 903
Result on banking activity	221 728	189 235
Result on operations	102 790	-17 506
Gross profit or loss	102 790	-17 506
Net profit or loss	134 746	52 575
Total assets	5 975 704	5 278 033
Receivables from financial institutions	685 735	869 430
Receivables from non-financial and public entities	2 345 284	1 653 700
Liabilities towards Central Bank	0	0
Liabilities towards financial institutions	474 105	485 311
Liabilities towards non-financial and public entities	3 451 515	3 482 049
Equalities, of which:	607 886	487 090
- initial capital	220 007	208 184
Net cash flows on operations	134 367	578 944
Net cash flows on investments	101 823	-528 575
Przepływy pieniężne netto z działalności finansowej	-323 226	-33 413

The balance sheet data were converted using average NBP rate as at the end of the given period. Data from the profit and loss account and from the cash flows account were converted at the average rate for the given period, determined as arithmetic average of average NBP rates as at the closing day of each month covered by the report.

14. INDICATION AND EXPLANATION OF GAPS BETWEEN THE FINANCIAL REPORT AND COMPARABLE DATA UNDER PAS, AND THE FINANCIAL REPORT AND COMPARABLE DATA THAT WOULD BE PREPARED UNDER IFRS OR US GAAP

This report of the Bank was prepared based on the Polish Accounting Standards (PAS); additionally the Bank, as the dominant entity, since 2005 has prepared its consolidated financial report under the International Financial Reporting Standards (IFRS).

Below one can find the description of major gaps and quantification of net assets and net profit of the Bank, calculated under the IFRS:

1. The principles for creating provisions for credit exposures impairment under the Polish Accounting Standards (PAS) are based on legal regulations defined by the Ordinance of the Minister for Finance, dated 10 December 2001, in the matter of creating provisions for the risk related to banking operations (as amended). Under the IFRS, their provisions define the obligation to determine the value of revaluation write-off as a difference between the balance sheet value of receivables and the discounted, under EIR, value of future cash flows related to the receivables. At the same time, under IAS 39 the interest accrued on loans with recognised impairment (credit exposure net value is the basis for accrual) is posted in the profit and loss account (while under the PAS, interest on NPLs is calculated on the gross value of loans, and recognised in the balance sheet as suspended interest. Whereas, any repayment of interest on NPLs is recognised in the profit account's interest margin under PAS, while any repayment on loans with recognised impairment (IFRS) shall reduce the net exposure.

2. According to the amended version of IAS 27 (in force since January 1, 2005), the solo report cannot show shares and stock held by the reporting unit valued using the equity method. On the contrary, the present wording of PAS (Ordinance of the Minister for Finance, dated 10 December 2001, in the matter of specific accounting principles for banks, as amended) impose the obligation to apply this particular valuation method to shares and stock held in subsidiaries.

3. The PAS contains detailed regulations regarding rules of generic risk provisioning. The IFRS do not allow creation of provisions for general risk, however IAS 39 introduced the term *'provisions created for incurred but not reported losses'* – the IBNR) applicable to provisions opened for homogenic portfolios with not reported loss.

Additionally, the regulator provided the way in which to recognise the effect of the deferred tax accrued on the gap between the general risk provisions and the IBNR provision as at the moment of the IFRS implementation. Following the rule, the smaller tax effect should be recognised directly in the equity as an adjustment to the retained profits opening balance.

4. The method and scope of data presentation are different in some areas of financial reports under IFRS and PAS; this in particular holds true for the following areas (other than those listed above):

- In the report according to IFAS, the balance sheet shows a separate category of *assets for sale*. Adequately to the IFAS definition, these assets are valued at the lower of the two: balance sheet value, or fair value minus cost of selling,

- Following the IAS 17, the *perpetual usufruct of land* is treated as an instance of operating leasing and recognised in the balance sheet under *other assets* (according to PAS – under *fixed assets*),
- Recovered receivables written off against provisions are according to the PAS presented in the profit and loss account's other operating income, while the IFRS demand their recognition as a reverse entry to the impairment write-offs.

Table (1) presents reconciliation of the Bank's equities, calculated using PAS and IFRS, as at 31 December 2004. According to the PAS, the equities include the adjustment of opening balance on the effective interest rate implementation (this issue is discussed in item 11.2 herein). Adjustment numbers correspond with the above-presented areas of difference between the PAS and IFRS; data in PLN thousands.

Table 1

	PAS	**Adjustment 1**	**Adjustment 2**	**IFRS**
Net capitals at 31 Dec 2004	2 035 720	8 627	-596 076	1 448 271

Table (2) presents reconciliation of net result of the Bank for the reporting period between January 1 and December 31 2005, determined under PAS and IFRS. Adjustment numbers correspond with the above-presented areas of difference between the PAS and IFRS; data in PLN thousands.

Table 2

	PAS	**Adjustment 1**	**Adjustment 2**	**IFRS**
Net profit of current period	542 119	22 448	-140 167	424 400

Table (3) presents reconciliation of the Bank's equities calculated under PAS and IFRS, as at 31 December 2005. Adjustment numbers correspond with the above-presented areas of difference between the PAS and IFRS; data in PLN thousands

Table 3

	PAS	**Adjustment 1**	**Adjustment 2**	**Adjustment 3 ***	**IFRS**
Net equity at 31 Dec 2005	2 346 317	31 075	-736 243	10 947	1 652 096

* In the calculation of the value of adjustment number 3 the gap between the value of the general risk provision and IBNR as at December 31 2005 was applied.