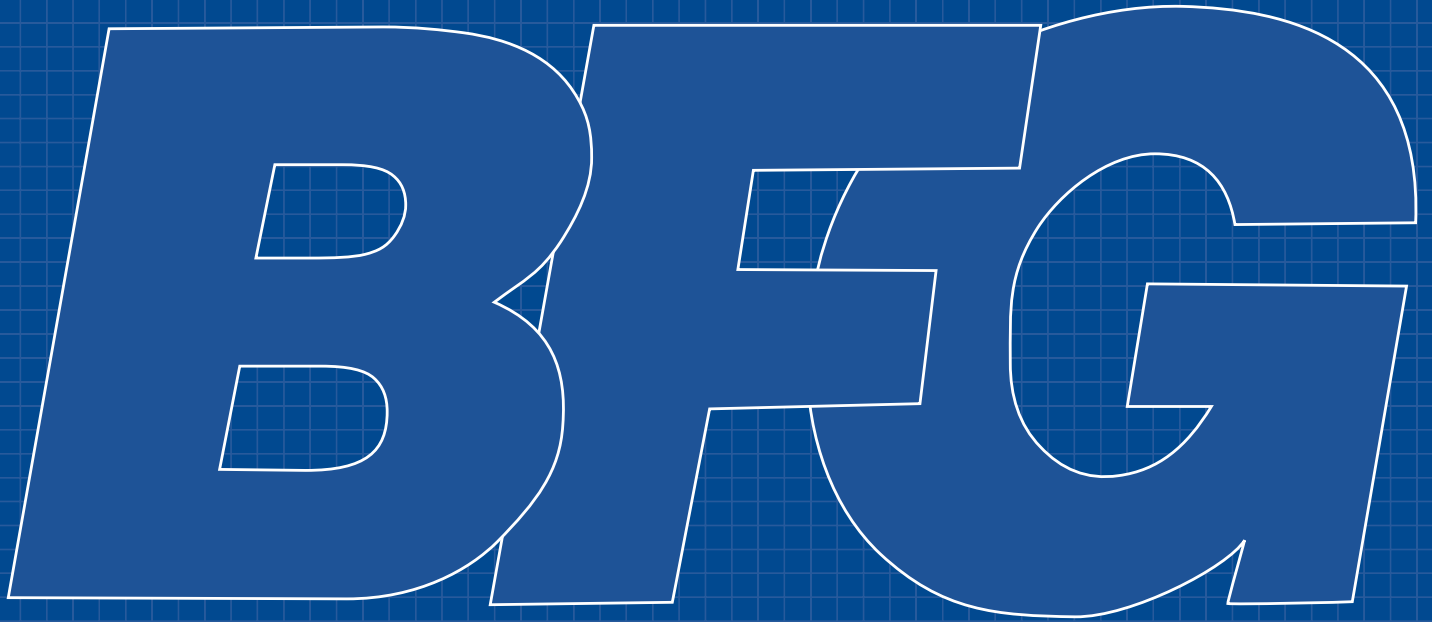




Bank Guarantee Fund



ANNUAL REPORT

2006

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Ladies and Gentlemen,

We are presenting the Annual Report of the Bank Guarantee Fund for 2006. I hope that reading of the Report would allow you to learn about both positive changes that take place in the Polish banking system, as well as about effects of the Fund's operation in the past year.

2006 was a subsequent good year for the Polish banking sector, especially from the viewpoint of the Bank Guarantee Fund. In that year no bankruptcy was declared for any bank, and the financial standing of the banking sector was considerably improved.

In the past 12 months the focus of works executed by the Fund was on working out new forms of assistance to banks, participation in development of a new system and legal solutions aimed at enhancing the stability of the banking system in Poland.

For many years now the Bank Guarantee Fund has been invariably active internationally. Last year representatives of the Fund participated in conferences and meetings of working groups organised by two international associations of deposit insurance institutions: the European Forum of Deposit Insurers (EFDI) and International Association of Deposit Insurers (IADI). Operation of BGF on the international forum allows a more extensive global use of knowledge and experience of deposit guarantee institutions in banking systems.

The effectiveness of our operation depends to a large extent on close and good co-operation with the National Bank of Poland, Finance Ministry, the Polish Banks Association and other entities on the financial market.

Words of gratitude are also be addressed at representatives of the aforementioned institutions for assistance and substantial support in fulfilment of current duties and for setting out development directions for the Fund.

As the new Chairman of the Fund Supervisory Board I wish to express my gratitude to persons who allowed the Bank Guarantee Fund to execute in an effective and competent way the Fund's mission, which was to care for safety of deposits and strengthening the trust vested by the Polish society in the banking sector.

Chairman of the Fund Supervisory Board
Robert Jagiello

Ladies and Gentlemen,

The Bank Guarantee Fund, of which I have been President as of 20 April 2007, constitutes an important element in the security system and financial stability of the banking system. Our mission is to help create a secure and stable bank system in Poland and to increase social awareness with respect to principles for guaranteeing bank deposits.

Execution of statutory objectives by BGF contributes to maintaining stability and strengthening of security of the banking system in Poland, and consequently is conducive to improvement of social confidence in banks.

Thanks to the improving condition of the banking sector in 2006, which was possible thanks to an favourable economic situation, professional management of banks, growing interest in bank products both from individual clients and enterprises, the Bank Guarantee Fund extended only 2 loans from the co-operative bank assistance fund to banks threatened by insolvency.

Strengthening the favourable situation of the banking sector was also enhanced by measures undertaken by the Fund, which comprised supporting the consolidation processes in the sector of co-operative banks and supporting their restructuring measures. In 2006 the Bank Guarantee Fund granted 6 loans from the co-operative banks restructuring fund, and this granted assistance helped moderate financial consequences of consolidation processes which were underway.

The crucial role of the Fund in strengthening the financial security of the banking sector was connected with increased importance of the in conducted analytic operation. Thanks to constant monitoring of financial standing of the banks, the Fund is able to determine in advance the risk of occurrence of insolvency and instigate preventive measures. Implementation of our mission, enhancing security and stability of banks and strengthening social confidence in the Polish Banking system would not have been feasible without close co-operation with the National Bank of Poland, Finance Ministry, the Polish Bank Association, as well as all banks which participate in the Polish deposit guarantee system.

President of the Bank Guarantee Fund Management Board
Małgorzata Zaleska

GUARANTEE ACTIVITY

1. Financing sources of guarantee activity

The basic source of financing for guarantee activity are funds collected by banks in the form of financial means for protection of guaranteed deposits. The obligation of setting up such funds comprises all banks which participate in the Polish deposit guarantee scheme. The value of funds is determined as product of the sum of deposits collected in the bank, used as basis for calculating obligatory reserve, and the percentage rate determined annually by the BGF Supervisory Board. The maximum level of the interest rate, according to which banks are obliged to set up funds for protection of guaranteed deposits, amounts to 0.4%. Taking into consideration potential threats in the banking sector, in resolution No. 19/2005 dated 17 November 2005 the BGF Supervisory Board defined the level of interest rate for setting up funds for protection of guaranteed deposits for 2006 amounting to 0.19% of the funds used as basis for calculating obligatory reserve. In 2006 funds for protection of guaranteed deposits set up by all banks and maintained in assets equalled to PLN 761,932,300. Despite the identified threats and occurring risk in the banking sector, in 2006 no bank was declared insolvent, as a consequence of which this fund was not used.

It should be emphasised that the way in which funds for protection of guaranteed deposits are created by the banks does not affect their financial encumbrance. It only limits the freedom in disposal of a small part of financial means as compared to their balance sum (at the end of December 2006 this constituted net 0.14% of the balance sum). Funds for coverage of deposits are kept in the form of treasury securities or money bills of NBP, which allows banks to achieve interest revenues. Only if a court declares a bank bankrupt, participants of the system transfer appropriate sums to BGF for payment of guaranteed funds.

A source of payments of guaranteed funds are also means recovered by the Fund from bankruptcy assets of insolvent banks¹.

¹Should funds for protection of guaranteed deposits and means recovered from bankruptcy assets of insolvent banks prove to be insufficient, BGF may use the assistance fund and other own funds. Should also these prove to be insufficient for execution of the Fund's obligations related to payment of guaranteed funds, it is possible to have a credit extended in the National Bank of Poland. Subsequently, there is a possibility of raising the rate for establishing of funds for protection of guaranteed deposits by the banks to 0.8% by way of a regulation of the Supervisory Board of Ministers, once opinion of the President of the National Bank of Poland has been obtained. In the hitherto operation of the Fund there was no need of using additional possibilities of obtaining funds for such payments.

2. Payment of guaranteed funds

In 2006 in its guarantee operation the Fund continued making payments of guaranteed funds for those depositors of Bank Staropolski SA in Poznań², whose claims have not been subject to limitation.

In the period from 1 January until 31 December 2006 limitation comprised claims of 4 depositors of this Bank for the amount of PLN 44,200, and on 31 August 2006 (in connection with lapse of 5 years since bankruptcy declaration of the bank) 411 depositors of Bank Spółdzielczy in Włodowice for the total amount of PLN 4,200.

In 2006 the Fund Office made payments of a total amount of PLN 5,600 for 3 depositors of Bank Staropolski SA, which have not taken up the sums due to them during payments effected by the trustee of bankruptcy estate, and towards which the course of limitation had been discontinued.

The second form of payments of guaranteed funds were payments executed by the receiver of Bank Staropolski SA. The basis for those payments were supplementing lists of depositors, submitted to the Fund by the receiver. Those lists comprised persons who had not been indicated in the primary list, i.e. heirs, as well as persons who have paid for the funeral of account owners, who died before the bank was declared insolvent. Funds for execution of payments came from liquid assets of a bankrupt bank, and the payments were made by a receiver. In this form paid out were PLN 80,500 for 5 depositors.

According to the state as on 31 December 2006, the overall amount of claims not subject to limitation towards the Fund with respect to uncollected guaranteed funds equalled to PLN 94,800. This amount comprised receivables of 49 depositors of Bank Staropolski SA in Poznań. Unit value of uncollected guaranteed funds was within the range of PLN 132.71 to PLN 28,531.93.

In the period from the beginning until the end of 2006, BGF paid out guaranteed funds to depositors of 4 commercial banks and 89 co-operative banks.

Payments of guaranteed funds made by the Bank Guarantee Fund totalled to PLN 814.4m and comprised 318.822 eligible depositors.

²Bankruptcy of Bank Staropolski SA was declared by the court on 11 February 2000, and limitation of claims of 2,626 depositors of the Bank to the amount of PLN 1,459,739.01 took place on 11 February 2005.

LOANS FROM THE ASSISTANCE FUND

1. Objectives and principles in granting assistance

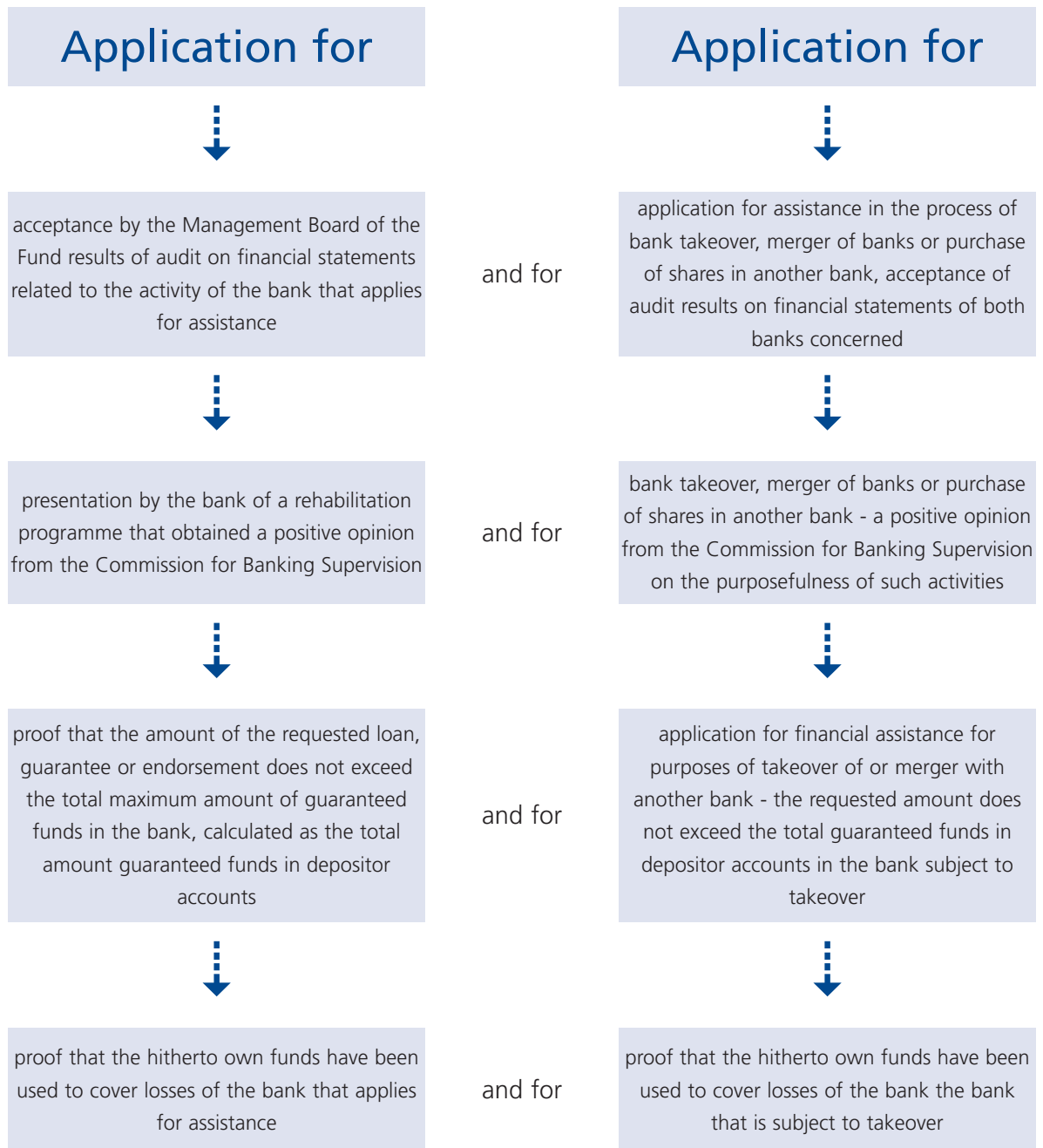
The basic objective of assistance activity is granting financial support for execution of restructuring measures to banks threatened by the risk of insolvency, and indirectly protection of depositors against a possible loss of deposits placed by them in such banks. Pursuant to the act on BGF, assistance may be granted in the form of loans, guarantees or endorsements, as well as acquisition of non-threatened debts of banks, on more favourable conditions than those usually applied by banks. Applications reviewed in 2006, similarly as those received in the preceding years, concerned exclusively granting support in the form of loans.

The Bank Guarantee Fund conducts its assistance activity in accordance with the following principles:

- equal treatment of the banks in terms of their access to assistance funds by applying uniform and transparent criteria and procedures for granting assistance,
- support for activities aimed at eliminating the threat of insolvency in banks with the participation of investors who have solid capital,
- assuring effectiveness of the assistance that supports rehabilitation programmes, the fulfilment of which by banks should contribute to the permanent re-establishment of solvency, including among others by means of :
 - rationalised operating expenses,
 - assigning the entire profit obtained thanks to the financial assistance of the Fund for coverage of losses,
 - reinvesting income obtained from losses in safe and profitable financial instruments,
 - sale of redundant components of fixed assets

2. Conditions for granting assistance in 2006

Pursuant to Article 20 of the BGF act the financial assistance is only possible upon fulfilment of specific terms and conditions, and in particular:



- acceptance by the Management Board of the Fund results of audit on financial statements related to the activity of the bank that applies for assistance, and in the case of application for assistance in the process of bank takeover, merger of banks or purchase of shares in another bank, acceptance of audit results on financial statements of both banks concerned,

- presentation by the bank of a rehabilitation programme that obtained a positive opinion from the Commission for Banking Supervision, and in the event of bank takeover, merger of banks or purchase of shares in another bank - a positive opinion from the Commission for Banking Supervision on the purposefulness of such activities,
- proof that the amount of the requested loan, guarantee or endorsement does not exceed the total maximum amount of guaranteed funds in the bank, calculated as the total amount guaranteed funds in depositor accounts, and in the case of application for financial assistance for purposes of takeover of or merger with another bank - the requested amount does not exceed the total guaranteed funds in depositor accounts in the bank subject to takeover,
- proof that the hitherto own funds have been used to cover losses of the bank that applies for assistance or of the bank subject to takeover.

Pursuant to delegation arising from Article 7 par. 2 item 6 of the BGF act, the Fund Supervisory Board has determined the principles, forms, conditions and procedures of granting financial assistance to entities subject to obligatory deposit guarantee scheme and it has specified criteria or assessing the insolvency threat.

In 2006 financial assistance in the form of loans could be extended on the following conditions:

- the interest on loans was based on the rediscount rate for bills of exchange fixed by the Monetary Policy Supervisory Board,
- annual interest rate at the level of 0.1 of the rediscount rate for bills of exchange,
- the commission amounted to:
 - 0.3% of the loan amount for commercial banks,
 - 0.1% of the loan amount for co-operative banks,
- lending period - up to 5 years, whereas in justified cases this period could be extended to 10 years,
- payment of the loan - one-off payment or payment in tranches,
- interest - accrued and collected quarterly, principal repayment - in quarterly or semi-annual instalments,
- in particularly justified cases the grace period for repayment of principal was available.

3. Granting loans and their repayments

At the beginning of 2006 thirteen banks received 18 loans advanced from the assistance fund. Indebtedness under those loans as on 1 January 2006 equalled to PLN 1,414,003,100. Throughout 2006 banks repaid principal instalments equalling to the total of PLN 540,619,800. By the end of the period under analysis, twelve loans were fully repaid by 9 banks, of which one continues to use financial assistance.

Furthermore, in 2006 loans were paid out for 2 co-operative banks amounting to a total of PLN 35,590,000 .

LOANS FROM THE CO-OPERATIVE BANKS RESTRUCTURING FUND

1. Objectives and principles for granting assistance

By virtue of the act on Operation of Co-operative Banks, their Affiliation and Affiliating Banks of 7 December 2000, the Bank Guarantee Fund grants financial assistance to support merger processes of co-operative banks from the co-operative banks restructuring fund established in 2001.

According to the said act, the BGF obtained funds amounting to PLN 123,409,700 earmarked for the support of merger processes in the sector of co-operative banks and for related investment projects, and especially for the unification of:

- software and hardware,
- banking technology,
- financial and accounting procedures,
- offer of banking products and services,
- as well as for acquiring shares in affiliating bank.

Financial assistance from the co-operative banks restructuring fund may be exclusively granted to those co-operative banks, which have merged with other banks within a period starting from the day specified as 3 years before the effective date of the Act (i.e. after 28 January 1998) or purchased shares in affiliating banks within 3 years from the effective date of the Act (i.e. by 28 January 2007), which have met the solvency criterion and possessed the capacity to repay the received loans.

2. Conditions for providing financial assistance

The Fund Supervisory Board defines forms, procedures and specific conditions for granting financial assistance from the co-operative banks restructuring fund.

Conditions for granting assistance to support merger processes and implementation of projects, as well as for purchasing shares in the affiliating bank in 2006, are presented in the below table.

Conditions for granting financial assistance from the co-operative banks restructuring fund in 2006

Conditions for granting assistance	Objective of assistance	
	Support of merger processes and implementation of investment projects	Purchase of shares in affiliating bank
annual interest rate on loan	0.1 rediscount rate of bills of exchange established by the Monetary Policy Supervisory Board	0.05 rediscount rate of bills of exchange established by the Monetary Policy Supervisory Board
commission	0.1% of loan amount deducted from such loan amount	
lending period	Maximum of 5 years	
grace period for principal repayment	Maximum of 2 years	
loan payment	One-off payment	
principal repayment	Semi-annual instalments	

3. Applications for loans from the co-operative bank restructuring fund

In 2006 applications submitted by banks for providing assistance from the co-operative banks restructuring fund concerned exclusively loans supporting merger processes and implementation of investment projects related to them.

Pursuant to resolution of the BGF Supervisory Board No. 15/2001, banks which apply for a loan from that fund submitted projections for their economic and financial standing in the period of suing the assistance and documents as proof of borne or anticipated costs and outlays connected with merger processes.

On the basis of developed uniform criteria the Fund executed assessments of the banks' solvency and their capacity to repayment of loans with due interest. Furthermore, analyses were made of the conformity of borne or anticipated costs and outlays with objectives stipulated in the Act on Operation of Co-operative Banks, their Affiliation and Affiliating Banks.

At the turn of 2005 and 2006 five applications for the amount of PLN 12,965,000, concerning increasing the financial assistance extended in the preceding periods, in connection with bearing higher merger costs than those planned were in the review phase. In 2006 two applications were submitted for loans of PLN 5,280,000 for financing merger costs. By the end of 2006 the Fund Management Board took resolutions about granting six loans in the amount of PLN 16,426,000, of which:

- 1 new loan to support merger processes and implementation of investment projects in the amount of PLN 3,872,000,
- 5 additional loans to banks using financial assistance granted in the preceding years in connection with additional capital expenditures incurred by such banks, for outlays unforeseen in previous applications - in the amount of PLN 12,554,000.

One application, sent in at the end of 2006 was reviewed in 2007 owing to the necessity making corrections.

4. Granting loans and their repayments

At the beginning of 2006, 79 banks benefited from 101 loans advanced from the co-operative banks restructuring fund. Indebtedness from those loans as on 1 January 2006 totalled to PLN 119,518,800.

During 2006 the banks repaid principal of PLN 40,268,000 . 20 loans have been fully repaid.

Taking into account the effected repayments and payments of financial assistance means, at the end of 2006 sixty-three banks were using 82 loans. As on 31 December 2006 indebtedness under the granted financial assistance from the co-operative banks restructuring fund totalled to PLN 95,676,800.

CONTROLLING USE OF THE BGF FINANCIAL ASSISTANCE

1. Number of carried out

Pursuant to the BGF act, tasks of the Fund comprise controlling the correctness of assistance use. In 2006 in banks using assistance from BGF 28 direct inspections were carried out.

Direct inspection in the banks that
use BGF assistance in 2006

Number of inspections	Banks using assistance:	
	From assistance fund	From the co-operative banks restructuring fund
Commercial banks	4	-
Co-operative banks	2	22
TOTAL	6	22

Direct inspections were carried out pursuant to inspection schedules (annual and quarterly schedules). Fixing of such schedules took into consideration the criterion of frequency of executing such inspections in banks that use financial assistance of the Fund and applications that arise from periodically executed reviews of economic and financial standing of banks and the degree of their execution of rehabilitation programmes of financial forecasts.

2. Scope of carried out inspections

Pursuant to stipulations of the act on BGF and to the Fund Statute, and to provisions contained in loan agreements, the scope of direct inspections in banks that received loans from the assistance fund included the assessment of the following:

- conformity of the utilisation of assistance funds with statutory objectives and targets specified in loan agreements,
- implementation of rehabilitation programmes, including the effectiveness of the utilisation of assistance funds,

- economic and financial standing of the banks, including trends in changes of principal economic indicators and their comparison to average values for the sector of co-operative or commercial banks,
- fulfilment of obligations that arise from loan agreements,
- execution of follow-up recommendations of BGF if subsequent inspection is carried out by the Fund.

In banks that use loans from the co-operative banks restructuring fund, the inspections concerned the assessment of:

- conformity of the use of assistance funds with the Act on operation of co-operative Banks, their Affiliation and Affiliating Banks,
- solvency of banks,
- implementation of financial forecasts and economic and financial standing,
- fulfilment of obligations arising from loan agreements,
- effectiveness of functioning following effected merger processes

In all the inspected banks the following aspects were subject to assessment:

- functioning of the management information systems,
- organisation and efficiency of internal audit,
- provisions included in statutes and other by-laws, as well as basic internal regulations with respect to their conformity with binding regulations of the law.

Furthermore, review comprised the implementation of:

- the obligation that arises under Article 26 of the Act on BGF as regards investing assets used to cover the fund for protection of guaranteed deposits,
- provisions contained in Article 111 of the Banking Law act and Article 38b. of the Act on BGF, and namely:
 - obligation of informing bank clients about the economic and financial standing of the bank,
 - obligation of informing bank clients on the bank's participation in the deposit guarantee scheme and on functional principles of that scheme.

Post-inspection recommendations were turned over to the bank management boards and for information to the supervisory boards, and in co-operative banks also to affiliating banks.

3. Inspection results

It was found that in all banks that had received loans from the assistance fund, the granted financial means were used and protected in conformity with provisions covered by respective loan agreements. Moreover, no reservations were made with respect to implementation of the remaining obligations arising from loan agreements concluded with BGF.

Furthermore, inspection results have confirmed that assistance granted by BGF fulfilled its

objectives, by helping eliminate the state of imminent bankruptcy and carrying out auto-rehabilitation or moderating the consequences of take-over of banks threatened by insolvency. Financial support of the Fund allowed implementation by banks of primary objectives adopted in rehabilitation programmes, and their restructuring was conducive to safe and effective functioning. Thanks to the undertaken measures and help of the Bank Guarantee Fund their bankruptcy and the necessity of paying out guaranteed funds was prevented.

The inspections have shown that the banks undertook measures aimed at execution of recommendations made by BGF.

For banks which use loans from the co-operative banks restructuring fund:

- it was ascertained that the implemented merger processes allowed the banks to:
 - meet the criteria stipulated in Article 172 of the Banking Law Act with respect to capital requirements,
 - enhance the safety of their operation,
- it was ascertained that financial assistance of BGF had been utilised pursuant to objectives set out Act on operation of co-operative Banks, their Affiliation and Affiliating Banks of 7 December 2000;
- no occurrence of insolvency was reported, nevertheless for one bank, which has been classified as threshold banks and remains under monthly monitoring scheme, the Fund obliged its management to develop and implement a plan of measures aimed at increasing the profitability of assets, reducing operating costs and improving safety of credit operation.

During the direct inspections carried out in 2006 it was found that:

- banks have been observing the provisions arising from Article 26 of the act on the Bank Guarantee Fund with respect to investing assets covering the fund for protection of guaranteed deposits,
- the majority of banks fulfils obligations resulting from Article 38b of the Act on the Bank Guarantee Fund with respect to informing clients about participation in the deposit guarantee scheme and Article 111 of the Banking Act with respect to informing clients and availability of specified information concerning the bank to the customers.

Problems identified during inspections of banks utilising the assistance of BGF were reflected in recommendations formulated following the said inspections. As regards the economic and financial standing and implementation of rehabilitation programmes or financial forecasts, they referred especially to the necessity of limiting credit risk, increasing costs discipline and improvement of operational effectiveness. Some of the conclusions also referred to the improvement of bank management quality.

EXECUTION OF CURATOR FUNCTION

Pursuant to Article 144 of the Banking Act, the Commission for Banking Supervision may take a decision to appoint a curator to supervise the implementation of a rehabilitation programme by a bank. The curator shall also be entitled to participate in meetings of bank authorities and shall have the right to obtaining any information indispensable to execute his function. Moreover, he shall be entitled to raise objections with respect to resolutions and decisions of the management board and the bank supervisory board or prosecution of a resolution of the general meeting of shareholders or resolution of general meeting in a co-operative bank, which violates interests of the bank.

Article 20a par. 2 of the Act on BGF also indicates that at its request addressed at the Commission for Banking Supervision, the Fund may be appointed as curator, as stipulated in Article 144 of the Banking Law, in relation to a bank covered by the guarantee scheme, provided it had granted a loan to that bank.

Pursuant to decision of the Commission for Banking Supervision of 14 July 2004, the Bank Guarantee Fund executes at its request the function of curator that supervises the rehabilitation programme implementation by one of the commercial banks, to which in 2004 it had granted assistance aimed at elimination of the insolvency threat in the form of a loan for a period of 3.5 years amounting to PLN 450m.

Detailed results of the curator's work were presented in quarterly operating reports submitted to the Commission for Banking Supervision and the Fund Supervisory Board.

GATHERING AND ANALYSING INFORMATION ON BANKS

1. Information data base and review of situation in the banking sector

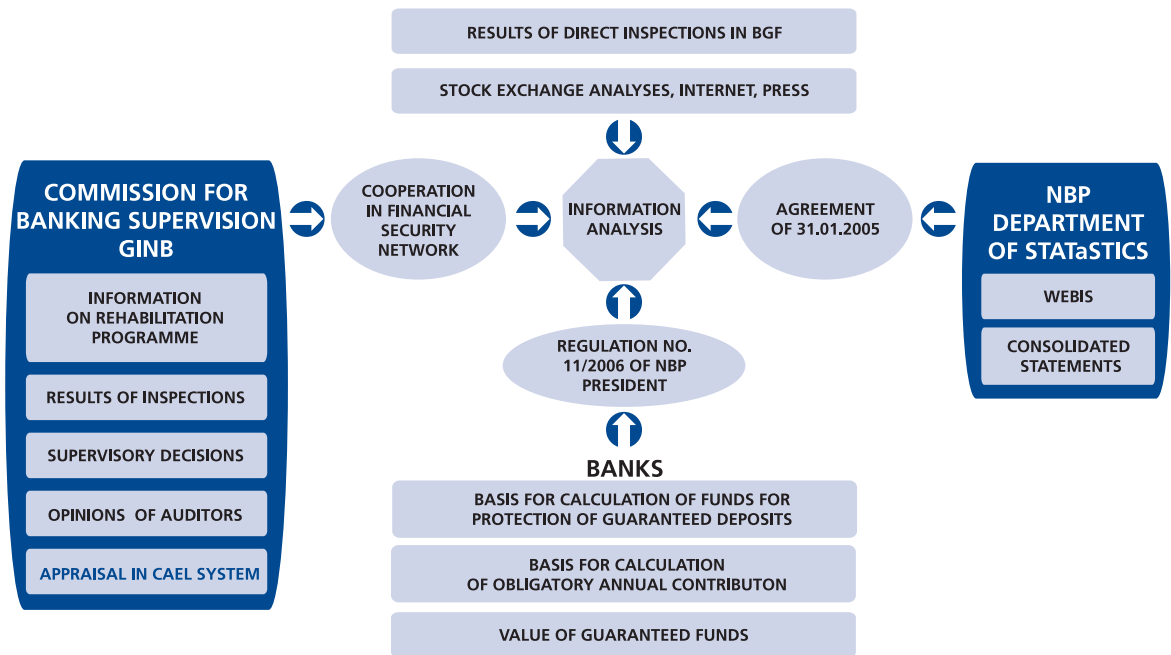
Analytic tasks of the Bank Guarantee Fund are implemented thanks to the statutory providing of the Fund with the right of access to information about banks, and consequently with the possibility of effecting independent and autonomous analyses of the economic and financial reviews for particular banks and appraisal of the existing and potential threats in their operation.

The principal functions of the analytic operation of BGF comprise: early evaluation of threats in the banking sector aimed at determination of demand for financial means in the deposit guarantee scheme, collected in banks in the form of funds for protection of guaranteed deposits as coverage of potential guarantee obligations, as well as identification of the insolvency threat in banks, which is a condition for undertaking necessary measures by the Fund in co-operation with the Commission for Banking Supervision and with other institutions in the financial security network.

Financial statements received by the Bank Guarantee Fund from the National Bank of Poland by virtue of the BGF Act and pursuant to agreement concerning the subject, scope, procedures and deadline for submission to the Bank Guarantee Fund of information by the National Bank of Poland dated 31 January 2005 and data submitted to the Fund directly by banks pursuant to the order No. 11/2006 of the President of the National Bank of Poland of 29 May 2006 concerning the scope, procedures and deadline for submitting by banks covered by mandatory system that guarantees submission of information to the Bank Guarantee Fund constitute a basic source of information on banks. Pursuant to this order the banks send over information concerning the basis for calculating the contribution of due annual payment and the value of guaranteed funds³.

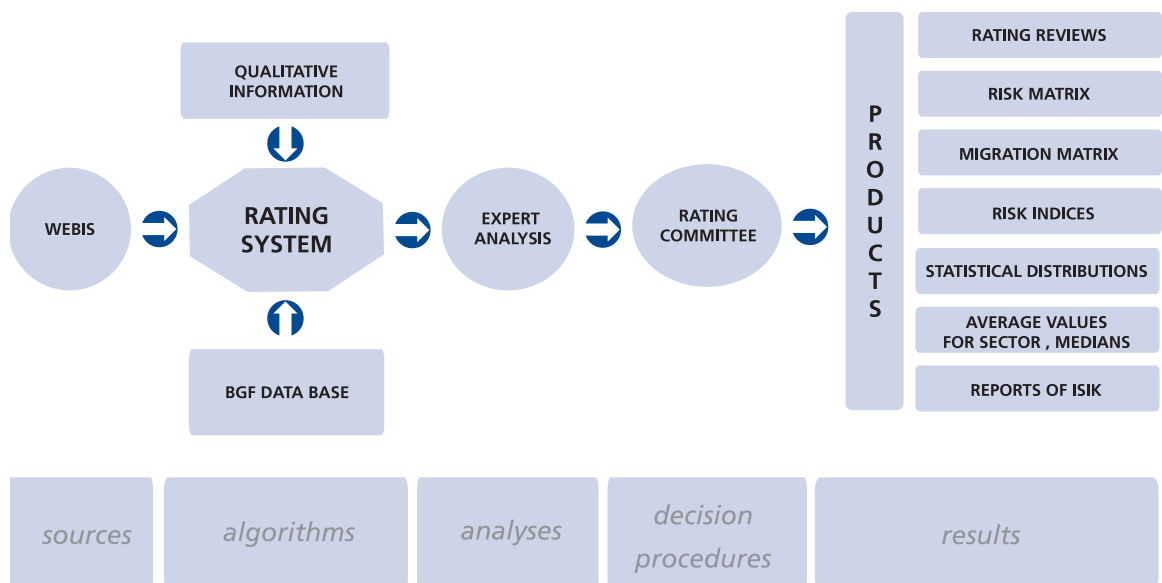
³Detailed information about the value of receivables covered by BGF guarantees and about the value of funds guaranteed by BGF shall be handed over to the Fund as of 1 July 2007.

BGF information environment



An important source of qualitative information is constituted by results of direct inspections executed by employees of the Fund in banks that use assistance, results of inspections of the General Inspectorate of Banking Supervision, reports from implementation of rehabilitation programmes, reports and opinions of auditors to financial reports of the banks.

Information processing in BGF



Based on a review of factors related to quantitative and qualitative data the banks receive individual rating (the so-called *rating*). Depending on the rating the banks are classified to the determined group in the so-called *risk matrix*.

Ratings and the *risk matrix* constitute a basis for primary information about the situation of banks. The banks, whose solvency risk is rated as high, are subject to profound assessment aimed at identifying the source of generated risk

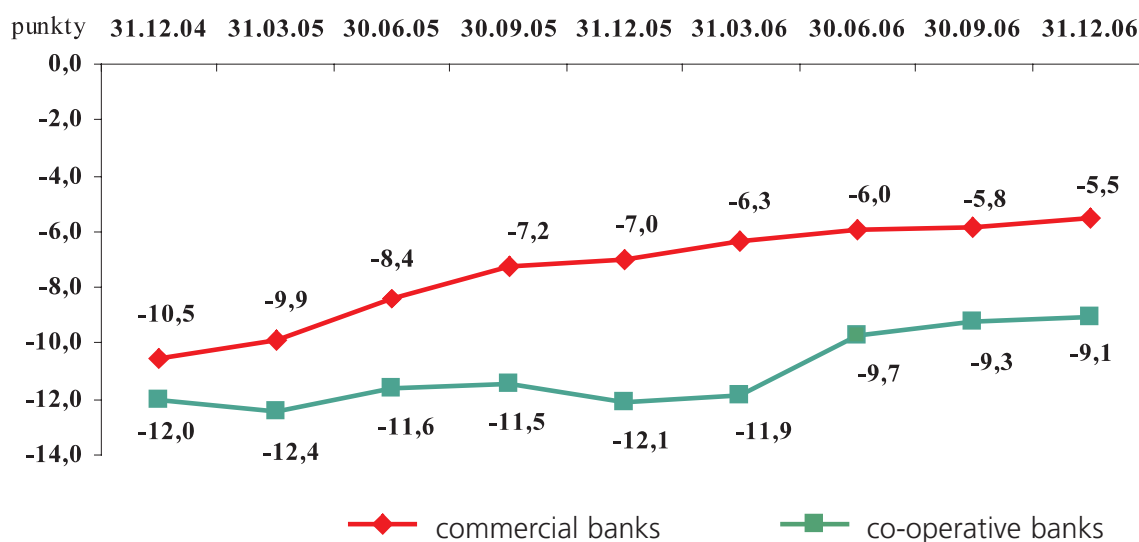
A basis for applications related to risks in the entire banking sector are the so-called *migration matrix and the risk index*. The *migration matrix* allows observations of changes in situation of banks in the *migration matrix* in subsequent reporting periods. In 2006 directions of migrations of the banks pointed at an improvement of the situation in the banking sector. In 2006 improvement was recorded for 76 banks, while 18 banks had worse risk appraisals. At the end of the analysed period 2 commercial banks and 1 co-operative bank were qualified to the category of very high risk.

The *risk index* presents the total standardised appraisal of effectiveness, solvency, assets quality and quality of granted off-balance sheet liabilities weighted by share of each bank in the banking sector deposits. The risk index is calculated separately for commercial and co-operative banks. The values of this index range from 0 (no risk) to 100 points (maximum risk).

Changes in the index level reflect changes in the assessment of threats for the sector.

In 2006 the risk index has gradually been improved. The diagram below presents index levels in the sector of commercial banks and co-operative banks within the quarterly cycle from the end of 2004 until the end of 2006. Thanks to good results of the banking sector in 2006 a stabilisation of the *risk index* was observed on a very low level.

Risk index in commercial and co-operative bank sectors during the period from December 2004 to December 2006



2. Changes in bank evaluation methodology and IT systems

In 2006 BGF worked on including liquidity parameters to the evaluation methodology. A review of risks related to liquidity assists early identification of the insolvency risk in banks.

In connection with the fact that in 2006 banks that represent over 72% of the balance sum of the banking sector applied harmonised principles of accounting and financial reporting pursuant to International Accounting Standards/International Financial Reporting Standards, an in-depth analysis was carried out of the way that new standards affect a change in evaluation of the economic and financial standing of those banks.

Furthermore, preparatory measures were also undertaken connected with introduction of a new financial reporting system FINREP and COREP planned for 2007. Several changes were proposed to drafts of report sheets taking into account information needs of the Fund. A lot of attention was dedicated to an analysis of changes necessary in 2007 to the monitoring system used by the Fund and risk evaluation in banks, both with respect to methodology, and changes in utilitional application software.

In 2006 works were executed on forecasting methods to determine the value of funds for protection of guaranteed deposit rates and the obligatory annual contribution in the functions of identified risks in the banking sector. Pursuant to the presented analyses and evaluations, having consulted the banking milieu, the BGF Supervisory Board determined rates for establishing by banks of funds for protection of guaranteed deposits and the obligatory annual contribution for 2007.

Taking into consideration the anticipated coming into effect in 2007 of regulations of the banking law which introduce solutions of the New Capital Agreement, the Fund implemented an initial analysis of possible modifications to the calculation base of the obligatory annual contribution pursuant to changes that arise from the new regulations.

In 2006 the IT system of the Bank Guarantee Fund was developed and streamlined, and furthermore a set of applications for the bank analyst was implemented. New utilitional applications are integrated on the intranet platform of the Management Information Interactive System (SIK) and allow standardisation of the IT tools used by the Fund and facilitate access to IT resources in implementation of the data warehouse concept.

3. Monitoring banks that benefit from financial assistance

All banks that use financial assistance of the Bank Guarantee Fund were subject to specific monitoring procedures. They included in particular an analysis of implemented rehabilitation programmes, effectiveness of granted assistance and implementation of obligations determined in loan agreements.

If the economic and financial standing of the banks deteriorate, if irregularities are found in execution of rehabilitation programmes or if obligations arising from loan agreements concluded with the Fund are not maintained, appropriate recommendations were made for bank management boards and then detailed direct inspections were carried out in those banks. General Inspectorate of Banking Supervision was consulted on the necessity of updating rehabilitation programmes or on undertaking other measures, which would guarantee success of reform projects.

Procedures for monitoring the banks that use different forms of financial assistance from loans coming from the cooperative banks restructuring fund were oriented at appraising the solvency and risks with respect to repayment of extended loans as statutory⁴ premises for appraisal of the standing of co-operative banks that use this form of the Fund's financial assistance.

No risk to solvency was found in any of the banks that use assistance from the cooperative banks restructuring fund.

⁴Arising from the Act dated 7 December 2000 on Operation of Co-operative Banks, their Affiliation and Affiliating Banks

NATIONAL AND INTERNATIONAL CO-OPERATION

1. Co-operation with national institutions

1.1. Co-operation concerning the banking sector

The principles of co-operation of the Bank Guarantee Fund with legislative and executive authorities have been stipulated in the BGF Act and other legal regulations. The President of the BGF Management Board is a member of the Commission for Banking Supervision by virtue of the act about the National Bank of Poland. Under this co-operation the Bank Guarantee Fund and the General Inspectorate of Banking Supervision, which is an executive body of the Commission for Banking Supervision, exchange information on potential risks to the banking sector.

On 16 November 2006 a meeting was organised in the Fund's premises of BGF authorities with representatives of the banking circles, with the participation of the Polish Bank Association and the National Association of Co-operative Banks. The meeting undertook the following items:

- presenting by the President of the PENTOR Institute for Opinion and Market Research results of poll survey related to knowledge of bank personnel about the deposit guarantee scheme, and about the Bank Guarantee Fund, as well as the feeling of security and considerations of social trust in the banking system,
- receiving opinion of the bank milieu as regards the value of rates for establishing funds for protection of guaranteed deposits proposed for 2007 and the annual contribution in the light of provisions for mandatory financing of the deposit guarantee scheme by 2010.

The Fund has also remained in constant contact with affiliating banks, and has informed them of decisions related to granting financial assistance to co-operative banks belonging to the association and received opinions about the planned projects and management staff in banks that apply for financial assistance of BGF.

1.2. Co-operation related to legislation

The Bank Guarantee Fund, which acts within the financial security network in Poland, significantly contributes to stabilisation of the financial system by its share in the process of issuing opinions of bills related to the financial market, which are submitted to the Fund under interdepartmental arrangements.

By participating in the processes of development of amending legal regulations, the Bank Guarantee Fund employees have reviewed and formulated remarks as regards bills of the following acts and executory acts:

- acts:
 - about supervision over financial institutions,
 - about European co-operative society,
 - about amendment to the Banking Law,
 - amending: the act on investment funds, the act on trade in financial instruments, the act on public offer and conditions of introducing financial instruments to an organised trade system and on public companies,
- regulation of the Finance Minister concerning specific co-operation principles between financial institutions authorised to guarantee customs debt, and the Main Inspector of Environment Protection and the National Fund for Environmental Protection and Water Management, and template forms for financial security in the form of civil liability insurance agreements and bank guarantee.

Under the commenced procedure of preparing a report concerning application of Directive 2002/47/EC on financial security (Official Journal of the EC L 168/43) for the European Parliament, the Fund has formulated its remarks to *Questionnaire appraising implementation of directive for Member States* sent in to obtain opinion and to be filled out in its competence.

An analysis was carried out and a relevant standpoint submitted with respect to the *Legal appraisal* sent to the Fund, which was prepared by the European Commission, to allow discussion and interpretation of solutions contained in the *Haag convention about relevant law applicable for execution of some regulations on securities kept by a financial intermediary*.

Within works conducted on amendment to regulations in the Sixth Supervisory Board Directive 77/388/EEC dated 17 May 1977 *concerning harmonisation of regulations of Members States with respect to turnover tax - common system of tax on value added - standardised basis for tax assessment*, wording was analysed of definitions of some financial services proposed by the European Commission.

The Fund participated in consultations proposed by The National Depository for Securities concerning standards for standardisation of opening days and hours of European deposit and settlement systems and standards concerning pre-settlement date matching.

2. International co-operation

Representatives of the Fund participated in conferences organised by the European Forum of Deposit Insurers (EFDI). The programme of those conferences comprised the following issues:

- review of financing methods for the deposit guarantee schemes,
- statute of EFDI,
- transformation of EFDI into a formal association registered in Brussels,
- role of deposit guarantee schemes in risk management in a major international bank,
- problems arising from transborder activity of banks important for the system.

The BGF representative also participated in conference organised by the International Association of Deposit Insurers (*IADI*). The conference concerned experience of Latin American in establishing an effective security system.

In co-operation with foreign guarantee institutions the Fund hosted delegations of those institutions from Russia and Albania. Furthermore, the Fund representatives participated in seminars organised by deposit guarantors in Italy, Albania and Russia and by the German Bank Association.

The Fund has concluded an agreement with a Swedish deposit guarantee institution (*Insättningsgarantinämnden*). Co-operation between both systems is of a particular importance for clients of banks from Sweden which are operating in Poland as divisions, because their deposits are subject to protection pursuant to the Swedish guarantee system. Also works were performed on an agreement with the Danish and Russia guarantee system.

3. Review of the Directive 94/19/EC on deposit-guarantee schemes

In 2006, the Bank Guarantee Fund actively participated in the review process regarding the Directive 94/19/EC of the European Parliament and of the Supervisory Board on deposit-guarantee schemes. One of the stages in consultations organised by the European Commission in the review procedure of Directive 94/19/EC was a meeting of the Working Group for Deposit Guarantee Scheme (appointed by the Bank Counselling Commission operating at the European Commission). During this meeting member states have presented their standpoints related to principal review points of the Directive as delimited by the Commission. The standpoint of Poland (agreed with the Finance Minister and the National Bank of Poland) was presented by a BGF representative.

Issues included in discussions comprised among others the value of guarantee limit and the guarantee scope, principle of the depositor's joint responsibility, *the de-minimis*⁵ clause, models of financing guarantee scheme, and models for differentiation of contributions depending on the bank's risk appraisal.

On 27 November 2006 the European Commission presented in the form of an announcement a standpoint concerning a review of the present solutions arising from EU law with respect to deposit guarantee schemes. This standpoint arose from the earlier consultations.

⁵Pursuant to it very small amounts, for which administrative costs are higher than the guaranteed funds as such, are not covered by guarantees.

ORGANISATION OF THE BANK GUARANTEE FUND

1. Composition of Fund Authorities

The statutory authorities of the Bank Guarantee Fund are as follows: the Fund Supervisory Board (11 members) and Fund Management Board (5 members).

In 2006 the Supervisory Board was composed of:

Chairman of the Supervisory Board:	Władysław Baka
Members of the Supervisory Board:	Janusz Czarzasty
	Bartosz Drabikowski
	Wojciech Kwaśniak
	Jacek Osiński
	Ryszard Pazura
	Krzysztof Pietraszkiewicz
	Jan Szambelańczyk
	Ewa Śleszyńska-Charewicz
	Andrzej Wiśniewski
	Grzegorz Wójtowicz

The composition of the Management Board was as follows:

Chairman of the Board:	Ewa Kawecka-Włodarczak
Deputy Chairman of the Board:	Hanna Krajewska
Members of the Board:	Jerzy W. Pietrewicz (until 22 January 2006)
	Przemysław Morysiak (as of 23 January 2006)
	Maria Pawelska
	Marek Pyła

2. Organisation of the Fund Office

The Bank Guarantee Fund implements its statutory tasks through the Office, the structure includes seven departments, internal audit post and the Fund Supervisory Board Secretariat.

Specific organisational units perform the following tasks.

- **Guarantee Department** performs tasks directly related to the guarantee of bank deposits, collecting the Fund's receivables due to transfers of funds to trustees for payment of deposits to customers of bankrupt banks and to international co-operation;
- **Assistance Department** performs tasks related to providing financial assistance to banks endangered with insolvency (from assistance fund) and granting loans from the cooperative banks restructuring fund;
- **Analysis Department** gathers and analyses information on current status of banks; prepares evaluations and development forecasts concerning their situation in future as well as performs tasks related to monitoring the banks that were granted assistance by the Fund;
- **Control Department** performs tasks related to control of the standing of the banks provided with the Fund's assistance and to the implementation of the curator's functions;
- Finance Department performs tasks related with financial management, accounting and Fund settlements;
- **Legal Department** provides legal service to the Fund and represents the Fund in court and administrative proceedings and in other adjudging organs;
- **Organisation Department** provides organizational services to the Management Board and the Fund Office, manages the issues related to employment, work organisation, administrative services and is responsible for material infrastructure of the Office;
- **Internal Audit Post** performs the tasks related to assessing the operating correctness and conformity of the Fund Office organisational units with the provisions of law and internal regulations;
- **Supervisory Board Secretariat** provides the substantial, organisational and technical service of the Fund Supervisory Board in its performance of statutory tasks.

Furthermore, there are five permanent interdepartmental committees and groups:

- **Assets Management Committee** creates and supervises the policy of investment available financial resources of the Fund;
- **Committee for Assistance Applications Assessment**, whose task consists in issuing opinions on applications prepared by the Assistance Department for granting financial assistance to banks from the assistance fund and loans from the co-operative banks restructuring fund;
- **Management Information System Group** prepares, monitors and ensures efficient functioning of the system transmitting information that is crucial to Fund activity between organisation units of the Fund;
- **International Co-Operation Group** supports co-operation with foreign deposit insurance institutions;
- **Website Editing Group** provides proper functioning of the Fund's website.

INFORMATION AND PROMOTION ACTIVITY

In 2006 in promotion and information activity an analysis was worked out of results of tests conducted on the order of BGF by IBOiR Pentor SA, which concerned knowledge about the deposit guarantee scheme among bank employees and customers. The survey confirmed the existence of a high trust level to the Fund, perceiving banks as safe independently of their size and period of operation on the market, and increased requirements with respect to banks. Furthermore, an adverse trend occurred in decreased knowledge concerning BGF and in interest in issues of deposit safety. From the viewpoint of clients this was partly understandable if we take into account that as of 2001 there was no bankruptcy of any bank, and that the financial sector belongs to the best developing economic sectors.

On the other hand, the deteriorating state of knowledge about the deposit guarantee scheme among bank employees who are responsible for granting information in this scope is disquieting. To improve this condition training courses of employees of all banks will be organised. Additional attention shall be drawn to improving the scope of information available to customers using only from internet links.

On the basis of applications arising from the conducted survey, the Fund prepared a plan of information actions related to dissemination of knowledge about the deposit guarantee scheme. In the preparatory phase:

- a survey was executed among economic universities concerning taking into account in didactic processes issues related to operation of the Bank Guarantee Fund,
- a brochure entitled "System gwarantowania depozytów w Polsce" [Deposit guarantee schemes in Poland] was published, which is addressed at employees of banks who handle directly services to the clients, and who should have extended knowledge about guarantees of BGF.



PricewaterhouseCoopers Sp. z o.o.
Al. Armii Ludowej 14
00-638 Warsaw, Poland
Telephone +48 (0) 22 523 4000
Fax +48 (0) 22 523 4040
www.pwc.com/pl

REGISTERED AUDITOR'S OPINION

TO THE SEJM OF THE REPUBLIC OF POLAND, COUNCIL OF MINISTERS, FUND SUPERVISORY BOARD AND MANAGEMENT BOARD OF BANKOWY FUNDUSZ GWARANYCJNY

We have studied the attached abbreviated financial report of Bankowy Fundusz Gwarancyjny, Warsaw, ul. ks. Ignacego Jana Skorupki 4 (hereafter referred as "the Fund") which comprised:

- a) balance sheet prepared as on 31 December 2006, which on the side of assets and liabilities has the amount of PLN 5,230,398,010.12
- b) profit and loss account for the financial year from 1 January until 31 December 2006 indicating a net profit in the amount of PLN 163,046,780.25
- c) cash flow account for the financial year from 1 January until 31 December 2006 indicating net cash flows in the amount of PLN 36,601.76
- d) additional information which covers additional information and clarification.

Preparation of a financial report and operating report is an obligation of the Management Board of the Fund. Our task was to express our opinion on the financial report pursuant to the executed examination.

We have audited the annual financial statements of the Fund pursuant to the following regulations which are binding on the territory of the Republic of Poland:

- a) regulations of section 7 of the Act dated 29 September 1994 on accounting ("The Act on Accounting" - Journal of Laws from 2002 No. 76 item 694 as later amended);
- b) regulations of Article 17 par. 2 of the Act dated 14 December 1994 on the Bank Guarantee Fund (harmonised text - Journal of Laws from 2000 No. 9 item 131 as later amended);
- c) provisions contained in regulation of the Finance Minister dated 25 October 1999 concerning detailed accounting principles of the Bank Guarantee Fund (Journal of Laws No. 90 item 1006 as later amended);
- d) statute of the Bank Guarantee Fund (Journal of Laws from 1995 No. 21 item 113 as later amended);
- e) standards for the profession of a statutory auditor issued by the National Chamber of Statutory Auditors in Poland.

REGISTERED AUDITOR'S OPINION

TO THE SEJM OF THE REPUBLIC OF POLAND, COUNCIL OF MINISTERS, FUND SUPERVISORY BOARD AND MANAGEMENT BOARD OF BANKOWY FUNDUSZ GWARANYCJNY
(continued)

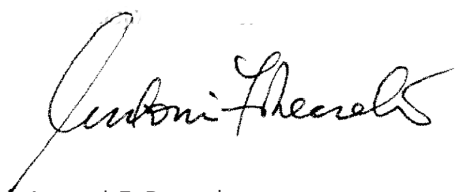
The audit was planned and executed in a way which was to assure with sufficient certainty that the financial statement contains no material errors or omissions. The audit comprised among others verifications, pursuant to the selected sample, of evidence confirming amounts and information specified in the financial statement. The audit also comprised an evaluation of accounting principles applied by the Fund and significant estimations made in preparation of the financial statement, as well as the general appraisal of its presentation. We are of the opinion that our audit constituted sufficient grounds to express the opinion.

Information contained in the report on operation of the Fund for the financial year from 1 January until 31 December 2006 take into account provisions of the Act on accounting and are consistent with information contained in the examined financial statement.

In our opinion, the attached financial report was in all material aspects:

- a) correctly prepared pursuant to accounting ledgers,
- b) consisted in form and content with legal regulations binding for the Fund and its statute,
- c) present reliably and in a clear way the material and financial situation of the Fund as on 31 December 2006 and financial result for the financial year from 1 January until 31 December 2006 pursuant to accounting principles binding on the territory of the Republic of Poland determined in the Act on accounting.

On behalf of PricewaterhouseCoopers Sp. z o.o., responsible for audit execution:



Antoni F. Reczek
Chairman of the Board
Statutory Auditor
Registered auditor No. 90011/503



Registered Audit Company No. 144

Warsaw, 1 March 2007

THE BANK GUARANTEE FUND BALANCE SHEET AS OF 31 DECEMBER 2006

ASSETS	Additional information	31.12.2006	(In PLN) 31.12.2005
Cash		450 462.93	487 064.60
1. Cash in hand		2 319.82	2 931.45
2. Cash in current account		308 418.23	316 509.64
3. Cash in special guarantee settlement account		1 798.65	1 798.65
4. Cash in term deposit account		–	–
5. Cash on Company Social Benefits Fund		137 926.23	165 824.95
Receivables from financial institutions	3	1 005 250 2005.07	1 534 680 605.82
1.Receivables from banks, due to:			
a) obligatory contributions to special guarantee settlement account		–	–
b) annual contributions to assistance fund		–	–
c) loans granted from assistance fund		909 536 733.51	1 415 109 725.36
d) loans granted from cooperative banks restructuring fund		95 713 471.56	119 570 880.46
e) realised guarantees and endorsements		–	–
f) purchased receivables		–	–
2. Receivables from other financial institutions		–	–
Receivables from state budget		–	–
Other receivables and claims	4	374.52	0.00
Securities	5	4 157 927 974.07	3 322 105 411.00
1.Debt securities:			
a) of state issuers		4 157 927 974.07	3 322 105 411.00
b) of other issuers		–	–
2. Stocks and shares			
a) in financial institutions		–	–
b) in other entities		–	–
Intangible and legal assets	6	–	–
Tangible fixed assets	6	66 768 993.53	68 599 588.53
Other assets		–	–
Prepayments and accruals		–	–
TOTAL ASSETS		5 230 398 010.12	4 925 872 670.04
Contingent receivables	12	479 323 225.63	490 429 379.23
a) debts claimed from bankruptcy estate		479 323 225.63	490 429 379.23
b) other receivables		–	–

THE BANK GUARANTEE FUND BALANCE SHEET AS OF 31 DECEMBER 2006

LIABILITIES	Additional information	(In PLN)	
		31 December 2006	31 December 2005
LIABILITIES	8	51 069 318.26	49 109 583.77
1. Liabilities towards trustee of bankruptcy estate due to payments arising from the guaranteed funds system		–	–
2. Other liabilities		51 069 318.26	49 109 583.77
ACCRUALS AND DEFERRED INCOME	9	600 108.07	1 158 710.82
PROVISIONS	10	5 500.00	250 000.00
1. Provisions for risk related to granted guarantees		–	–
2. Provisions for risk related to granted endorsements		–	–
3. Other provisions for risk		5 500.00	250 000.00
STATUTORY FUND	7	1 394 046 227.08	1 282 711 688.72
RESERVE FUND	7	560 000 000.00	510 000 000.00
ASSISTANCE FUND	7	2 938 082 461.36	2 797 732 634.55
1. Assistance fund to be used		2 029 109 142.36	1 383 729 489.55
2. Used assistance fund		908 973 319.00	1 414 003 145.00
CO-OPERATIVE BANKS RESTRUCTURING FUND	7	123 409 688.87	123 409 688.87
1. Co-operative banks restructuring fund to be used		27 732 910.87	3 890 938.87
2. Used co-operative banks restructuring fund		95 676 778.00	119 518 750.00
REVALUATION FUND		–	–
SPECIAL FUNDS AND OTHER LIABILITIES	11	137 926.23	165 824.95
FINANCIAL PROFIT (LOSS)		163 046 780.25	161 334 538.36
1. Profit (positive value)		163 046 780.25	161 334 538.36
2. Loss (negative value)		–	–
TOTAL LIABILITIES		5 230 398 010.12	4 925 872 670.04
Off-balance liabilities		–	–

THE BANK GUARANTEE FUND PROFIT & LOSS ACCOUNT FOR THE PERIOD ENDING ON 31 DECEMBER 2006

		12 months ending on 31.12.2006	(In PLN) 12 months ending on 31.12.2005
Income from statutory activity	13.	8 535 343.20	18 361 942.40
1. Interest income		8 482 442.69	16 995 452.44
2. Commission income		52 036.00	1 366 409.00
3. Income from interest for delayed contributions by banks for effecting guarantee payment.		–	–
4. Income from interest for delayed annual contributions paid by banks		232.86	0.41
5. Income from interest for delayed repayments of loans and interest on loans by banks		631.65	80.55
Cost of statutory activity		–	–
1. Interest on credits received from the National Bank of Poland		–	–
2. Others		–	–
Profit (loss) on statutory activity (I-II)		8 535 343.20	18 361 942.40
Profit (loss) on financial operations		172 716 805.74	160 416 437.37
1. Securities		172 688 343.60	158 926 706.02
2. Other		28 462.14	1 489 731.35
Operational costs of the Fund	14.	16 421 499	16 621 353.09
1. Third-party services		3 199 575.22	3 243 595.42
2. Payroll		10 661 113.50	10 694 552.74
3. Payroll margins		1 334 096.53	1 340 206.37
4. Other		1 226 714.49	1 342 998.56
Depreciation of fixed and intangible and legal assets		2 139 420.78	2 301 673.63
Write-offs for provisions and revaluation		–	–
Liquidation of provisions and revaluation decreases		237 555.09	0.00
Other income		259 824.13	1 587 137.20
Other costs		141 827.39	107 951.89
Profit (loss) on operational activity		163 046 780.25	161 334 538.36
Profit (loss) on extraordinary operations	–	–	–
1. Extraordinary profit	–	–	–
2. Extraordinary loss	–	–	–
Financial result of the Fund (XI+XII)	163 046 780.25	161 334 538.36	
1. Profit (positive value)	163 046 780.25	161 334 538.36	
2. Loss (negative value)	–	–	

THE BANK GUARANTEE FUND CASH FLOW STATEMENT FOR THE PERIOD ENDING ON 31 DECEMBER 2006

	Additional information	12 months ending on 31.12.2006	(In PLN) 12 months ending on 31.12.2005
Cash flow from operating activity			
Net financial profit/loss		163 046.25	161 334 538.36
Adjusted by items			
1. Depreciation		2 139 420.78	2 301 673.63
2. Provisions for endangered receivables created as costs		–	–
3. Other provisions created as costs of the Fund's activity	(244 500.00)		
4. Change in receivables and claims		(374.52)	107.27
5. Change in short-term liabilities (except loans and credits) and special funds		1 931 835.77	(723 719.91)
6. Change in prepayments and accruals		–	–
7. Change in deferred income		–	–
8. Other items		(64 637.08)	3 676.00
Net cash from operating activity		166 808 525.20	162 916 275.35
Cash flow from investment activity			
Purchase/sale of intangible assets		(5 635.03)	–
Purchase/sale of tangible fixed assets		(238 553.67)	(293 945.59)
Purchase/sale of treasury bonds, NBP money bills, bonds		(832 288 715.40)	(816 971 437.92)
Granted/repaid loans from the assistance fund		505 029 826.00	269 399 744.00
Granted/repaid loans from the co-operative banks restructuring fund		23 841 972.00	(11 120 550.00)
Purchased/sold receivables		–	–
Interest received/repaid		(3 533 847.67)	(33 789 441.08)
Other items		–	–
Net cash from investment activity		(307 194 953.77)	(592 775 630.59)
Cash flow from financial activity			
Change in statutory fund		–	–
Change in assistance fund (payment of annual contribution)		140 349 826.81	124 247 011.77
Change in cooperative banks restructuring fund		–	–
Receiving/repayment of short-term bank credits and loans		–	–
Interest repaid/returned		–	–
Other items		–	–
Net cash from financial activity		140 349 826.81	124 247 011.77
Change in net cash		(36 601.76)	(305 612 343.47)
Cash at the beginning of the accounting year		487 064.69	306 099 406.16
Cash at the end of the accounting year		450 462.93	487 064.69



BANK GUARANTEE FUND

ul. Ks. Ignacego Jana Skorupki 4

00-546 Warsaw, Poland

www.bfg.pl