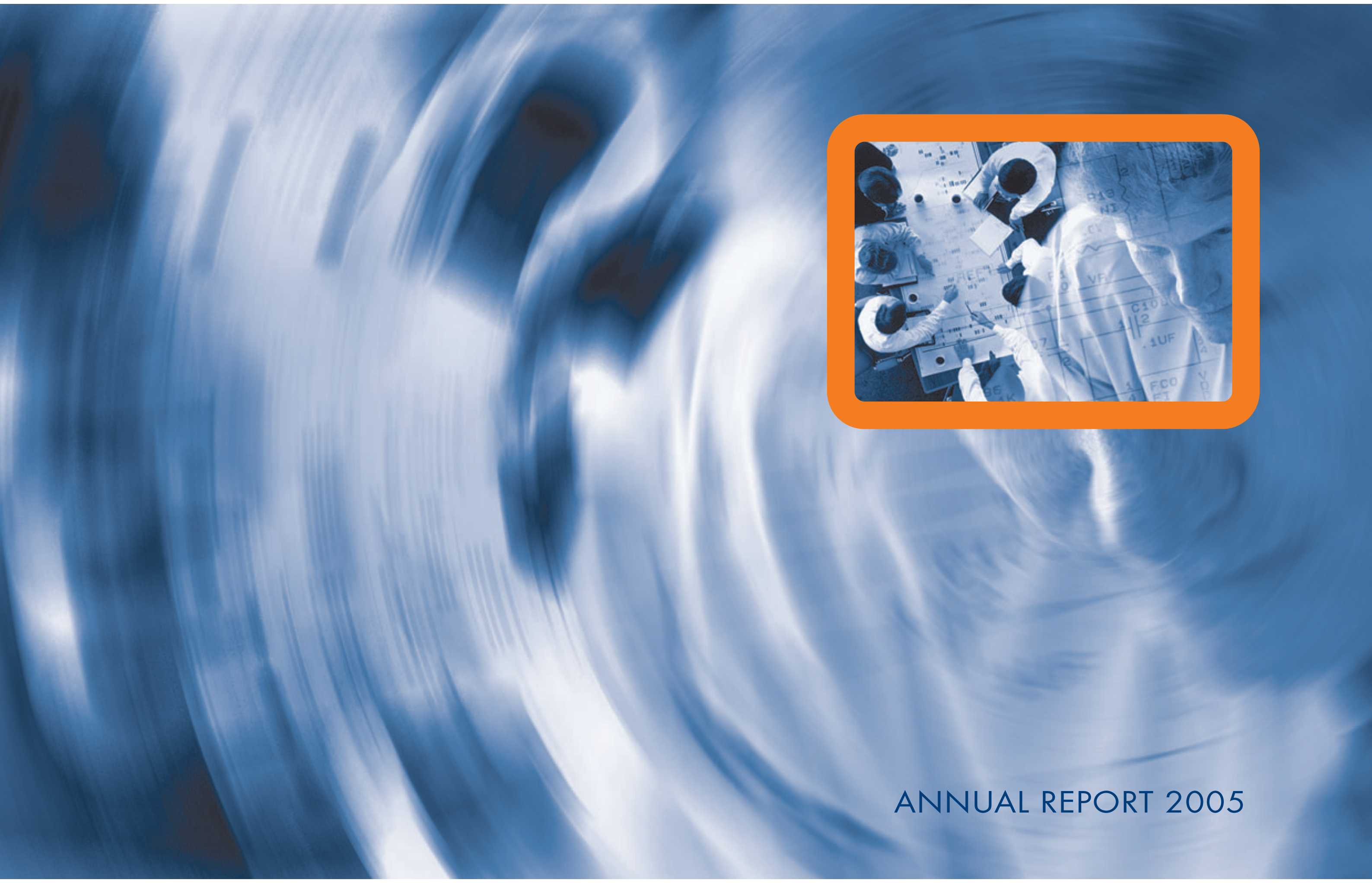
PGNiG



ANNUAL REPORT 2005

Polskie Górnictwo Naftowe i Gazownictwo SA
Head Office
ul. Krucza 6/14, 00-537 Warszawa, Poland
Phone (+48 22) 583 50 00, (+48 22) 691 79 00

CONTENTS

Letter from the President of the Management Board........................4

Shareholders and Statutory Bodies of PGNiG................................6

Financial Highlights..11

Corporate Governance...14

Strategy...18

PGNiG Group 22

Business Areas of PGNiG Group 29

Investment and Business Development Plans 42

Financial Performance..50

Definitions and Explanations..107

LETTER FROM THE PRESIDENT OF THE MANAGEMENT BOARD

LETTER FROM THE PRESIDENT OF THE MANAGEMENT BOARD

Warsaw, 31 May 2006

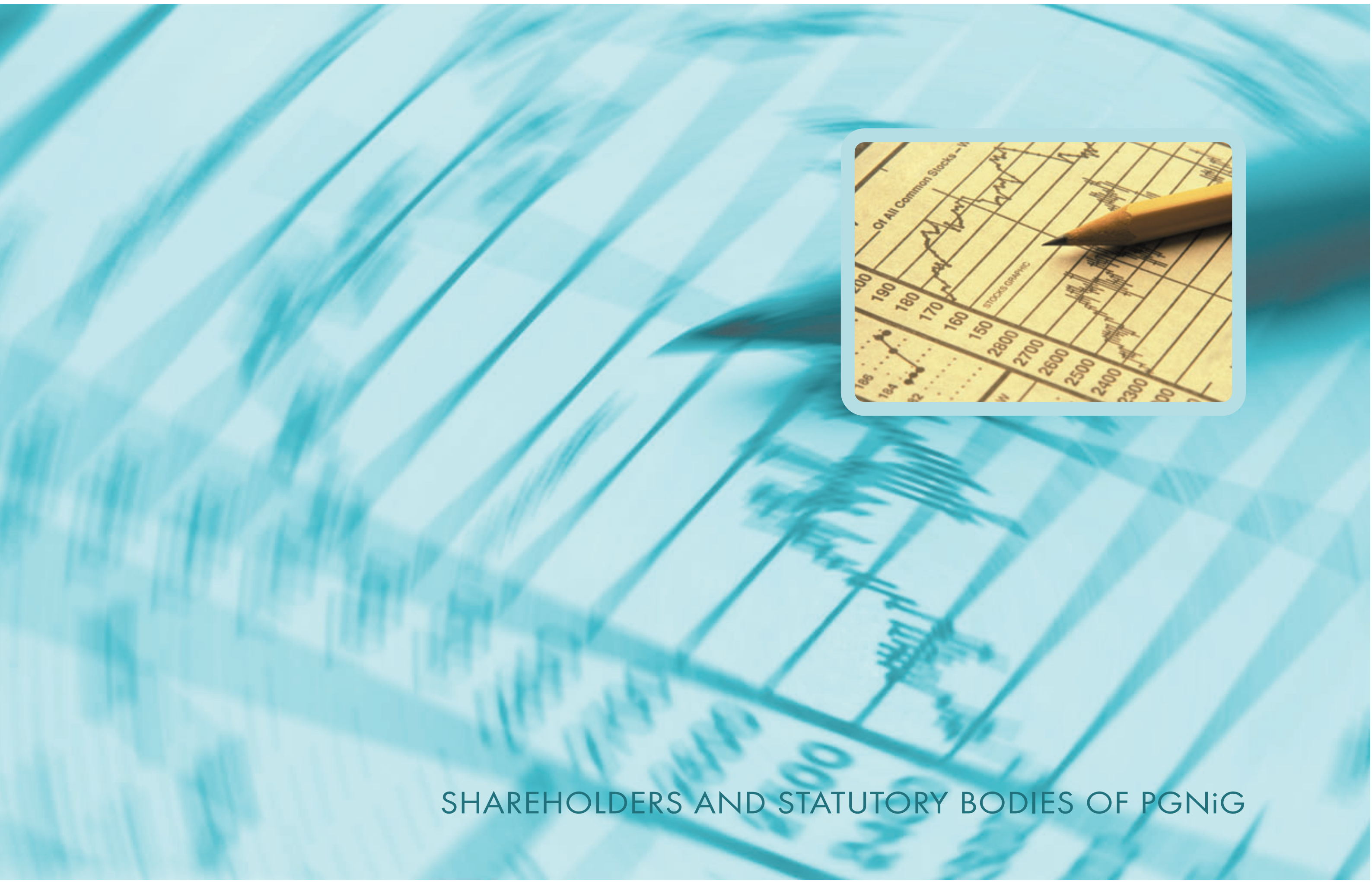
Ladies and Gentlemen,

The year 2005 was the year of record-breaking financial results and significant change within PGNiG. The results confirm that during the last year the Company continued to pursue the value creation path. The process of finance restructuring undertaken by PGNiG led to a significant reduction in the indebtedness. Through the initial public offering of shares carried out in September, on the Warsaw Stock Exchange, the Company raised around PLN 2.7 billion. In line with the adopted strategy, these funds are earmarked for investments into the Group's development and particularly in strategic projects including an increase in the domestic oil and gas production, expansion of the natural gas storage capacity and diversification of sources of gas supply to Poland. All these projects are focused to strengthen PGNiG Capital Group and enhance the security and reliability of gas supply to its customers. In 2005, PGNIG Group was actively involved in the process of gas market liberalisation. In accordance with the EU directives, the process of unbundling the transmission operation was being continued and over two thousand employees of Regional Transmission Branches changed their employer for the transmission operator company Gaz-System. Gaz- System received transmission assets worth PLN 500 million as an in-kind dividend. The process of the assets transfer will be continued in 2006 and following years.

The year 2005 was also marked by changes in the Group image - a new corporate brand was introduced and it is currently implemented by six Gas Distribution Companies supplying natural gas to, particularly, retail customers. Progress was also made in terms of the perceptions of the Company among investors and financial institutions – in October, following the share issue, rating agencies increased their ratings for PGNiG. Since 2004 the Company has been published its financials in accordance with the International Financial Reporting Standards. The Management Board of PGNiG declared for the compliance with the corporate governance principles recommended by the Warsaw Stock Exchange on 31 August 2005. The Supervisory Board of PGNiG endorsed the adoption and the adherence of the best practises pointed out by the Management.

With regard to compliance with the Act on Environment Protection, PGNiG carried out a number of environmental investments continuing the measures to mitigate the adverse impact of the business on the environment. The Company was also the first entity in Poland to obtain an attestation in accordance with Council Directive 92/13/EEC that its contract award procedures and practices were in conformity with the Community law. The constantly improving position of the Group is reflected in yearly rankings prepared by recognized consulting companies – PGNiG Group is ranked higher than a year before and belongs to the elite of the largest and most valuable companies in Poland.

Bogusław Marzec
President of the Management Board of PGNiG



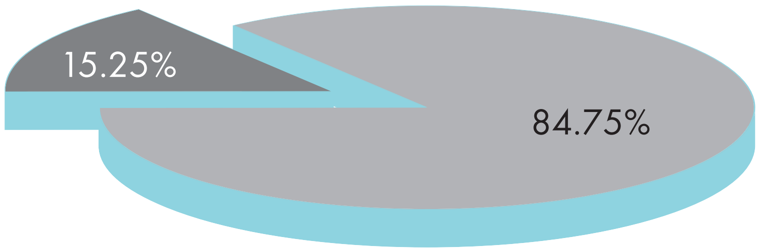
SHAREHOLDERS AND STATUTORY BODIES OF PGNiG

SHAREHOLDERS

On 31 December 2005 the share capital of PGNiG amounted to PLN 5 900 000 000 and divided for 5 900 000 000 shares at nominal value at PLN 1.00 each.

The shareholder structure of PGNiG as at 31 December 2005 is presented below:

SHAREHOLDER STRUCTURE



State Treasury – 84.75%

other shareholders – 15.25%

SUPERVISORY BOARD

Pursuant to the provisions of PGNiG's Articles of Association, its Supervisory Board is composed of five to nine members, appointed by the General Shareholders Meeting for a common term of three years. As long as the State Treasury holds a stake in the Company, the State Treasury, represented by the minister competent for matters pertaining to the State Treasury, acting in consultation with the minister competent for economic affairs, has the right to appoint and remove one member of the Supervisory Board. Two-fifths of all Supervisory Board members are appointed from among persons nominated by the Company's employees.

Composition of the Supervisory Board (as at 31.05.2006):

- Krzysztof Głogowski – Chairman of the Supervisory Board
- Andrzej Rościszewski –Vice-Chairman of the Supervisory Board
- Kazimierz Chrobak – Secretary of the Supervisory Board
- Wojciech Arkuszewski – Member of the Supervisory Board (as of 1 January 2006)
- Piotr Szwarc – Member of the Supervisory Board
- Mirosław Szkałuba – Member of the Supervisory Board
- Mieczysław Kawecki – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board

Composition of the Supervisory Board (as at 31.12.2005):

- Krzysztof Głogowski – Chairman of the Supervisory Board
- Andrzej Rościszewski – Vice-Chairman of the Supervisory Board
- Kazimierz Chrobak – Secretary of the Supervisory Board
- Magdalena Bąkowska – Member of the Supervisory Board
- Mieczysław Kawecki – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Mirosław Szkałuba – Member of the Supervisory Board
- Piotr Szwarc – Member of the Supervisory Board.

During the period running from 29 April 2005 until 27 October 2005 there were no representatives of the employees serving in the Supervisory Board of PGNiG.

THE MANAGEMENT BOARD

As stipulated in the Company's Articles of Association, the number of persons at PGNiG's Management Board is determined by the body responsible for appointing the Board and ranges from two to seven. The members are appointed for the common term of office which lasts three years. Individual members or the Management Board as a whole are appointed by the Supervisory Board. Each member of the Management Board may be dismissed or suspended in duties by the Supervisory Board or the General Shareholders Meeting. As long as the State Treasury remains the Company's shareholder and the average annual headcount exceeds 500, a person elected by the Company employees is appointed to the Management Board.

Composition of the Management Board as at 31.05.2006

Bogusław Marzec – President of the Management Board

Jan Anysz
– Vice-President
of the Management Board,
Human Resources and
Restructuring

Bartłomiej Pawlak
– Vice-President
of the Management Board,
Strategic Projects

Stanisław Niedbalec
– Vice-President
of the Management Board,
Technology and Investments

Zenon Kuchciak
– Vice-President
of the Management Board,
Trade

As at 31 December 2005, PGNiG's the Management Board consisted of following members:

- Jan Anysz - Vice-President
- Marek Foltynowicz - Vice-President
- Mieczysław Jakiel - Vice-President
- Franciszek Krok - Vice-President

It should be pointed out, however, that on 25 November 2005 the Supervisory Board suspended Mr Foltynowicz in his duties at the Management Board.

The following changes occurred in the composition of the PGNiG's the Management Board in 2005:

- On 10 January 2005, the Supervisory Board appointed employee-elected Mr Jan Anysz to the Management Board.

- On 29 April 2005, upon expiry of his mandate, Mr Jerzy Staniewski, Vice-President of PGNiG's the Management Board, stepped down from office.

- On 25 November 2005, Mr Marek Kossowski, President of the Management Board, and Mr Paweł Kamiński, Vice-President of the Management Board submitted their resignations from the Management Board membership.

- Pursuant to a resolution adopted by the General Shareholders Meeting on 12 December 2005, Mr Marek Foltynowicz and Mr Mieczysław Jakiel were removed from office, with effect from 1 January 2006.

- On 17 February 2006, PGNiG's Supervisory Board appointed Mr Stanisław Niedbalec to the Management Board for the position of Vice-President for Investments and Technology and Mr Bogusław Marzec - for the position of Vice-President for Financial and Economic Matters.

- On 3 March 2006, PGNiG's Supervisory Board dismissed Mr Franciszek Krok, who had held the position of Vice-President of the Management Board.

- On 6 April 2006 the Supervisory Board appointed Mr Bartłomiej Pawlak as Vice-President for Strategic Projects, and on 7 April 2006 Mr Zenon Kuchciak as Vice-President for Sales and Marketing.

- Mr Bogusław Marzec was appointed as the President of the Management Board of PGNiG on 25 April 2006.

FINANCIAL HIGHLIGHTS

FINANCIAL HIGHLIGHTS

Summary information on PGNiG Group's financial standing in 2005, compared with the 2004 data, is contained in the following tables prepared in accordance with the International Financial Reporting Standards:

- the profit and loss account
- the selected financial ratios.

Consolidated Profit and Loss Account (EUR thousand)	2005	2004
Sales revenue	**3,121.2**	**2,414.4**
Total operating expenses	**(2,809.9)**	**(2,121.0)**
Change in inventories	1.4	2.6
Cost of products and services for own needs	124.0	112.3
Raw materials and energy used	(1,600.1)	(1,134.3)
Employee benefits	(409.0)	(357.0)
Depreciation and amortisation	(348.4)	(338.8)
Contracted services	(442.1)	(242.8)
Other net operating expenses	(135.8)	(163.0)
Operating profit	**311.3**	**293.4**
Financial income	196.3	216.4
Financial expenses	(208.2)	(284.6)
Share in profit/(loss) of undertakings valued with equity method	12.3	31.1
Pre-tax profit	**311.7**	**256.3**
Corporate income tax	(51.4)	(48.4)
Net profit on business activities before statutory profit distribution	**260.3**	**207.8**
Profit distribution	(41.4)	(32.3)
Net profit on business activities	**218.9**	**175.5**
Discontinued operations	0.0	0.0
Profit/(loss) for the financial year on discontinued operations	0.0	0.0
Net profit for the financial year	**218.9**	**175.5**
Attributable to:		
Parent undertaking's shareholders	218.6	175.5
Minority interests	0.2	0.0
	218.9	**175.5**

Financial Ratios	2005	2004
PROFITABILITY RATIOS		
EBIT margin (EUR million) operating profit	311,3	293,4
EBITDA margin (EUR million) operating profit plus depreciation/amortisation	659,7	632,2
ROE (return on equity) net profit to equity** at end of period	4.2%	4.5%
NET SALES MARGIN net profit** in to net sales revenue	7.0%	7.3%
ROA (return on assets) net profit** in to assets at end of period	2.9%	2.8%
LIQUIDITY RATIOS		
CURRENT LIQUIDITY RATIO current assets (net of prepayments and accrued income) to current liabilities	2.3	0.7
QUICK CURRENT LIQUIDITY RATIO current assets (net of prepayments and accrued income) decreased by inventories to current liabilities	2.0	0.6
DEBT RATIOS		
TOTAL DEBT RATIO total liabilities to total equity and liabilities	31.6%	37.6%
TOTAL LIABILITIES TO EQUITY RATIO total liabilities to equity*	46.2%	60.1%

* equity attributable to the parent undertaking's shareholders

** net profit for the financial year attributable to the parent undertaking's shareholders

CORPORATE GOVERNANCE

Since the shares of PGNiG started to be traded on the Warsaw Stock Exchange, the Management of the Company has been attaching particular attention to the transparency of the corporate governance principles. The care about the shareholder interest is reflected in the key management principles, which provide for equal access by all shareholders to transparent information about generated by the Company. The Management, being aware of the market expectations, approves and supports all measures aimed at protecting the shareholder interest.

On 4 September 2004, the Board of the Warsaw Stock Exchange amended the WSE Rules providing for adoption of the corporate governance guidelines for public companies, which were eventually set forth in the document titled The Code of Best Practises in Public Companies in 2005. The measures proposed in the document provide for an obligation of the issuers to report on compliance with corporate governance rules in their companies. The solutions are based on the 'comply or explain' principle that is commonly accepted in other markets and provides that issuers have to make a public declaration of compliance or non-compliance with the corporate governance guidelines indicated by the issuer.

The first listing of PGNiG on the Warsaw Stock Exchange was thus a good occasion for the Company to adopt the Best Practices applied in public companies with regard to corporate governance. They are based on a system of legal and economic institutions (formal and informal rules of conduct) that govern the contractual relations between all relevant stakeholders (shareholders, lenders, managers, employees, suppliers). By adopting the corporate governance principles, PGNiG intends to achieve full independence and transparency of its business and join the group of most trusted companies.

CORPORATE GOVERNANCE

On 31 August 2005, PGNiG published a statement declaring compliance with 49 of 53 principles (5 general and 48 specific ones) and non-compliance with 4 principles (principles 2, 20, 28 and 43). PGNiG implements the principles of good and loyal management through its own corporate acts, i.e. the Regulations of the Management Board, Regulations of the Supervisory Board and the Regulations of the General Shareholder Meeting, as well as other internal procedures that ensure transparent and rational decision-making by the corporate bodies. PGNiG applies the principles taking into account the justified interest of the Company and its shareholders in line with the expectations of the market.

One of undertakings recognized as a priority by the new Management Board of PGNiG was a review of corporate governance principles in PGNiG. The Management Board is committed to undertake all possible measures in order to remove any formal or organizational barriers in the way of implementing all principles of best practises adopted by the Warsaw Stock Exchange. In 2005, the Rules of the General Shareholder Meeting were adopted, in line with the declaration of the Company.

Our goal is to ensure that the Company is well managed and effective in achieving its goals. The Management Board is accountable to both the Supervisory Board and the shareholders. We make all efforts to make sure that best practices and quality management jointly contribute to creation of the Company's value. The confidence in our Company is continuously growing. We promote a culture of dialoque providing information to the shareholders and other stakeholders in the capital markets through publication of current reports, by setting strategic targets and opening up a discussion about key undertakings.

Declaration of the Management Board concerning compliance with the corporate governance principles

Pursuant to § 29 of the Rules of the Warsaw Stock Exchange and the Resolution of the Exchange Board concering the adoption of corporate governance guidelines for the issuers of securities that are admitted to trading, the Management Board of PGNiG declared for the compliance with the corporate governance principles on 31 August 2005.

The Supervisory Board endorsed the position of the Management Board recommending the adoption and application of the corporate governance principles indicated by the Management Board, as recommended by the Warsaw Stock Exchange.

On 11 April 2006 the Management Board of PGNiG acknowledged the declaration of compliance with the corporate governance principles contained in "The Code of Best Practises for Public Companies in 2005" applicable to joint-stock companies issuing shares, bonds or bonds with pre-emprive rights in unchanged form as it was adopted by the Management Board of PGNiG on 31 August 2005.

On 25 April 2006, the Supervisory Board approved the Company's position on the corporate governance principles introduced by the Management Board as well as a motion submitted to the General Shareholder Meeting for an acceptance of this position.


STRATEGY

MISSION

The mission of PGNiG Group is:

to ensure the comfort of living for its domestic consumers and the convenience of operations for the business customers by providing them with the best energy solutions.

PGNiG is the Parent Company for around 50 subsidiaries which make up the Capital Group.

As a key player, in the Polish gas market, the Company boasts long-lasting experience in the industry, well developed technical infrastructure and excellent qualifications of its staff. These assets provide a solid base for further development of the Group's position in the changing environment and a strong basis to succeed in facing challenges of the opening up and more competitive market.

STRATEGY

PGNiG Group is currently enjoying a leadership position and thus is playing a dominat role at the domestic gas market. The obligation imposed by Directive 2003/55/EC to ensure third-party access to transmission services for all consumers as of 1 July 2004 (excluding households which will be entitled to chose a supplier as of 1 July 2007) stipultes new challenges for PGNiG. In a long-term market liberalisation will lead to an emergence of competitive gas companies at the Polish market.

In order to maintain the leadership position in the Polish gas market, PGNiG Group has been intensifying its efforts to ensure optimum terms under existing customer relationships and to attract new consumers.

In this regard, particular importance will be attached to:

- marketing undertakings, service standards,
- ensuring continued price competitiveness of the product and service offering,
- customer service improvements,
- achieving consistent and high customer service levels,
- separation of the commercial and technical operations.

In order to succeed in the above-mentioned undertakings the Gas Distribution Companies will be transformed into Distribution System Operators, and a single unit will be established to integrate all wholesale and retail operations at PGNiG level.

Owing to its integrated structure, which covers production, storage and wholesale trade in natural gas, as well as distribution and retail trade carried out by the Gas Distribution Companies, PGNiG is able to deliver gas on competitive terms while ensuring security and reliability of supply.

The proceeds gained from the stock market is used by PGNiG to implement its long-term investment strategy.

The key elements of the strategy are:

- an increase in the domestic oil and gas production,
- construction of new pipeline connections,
- expansion of Underground Gas Storage (UGS) capacity,
- projects aimed at diversification of the sources of gas supply to Poland.

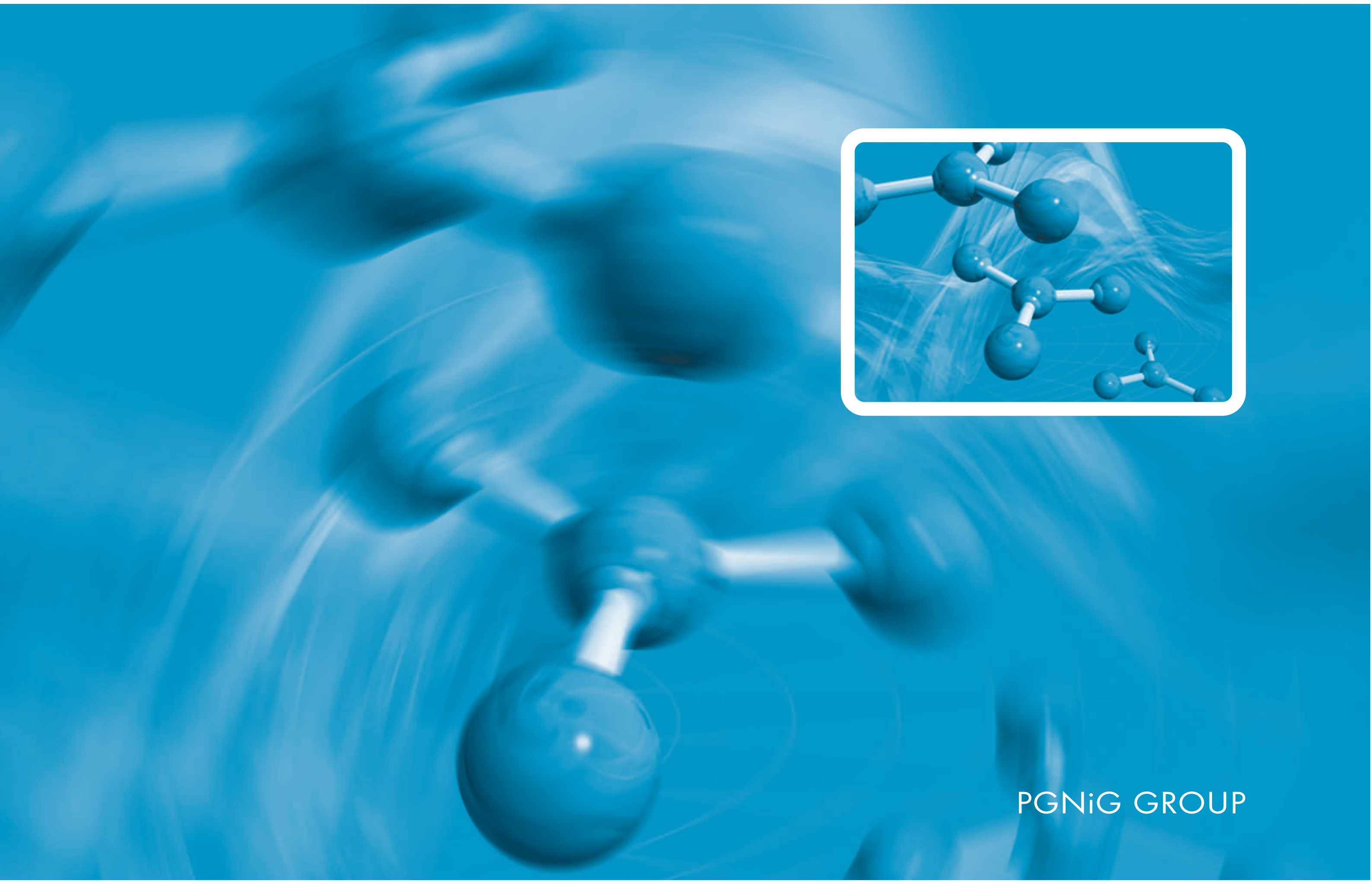
Consistent implementation of these elements of the investment strategy, above all, enhance both the security and the flexibility of gas supply to consumers, and thus the energy security of the country. The cost of gas sourcing is one of the key drivers of the Company's competitiveness in the gas trade business. The development of exploration and production activity improves the competitive position of the Company, since it provides access to gas at much lower cost than imports. Therefore, the strategic objective of PGNiG is to retain the exploration and production segment within the structure of the Company and to boost the production from domestic fields so that it ultimately covers 35% of the natural gas demand of PGNiG Group customers.

The recent major field discoveries and the existing proven reserves of oil provide good basis for planning a substantial growth in the production of this fuel. In order to ensure the expected production level over the coming years, the Company has to replace its recoverable reserves by documenting or acquiring new fields. This will be achieved based on the existing and new exploration licences. Due to considerable risk involved in the exploration activities and major financial investments required, PGNiG will seek to carry out some of the exploration efforts jointly with domestic and foreign partners. It will be done in parallel with implementation of the international strategy oriented on acquisition of exploration and operating licences abroad through undertakings carried out individually and jointly with interested Polish and foreign parties.

PGNiG sees significant opportunities in the rapid development of new gas application technologies such as co-generation, tri-generation, LNG, compressed natural gas as a motor fuel, and, in more remote future, production of light oil distillates from natural gas (GTL) and use of natural gas as a fuel in new unconventional technology, i.e. fuel cells. In addition to gas deliveries for co-generation or tri-generation units, due to the synergy with the core business of the Company, these areas set out the natural direction for further expansion, e.g. to electricity and heat generation (cooling) in small-scale units. Furthermore, since this business is not subject to regulation, the involvement of PGNiG in this market segment will partly reduce the Company's dependence on the revenues from regulated markets.

In order to achieve higher profitability, PGNiG will seek operational efficiency improvements through cost optimisation, including the cost of materials and energy consumption, third-party services, salaries and capital expenditures. The already implemented Centralised Procurement System is an important step in this direction.

The plans for the coming years also include reorganisation of PGNiG Group. Its target structure should comprise the Distribution System Operators, the upstream companies and other companies of major importance for PGNiG. In order to achieve the above objectives, restructuring measures are underway with respect to both the organisational and functional model of PGNiG and its ownership structure.


PGNiG GROUP

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG SA), registered office in Warszawa, ul. Krucza 6/14, was established as a result of transformation of a state-owned enterprise under the name Polskie Górnictwo Naftowe i Gazownictwo into a state-owned joint-stock company. The Deed of Transformation together with the Company's Articles of Association were executed in the form of a notarial deed dated 21 October 1996.

On 5 October 2004, the Council of Ministers adopted the *Restructuring and Privatisation Programme of PGNiG*. As a result of this decision, the Extraordinary General Shareholder Meeting gave the Management Board of PGNiG the authority to implement the Programme and, particularly, to take measures aimed at privatisation of the Company through an IPO process.

The admission of the shares of PGNiG to public trading by the Polish Securities and Exchange Commission on 24 May 2005 marked an important date in the history of the Company.

On 6 October 2005, the District Court of the Capital City of Warsaw registered a share capital increase at PGNiG. Following the increase, the Company's share capital currently amounts to PLN 5,900 million and is divided into 5 900 000 000 shares, including:

- 4 250 000 000 Series A ordinary bearer shares with the aggregate par value of PLN 4,250 million,
- 750 000 000 Series A1 ordinary bearer shares with the aggregate par value of PLN 750 million,
- 900 000 000 Series B ordinary bearer shares with the aggregate par value of PLN 900 million.

On 23 September 2005 the allotment certificates were listed for the first time on the Warsaw Stock Exchange. The offering of allotment certificates of PGNiG was a success and the Company gained around EUR 688.5 million*. It was one of the best stock market debuts in 2005.

PGNiG shares have been listed on the Warsaw Stock Exchange in continuous trading system since 20 October 2005.

After the session of 31 December 2005, the shares of PGNiG have entered the WIG 20 Blue Chips index with 3.2% weight in its composition.

At the moment, PGNiG Group is the only vertically integrated Company in the Polish gas sector, holding the leadership position in all areas of the domestic gas sector. PGNiG is the Parent Company of PGNiG Group.

* exchange rate for the report's purpose (24 August 2006): 1EUR = 3.9218 PLN

PGNiG is one of the key Polish companies of the energy sector and one of the very top Polish enterprises in terms of revenues with the level of sales revenues in 2005 reaching around EUR 3.187 billion. The shares of PGNiG make part of the most prestigious index of the Warsaw stock market, WIG 20, which gathers the largest and most liquid companies. At the same time it is a Company of strategic importance for the economy and energy security of the country, and one the largest employers in Poland with over 30 thousand employees in the Group at the end of 2005.

The position of PGNiG Group is getting stronger year by year. In terms of revenues generated in 2005, the Group was classified on the 4th place in the ranking of *Polityka* magazine and in the 5th place in the Top500 list complied by *Rzeczpospolita* daily. In the ranking of 100 most valuable companies prepared by the strategy consulting company A.T. Kearney for *Newsweek,* PGNiG was rewarded the 2nd position among fuel and energy companies (7th place in the general classification).

PGNiG has also raised appreciation of international markets, which is confirmed by its 8th place in Poland in the ranking *Giants of Central Europe*, which featured the largest companies from 13 Central European countries. The ranking was developed jointly with Dun&Bradstreet, the international business intelligence company, and ten business journals of Bonnier publishing group from all around Europe.

PGNiG's performance is being reviewed by international rating agencies including Standard & Poor’s (BBB) or Mooody’s (Baa1) while enjoying increasing recognition in the stock market. The firm has been granted the Golden Company status and the shares of PGNiG also make part of the emerging markets index of Morgan Stanley Capital International Inc.

PGNiG Group is actively pursuing business opportunities in all areas of the gas sector. The strategy pursued to date enabled the Company to achieve unquestionable leadership in:

- field exploration (PGNiG and core companies of the Group)
- gas production (PGNiG and core companies of the Group),
- gas imports (PGNiG),
- storage (PGNiG),
- trade and distribution (PGNiG and strategic companies of the Group).

PGNiG Group is active in the E&P segment abroad including prospecting and development of oil and natural gas fields through its Branches and core business subsidiaries.

ORGANIZATIONAL STRUCTURE OF PGNiG GROUP

PGNiG Group comprises commercial law companies of production, trading and services profiles. PGNiG is the dominant entity of the Group.

The Management Board of the Group is pursuing an optimization of the organizational structure. These efforts are focused on maximization of the operating efficiency of the companies that pursue key objectives set out in the strategy of the Group.

As at 31 December 2005, PGNiG held shares in 56 commercial-law companies, including:

- 25 companies in which PGNiG held over 50% of shares,
- 17 companies in which PGNiG held between 20% and 50% of shares,
- 14 companies with the Company's shareholding below 20%.

Based on their scope of business and importance to the Group's operations, the Group Companies have been divided into the following categories:

- strategic companies,
- core companies,
- dedicated companies,
- others.

The total nominal value of PGNiG's equity interests in commercial-law companies was around EUR 1,668.5 million as at 31 December 2005.

STRUCTURE OF PGNiG EQUITY HOLDINGS IN COMMERCIAL LAW COMPANIES AS AT 31.12.2005

PGNiG

- **STRATEGIC COMPANIES**
  - Mazowiecka Spółka Gazownictwa Sp. z o.o. 100%
  - Dolnośląska Spółka Gazownictwa Sp. z o.o. 100%
  - Karpacka Spółka Gazownictwa Sp. z o.o. 100%
  - Pomorska Spółka Gazownictwa Sp. z o.o. 100%
  - Wielkopolska Spółka Gazownictwa Sp. z o.o. 100%
  - Górnośląska Spółka Gazownictwa Sp. z o.o. 100%
- **CORE COMPANIES**
  - PNiG Jasło Sp. z o.o. 100%
  - PNiG Kraków Sp. z o.o. 100%
  - PNiG NAFTA Sp. z o.o. 100%
  - GEOFIZYKA Kraków Sp. z o.o. 100%
  - GEOFIZYKA Toruń Sp. z o.o. 100%
  - Poszukiwania Naftowe "Diament" Sp. z o.o. 100%
  - Zakład Robót Górniczych Krosno Sp. z o.o. 100%
  - SGT EuRoPol Gaz S.A. 48%
  - GAS - TRADING S.A. 43,41%
  - BSiPG Gazoprojekt S.A. 75%
- **DEDICATED COMPANIES**
  - PGNiG Finance B.V. 100%
  - Górnictwo Naftowe Sp. z o.o 100%
  - InterTransGas GmbH 50%
  - Dewon S.A. 36,38%
  - INVESTGAS S.A. 49%
  - NYSAGAZ Sp. z o.o. 51%
  - Polskie Elektrownie Gazowe Sp. z o.o. 48,48%
- **OTHER COMPANIES**
- Branch in Sanok
- Branch in Zielona Góra
- Branch in Odolanów
- Central Measurement & Reaserch Laboratory
- Operating Branch in Pakistan

Strategic companies

Gas Companies are the strategic companies within the Group. Their activities encompass retail trade and distribution of natural gas, sale-related activities as well as the activities connected with the operation, maintenance and development of the distribution system.

Their operations span the whole territory of Poland. They supply with natural gas over six million customers, including industrial customers and households. Retail customers form their largest customer group (more than 95%).

Core companies

The core companies of the Group are those entities whose scope of business and the actually performed function support achievement of key objectives of PGNiG. Their scopes of business and the functions they perform are vital for the implementation of PGNiG's principal business objectives and facilitate expansion of the supply base and development of the gas sales market.

The core companies are:

- exploration companies:
  PNiG Kraków Sp. z o.o.,
  PNiG Jasło Sp. z o.o.,
  PNiG NAFTA Sp. z o.o. w Pile.

- service companies:
  PN „Diament" Sp. z o.o.,
  Zakład Robót Górniczych Krosno Sp. z o.o.

- geophysical companies:
  GEOFIZYKA Kraków Sp. z o.o.,
  GEOFIZYKA Toruń Sp. z o.o.

- companies operating the Transit Pipeline Network:
  SGT EuRoPol Gaz S.A.,
  GAS-TRADING S.A.

- an engineering company BSiPG "Gazoprojekt" SA.

Dedicated companies

As a part dedicated companies are undertakings established for the purpose of pursuing long-term strategic objectives of PGNiG Group.

CHANGES IN PGNIG GROUP STRUCTURE IN 2005

The key event affecting PGNiG Group's structure was the conclusion on 28 April 2005 of a Donation Agreement between PGNiG and the State Treasury concerning 100% of shares in PGNiG - Przesył Sp. z o.o., which upon the execution of the Agreement were transferred to the State Treasury. As a result, an unbundled transmission system operator, Gaz-System, independent of PGNiG, was established.

During 2005, the Parent Company disposed of its shares in five subsidiaries that were not related to the core business of PGNiG or where PGNiG held minority interests.

EMPLOYMENT IN PGNIG GROUP

At the end of December 2005, the Group employed 30,176 people. The employment restructuring programs are underway both within PGNiG itself and in the Group.

As part of the Programme, started in 2000, extensive restructuring measures are to be undertaken, including:

- Old-age and early retirement schemes,
- Granting pre-retirement benefits to eligible employees,
- Employing some staff in companies partly owned by PGNiG and in companies taken over by employees,
- Employing some staff at entities cooperating with PGNiG,
- Shortening the working hours on certain posts and making other posts redundant.

Since 2003, PGNiG Group has been implementing the "Programme of employment restructuring... Phase II", whose completion is scheduled for 2007.

In the years 2004-2005, 3,260 employees were covered by the Programme. As a result of the Programme implementation, the Group achieved cost savings related to payroll and employee benefits in the amount of around EUR 36.71 million, while the effect of restructuring, after the costs of restructuring and the financial costs incurred in connection with recruitment of new staff, reached the level of EUR 15.5 million.

In the period from 1 January 2003 to 31 December 2005, absolute headcount at companies covered by the Programme decreased by 5,511 employees (taking into account the transfer of 2,181 employees in connection with the spin-off of Gaz-System).

BUSINESS AREAS OF PGNiG GROUP

FIELD EXPLORATION

PGNiG conducts exploration and prospecting work domestically and abroad through the exploration companies of PGNiG Group and within its own organizational structure. The work mainly includes the exploration and development of geological structures containing reserves of hydrocarbons in the form of natural gas and oil. The exploration and prospecting of reserves comprise a study of historical data, as well as geological analyses and geophysical and drilling research.

The exploration and production activity in Poland is regulated under The Geological and Mining Law and, in accordance with its provisions, it is subject to licensing.

In 2005 PGNiG carried out exploration and prospecting activity in Poland, particularly in the Carpathians, the Carpathian Foothills and the Polish Lowlands, spending in total around EUR 109.9 million, which resulted in the discovery of producible reserves of:

- oil by 3.0 million tones,
- natural gas by 4.9 bcm* of high-methane equivalent.

As at the end of 2005, the producible reserves of natural gas amounted to 106.3 bcm (of high-methane equivalent), including 103.0 bcm already favourably assessed by the Mineral Reserves Commission and accepted by the Minster of Environment, while the reserves of oil were estimated at 21.9 million tones.

The following Companies included in PGNiG Group conduct deposit exploration:

- GEOFIZYKA Kraków Sp. z o.o.,
- GEOFIZYKA Toruń Sp. z o.o.,
- Poszukiwania Nafty i Gazu Jasło Sp. z o.o.,
- Poszukiwania Nafty i Gazu Kraków Sp. z o.o.,
- Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.,
- Poszukiwania Naftowe „Diament" Sp. z o.o.,
- Zakład Robót Górniczych Krosno Sp. z o.o.

The core business of the exploration Companies comprises the broadly meant exploration of oil and natural gas fields within the territory of Poland and abroad. Modern equipment and experienced staff enable the Companies to perform high-quality work in the field of deposit exploration.

* billion cubic metres

The growing demand for energy sources making new contracts and markets easier to win for the core companies represented the most important factor influencing the 2005 financial results of the Group's exploration, servicing and geophysical Companies. An active presence on markets promising for geological and exploration services enables the development of export potential of the core companies.

The exceptional attention to the environmental protection shown by the Group Companies, reflected in favourable results of quality control, undoubtedly has also impacted the financial results on the Companies' 2005.

Achieving the objectives set for PGNiG Group for 2005 contributed to the increase in capital expenditure on the purchases of equipment and appliances necessary to maintain an appropriate technical condition. New investments not only improved the quality of work and services provided by the Group Companies, but also contributed to further specialisation in the scope of tasks performed and reduction of costs affecting the Companies' financial results.

ACTIVITY ON INTERNATIONAL MARKETS

PGNiG Group has been present with its exploration activity in the Middle East and Asia countries for many years:

- Iraq – in the years 1987–1991 (in Northern and South Iraq, in the regions of Kirkuk and Basra) qualified technical staff drilled exploration and production boreholes up to the depth of approx. 5,000 meters.

- Syria – in the years 1988–2004 2D and 3D seismic surveys were performed for Syrian Petroleum Company and MOL Syria. Initially, exploration for oil and gas fields was carried out using WEGA-D, an advanced electromagnetic surveying method developed in Poland. At the moment, one of the exploration companies – Poszukiwania Nafty i Gazu NAFTA - performs drilling work under a contract with Crosco.

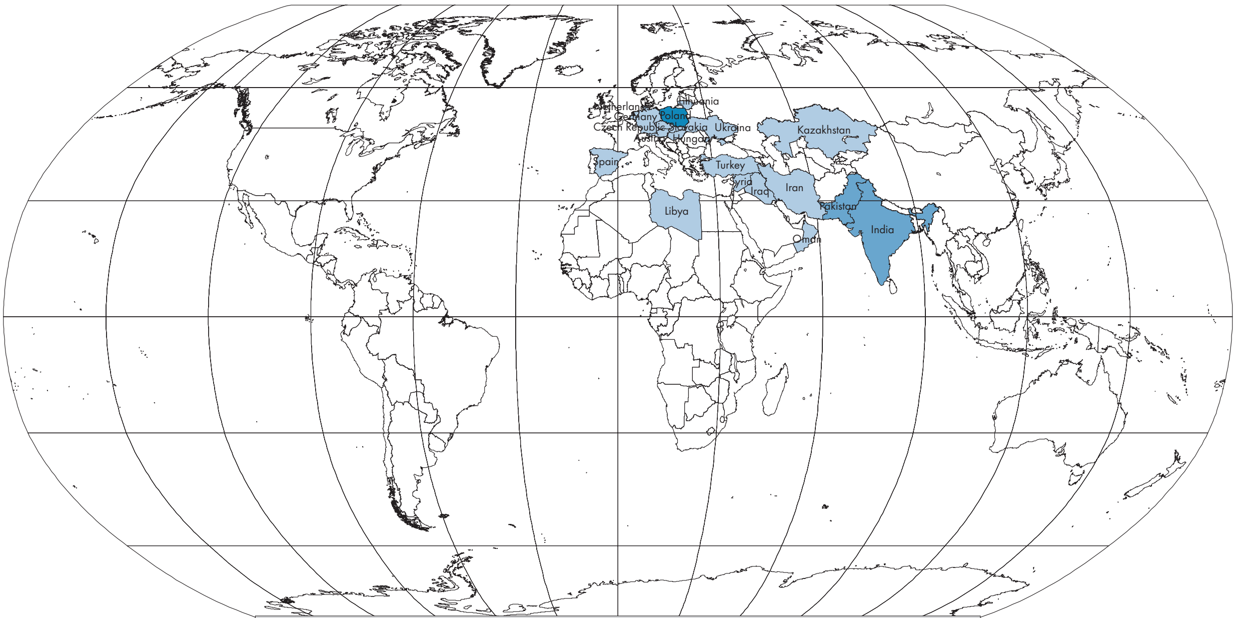
- **Pakistan** – in the years 1985–2004 seismic surveys were performed using the 2D method for Lasmo Oil Pakistan Ltd, MOL, Tullow Pakistan (Development) Ltd. and for the Operating Branch in Pakistan. The drilling companies performed 18 boreholes for Oil and Gas Development Corporation, British Gas International (Pakistan), Lasmo Oil Pakistan Ltd, Occidental Petroleum, Orient Petroleum Inc., OMV Pakistan, Tullow Pakistan (Development), Union Texas Pakistan and the Operating Branch in Pakistan.

- **Kazakhstan** – since 1998, Poszukiwania Nafty i Gazu Kraków, a company registered in Almaty, performs drilling work. GEOFIZYKA Toruń also registered its local branch, which provides services in respect of well geophysics.

- **India** – subsidiaries of PGNiG have been present in the country since 1984 performing contracts for drilling and geophysical work. Currently, three seismic teams of GEOFIZYKA Toruń carry out seismic surveys and interpretation of data collected in the states of Andhra Pradesh and Rajasthan.

Branches of PGNiG Group subsidiaries worldwide:
- in **Oman** (Polish-Omani company Sahara Petroleum Technology LLc.),
- in **Pakistan** (Operating Branch of PGNiG in Pakistan, branches opened by Group Companies: Poszukiwania Nafty i Gazu Kraków and GEOFIZYKA Kraków),
- in **Kazakhstan** (Poszukiwania Nafty i Gazu Kraków, a Group company of PGNiG has its branch in Almaty),
- in **Libya** (GEOFIZYKA Kraków and Poszukiwania Nafty i Gazu Jasło opened up their branches in Tripoli in 2005),
- in **India** (companies of PGNiG Group, i.e. GEOFIZYKA Toruń and Poszukiwania Nafty i Gazu NAFTA have opened their branches, and Poszukiwania Nafty i Gazu Kraków has its representative office).

Futhermore, Poszukiwania Nafty i Gazu Piła established a branch in Hungary. GEOFIZYKA Kraków opened up its branches in the Czech Republic and in Slovakia. The exploration companies were active players in the foreign markets. The main markets where geophysical companies of the Group were operating in 2005 were: Austria, Iran, India, Czech Republic, Slovakia, Turkey, Hungary and Pakistan. Drilling services were performed for customers in Kazakhstan, Pakistan, India, Ukraine, Lithuania, Germany, Libya and Hungary. The servicing companies of PGNiG Group provided their services in Belarus, Ukraine, the Czech Republic, Spain, the Netherlands and Germany.



PGNiG Capital Group
Activity in the World

- headquarters
- countries where PGNiG Group operates under exploration licences
- countries where PGNiG Group carries out production or provides services
- other countries

FIELD OPERATIONS – PRODUCTION

PGNiG acts as an upstream operator in several regions of the country and is the only Company in Poland producing natural gas from domestic onshore reserves.

The production of natural gas and oil is one of the key sources of the competitive advantage of the Company in the liberalising gas market.

As required by the principles of the economic management of the reserves, newly discovered reserves are developed, while boreholes are repaired and intensifying operations are carried out on the operated reserves in order to maintain their maximum production capacities. The boreholes where hydrocarbon production ceases to be economically viable are liquidated and the post-production ground is cleaned up.

In this scope, the exploration Companies of PGNiG Group offer comprehensive services and operations, with use of specialist equipment, in the area of:

- production intensification (hydraulic slotting, mini-slotting, acid treatment and casing hydroperforation),
- deposit sampling,
- production tests and mining work (borehole recompletion),
- repairs of operated boreholes,
- liquidation of boreholes on worked out fields,
- mine rescue work.

The production of PGNiG in 2005:

Product	Quantity
Natural gas, of which:	4,318.1 mmcm*
- Branch in Zielona Góra	2,419.0 mmcm**
- Branch in Sanok	1,899.1 mmcm
Crude oil, of which:	602.3 thousand tons
- Branch in Zielona Góra	551.5 thousand tons
- Branch in Sanok	50.8 thousand tons
Condensate	16.3 thousand tons
Sulphur	21.2 thousand tons
LPG	15.8 thousand tons
Helium	2.7 mmcm
LNG	10.7 mmcm

* million cubic metres

** after conversion to high-methane natural gas volumes.

Two branches of PGNiG, the Zielona Góra Branch and Sanok Branch, produce natural gas from fields located in Poland:

- The Zielona Góra Branch produces low-methane gas at 18 mines. 387 boreholes are currently operated by the Branch.
- The Sanok Branch produces high-methane gas in 37 mines, with a total of 682 active natural gas boreholes.

PGNiG's Branches in Zielona Góra and Sanok also produce oil:

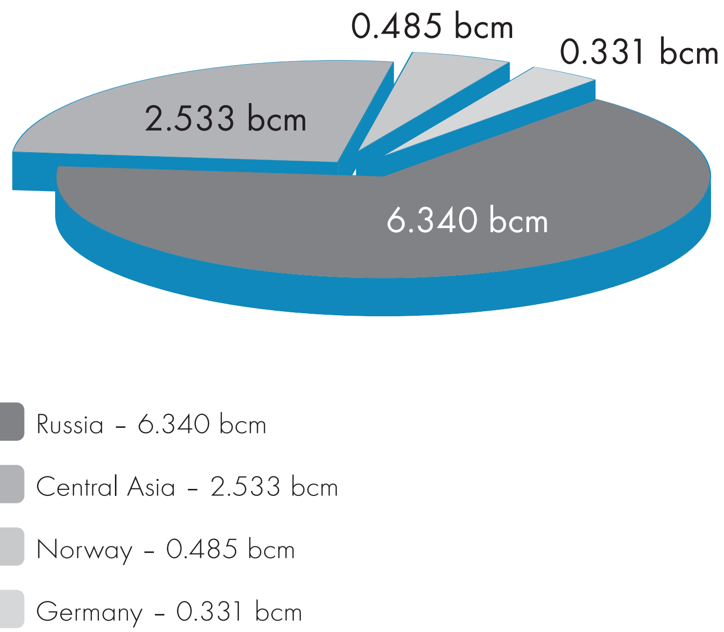
- The Zielona Góra Branch operates ten oil mines grouped into three Mine Centres. The Branch produces oil from 55 boreholes.
- The Sanok Branch operates 22 oil mines grouped into four Mine Centres. The Branch produces oil from 1,069 active boreholes

The investment in the production segment exceeded around EUR 49.5 million.

GAS IMPORTS

PGNiG is an importer of natural gas. In 2005, the gas imports came mainly from Russia, Central Asia, Norway and Germany.

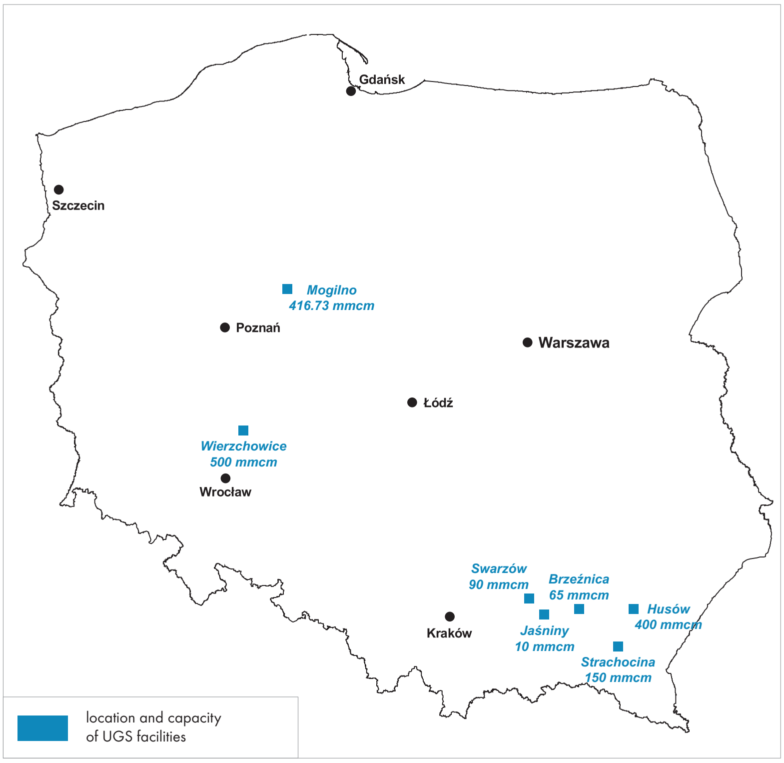
NATURAL GAS IMPORTS IN 2005



PGNiG imports natural gas from Russia under a long-term supply contract which will be binding until 2022 and from Central Asia, Norway and Germany - under medium-term contracts.

STORAGE

PGNiG owns 7 Underground Gas Storage facilities, 6 of which are in operation. Owing to the gas storage system, PGNiG can ensure reliable and secure supply of this fuel to the consumers. The storage facilities accommodate the surplus gas from the transmission system during the summer and provide extra gas volumes during the peak demand period.



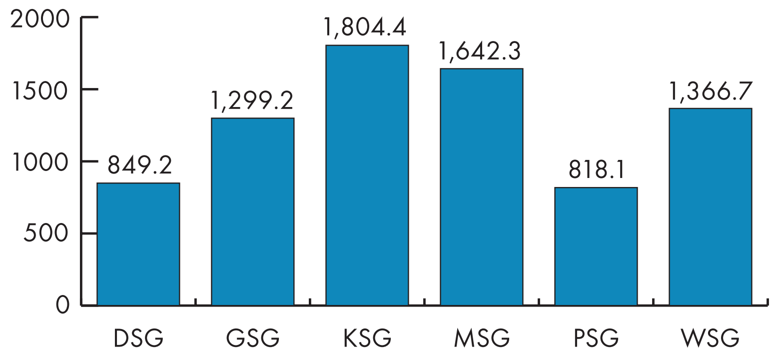
TRADE AND DISTRIBUTION

Natural gas retail trading and distribution represent one area of the core business activities of PGNiG Group. These activities are conducted by the Gas Companies, which are of strategic importance for PGNiG Group. The Gas Companies also operate, maintain and expand the distribution system.

Trade and distribution of natural gas are regulated by The Energy Law. Consequently, these activities must be carried out under a concession and the related revenues of the Group depend on the gas tariffs approved by the President of the Energy Regulatory Office.

The trading activities conducted by the Gas Companies in 2005 primarily included the sale of GZ 50 high-methane gas, which accounted for nearly 91% of the volumes of sold natural gas and 92% of the volumes of sold natural gas distribution segment. Low-methane gas, which was sold by Wielkopolska Spółka Gazownictwa and Dolnośląska Spółka Gazownictwa, accounted for 9% of the volume of natural gas sold, and 8% of the value of sales in the distribution segment. Also worth notifying is the growing volume of compressed natural gas (CNG) sales, which reached the level of 1.3 mmcm in 2005.

GAS SALES BY GAS DISTRIBUTION COMPANIES IN 2005 (IN MILLION M³)



DSG - Dolnośląska Spółka Gazownictwa Sp. z o.o.
GSG - Górnośląska Spółka Gazownictwa Sp. z o.o.
KSG - Karpacka Spółka Gazownictwa Sp. z o.o.
MSG - Mazowiecka Spółka Gazownictwa Sp. z o.o.
PSG - Pomorska Spółka Gazownictwa Sp. z o.o.
WSG - Wielkopolska Spółka Gazownictwa Sp. z o.o.

The Gas Distribution Companies employ jointly 16,799 people and sell and distribute gas to 16.3 million customers, both households and institutions, thorough their own networks with the total length of over 103 thousand km.

Key activities of Gas Distribution Companies in 2005:

- conceptual work on bringing the organizational structures in line with the EU Directive (2003/55/EC), under which natural gas distribution should be kept separate from the trading business. These business segments of the Gas Companies were organizationally separated last year.

- implementation of the Integrated System for Quality, Environment, Safety and Health Management in accordance with the ISO standards. In addition, the Gas Companies restructured their sales forces.

- implementation of the development policy for the natural gas sales market through expansion and upgrade their gas pipeline networks and connections of new customers to their grids. The Gas Companies implemented gas supply accessibility programs for areas with poor or no gas pipeline systems (the so-called white spots territories) in cooperation with local authorities, taking into account the effectiveness of investment projects and their co-financing with the EU funds.

- stimulation of the demand for natural gas by taking various measures including promotion of state-of-the-art equipment for cogeneration of electricity and thermal energy, local gas-fired boiler houses and the use of compressed natural gas by combustion engines (CNG).

Sales structure of PGNiG

PGNiG conducts commercial activities including the trade in natural gas and sale of products manufactured by the Company, including natural gas from domestic resources, crude oil, condensate, LPG, helium, nitrogen and sulphur. Imported natural gas is purchased mainly from eastern markets. The sale of natural gas from the transmission network is regulated by the Polish Energy Law, while gas prices are determined by based on the tariffs approved by the President of the Polish Energy Regulatory Office. Sales of natural gas directly from reserves as well as sales of other products of the Company are conducted on free-market terms, whereby prices are individually negotiated with customers on a case-by-case basis.

The key products sold by PGNiG are natural gas and oil. The sales of natural gas and oil represent approx. 97% of the sales revenue from PGNiG products. The sales structure of the key products of PGNiG in 2005 is presented in the table below.

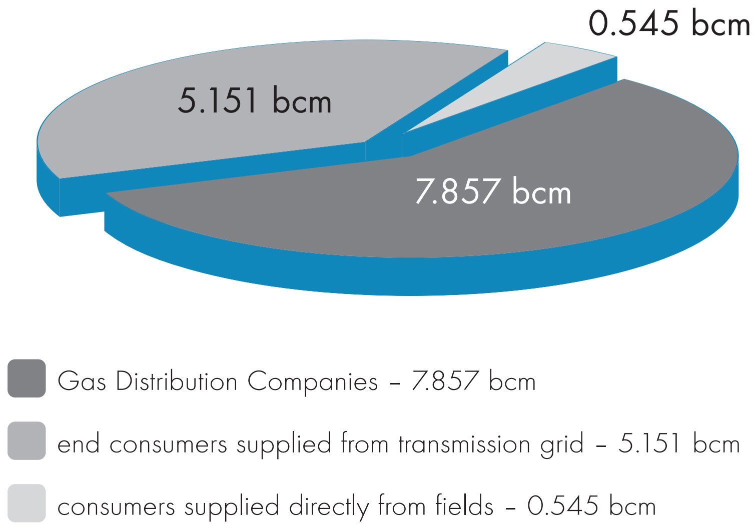
Sales structure of main products

Product	Unit	Quantity	Net value (in PLN million)	Net value (in EUR million)
Natural gas	mmcm*	13,554.5	8,754.6	2,232.4
Crude oil	thousand tons	608.0	783.6	199.8
Condensate	thousand tons	8.3	13.9	3.5
Helium, LPG, nitrogen, sulphur	-	-	67.1	17.1

* after conversion to high-methane gas volumes

The Company's key customers include Gas Companies, members of PGNiG Group. Other customers who purchase the Company's products from the transmission grid primarily include nitrogen producers, steel industry and power sector.

GAS SALES STRUCTURE OF PGNIG BY CUSTOMER



INVESTMENT AND BUSINESS DEVELOPMENT PLANS

New investments represent a key element in the strategy of PGNiG, as they strengthen the market position of the Company and ensure its continued growth. The main investment objectives are:

- diversification of gas supply directions,
- increase in oil and natural gas production from domestic fields,
- expansion of underground gas storage capacity.

EXPLORATION

Exploratory Work in Poland

For 2006, Exploration in Poland in the following areas is planned:
- Międzychód-Gorzów Wielkopolski
- Nowy Tomyśl
- Środa Wielkopolska-Jarocin (in cooperation with FX Energy)
- Pionki-Kazimierz
- Górowo Iławeckie
- the Carpathian Foreland and the Carpathians.

The planned work will include the following tasks:
- due to seismis operations, discovery and documentation of new fields with potential hydrocarbon reserves,
- research into gas and oil bearing characteristics of new prospective fields,
- continuation of exploratory work on prospective or newly discovered fields,
- development of identified fields of oil and natural gas.

Exploratory Work Abroad

In October 2005 the Company commenced work on the determination of strategic directions of PGNiG's activity in the area of identifying foreign markets with a potential for obtaining licences or shares in joint ventures for the exploration and production of hydrocarbons.

In 2005, PGNiG obtained the Kirthar exploratory licence in Pakistan. The licence will enable the Company to perform licence obligations of past years. On 18 May 2005, PGNiG and the Pakistani Government signed a three-year agreement for the exploration of hydrocarbons on the Kirthar licence.

The shareholder structure of this joint venture is as following:

- PGNiG – 70%
- Pakistan Petroleum Ltd. – 30%.

PGNiG's interests connected with the business operations on Pakistani licences are represented by the Operating Branch established under the Pakistani law, which requires that a representative unit of the Parent Company should be established in Pakistan.

Growth Prospects for Exploration Companies

In 2006, the activities of the exploration Companies will include both the strengthening of their positions on the domestic market and continued expansion on foreign markets.

In 2006, the major foreign markets for services offered by the geophysical Companies of PGNiG Group will be:

- India,
- Iran,
- Turkey,
- Pakistan,
- Czech Republic,
- Austria,
- Germany,
- Libya.

Multiyear dedicated marketing activities enabled the Companies to acquire contracts for services and geophysical work. Vast experience and constantly enhanced service portfolio have contributed to optimised use of resources.

Given their rich reserves of oil, following countries are the most promising exports markets for the exploration (drilling) Companies:

- countries of Africa and the Middle East (Saudi Arabia, Iran, Libya, Nigeria and Kuwait),
- Asian countries (Russia, China, India, Indonesia and Kazakhstan),
- Ukraine.

Intensive marketing actions also cover India, Hungary, Morocco, Egypt and the United Kingdom. The German market is promising as well; numerous geothermal projects are being developed for that market.

The conducted marketing actions, comprehensive range of work and continuous modernisation of specialist equipment and subassemblies, all contribute to the strengthening of the Companies' positions on prospective foreign markets. Constant effort to ensure work quality and safety, as well as limiting adverse effect of work on natural environment, combined with multiyear experience support the Companies in winning new business partners on foreign markets.

The domestic market remains the strategic market of the servicing Companies in 2006, while the target market of these Companies is Central and Eastern Europe, and particularly Belarus and Ukraine reporting demand for intensification work and borehole mining services. Deepening specialization in the scope of servicing provided, purchases of state-of-the-art investment assets supporting service range broadening, as well as repairs and specialist equipment undertaken with view to maintain the appropriate technical condition of the operated equipment, all render placing a part of production capacities on the prospective markets feasible.

Activities Planned in the Trading Segment

In line with PGNiG Group's strategy for 2005-2008, the operating plan "The Acquisition of New Strategic Customers in the Power Sector" was launched with a view to enhancing the Group's commercial efficiency. The feasibility of a number of pilot projects in the areas of construction, extension and modernisation of energy sources with the use of natural gas was reviewed.

In August 2005, PGNiG jointed into a multi-lateral agreement concerning the establishment of the Polish Technology Platform for Hydrogen and Fuel Cells. Under the agreement, as part of support for efforts and projects aiming to develop new technologies in the power sector, PGNiG lent its support to the SOPTUS project concerning "Development, Construction and Testing of the Fuel Cell Stack of 1 kW Capacity", which was forwarded to the Qualifying Committee for Commissioned Research Projects at the Ministry of Science and Information Technology.

The most significant project in 2006 concerns the approval and implementation of the concept to unbundle the trading activity from technical gas distribution within PGNiG Group. This involves the transformation of 6 Gas Distribution Companies into Distribution System Operators (DSOs). The trading activity will be separated from the existing Gas Distribution Companies and transferred to PGNiG.

The proposed concept will ensure compliance with the legal obligation to unbundle the trading activity and technical gas distribution, as required under the Energy Law and Directive 2003/55/EC of the European Parliament and the Council, by 1 July 2007. Moreover, the option selected out of multiple transformation alternatives that address this requirement is the optimal one, as it not only maximises the value of PGNiG but also ensures implementation of the governmental recommendation that the DSOs should own the network assets.

DISTRIBUTION

Poland's economic growth and its membership in the European Union create a conducive environment for establishing new companies and, consequently, provide the Gas Companies with greater opportunities to attract new customers. Furthermore, the development of cuttingedge technologies used by end-users of gas, implementation of the EU environmental law and high and steadily growing significance of the gaseous fuel contribute to the growth of demand for that type of fuel. In view of the liberalisation of the market, a vital factor is the growing trust placed with the companies by their customers.

The strategies of the Gas Companies represent an extension of PGNiG Group's strategy which assumes:

- increase in the value of PGNiG Group,
- higher efficiency of the conducted business and
- optimum use of the Group's assets.

One of the key directions for development of the Gas Companies is product diversification. It assumes the development of products and of the associated services for the markets of both retail and institutional customers.

In addition to new services related to the existing products, product diversification also means:

- looking for new applications for natural gas,
- commercial use of new applications
- the launch and continuation of sales of three new products, including compressed natural gas (CNG) for vehicles, generation of heat, and co-generation.

The development-centred actions taken by the Gas Companies are intended to increase revenues, particularly the revenues derived from activities which do not require licences, and to strengthen their market positions. These measures should also result in reducing the effects of seasonality of natural gas sales. With the internally generated funds and the possibility of raising capital through issues of PGNiG shares, the Companies will carry out the following development-focused actions:

- adjustment of organisational structures to market requirements and development of the target model of the enterprise based on a functional and eventually also legal separation of the trading and distribution businesses,
- implementation of new system solutions designed for the functioning of the Companies in business relations on an effective, efficient and competitive basis,
- improving key processes in the sales and marketing segments through pursuing detailed procedures and application of IT solutions for customer service,
- intensifying sales efforts in the retail and institutional markets,
- raising the offering's attractiveness by executing marketing programmes designed for newly connected customers,
- increasing loyalty and satisfaction of key customers through implementation of the Account Manager programme,
- increasing sales of compressed natural gas (CNG) for vehicles,
- increasing sales of natural gas for generation of heat, as well as sales of heat,
- increasing sales of natural gas for cogeneration systems (CHPs) and sales of co-generated energy,
- application of liquefied natural gas (LNG) and compressed natural gas (GTM CNG) in the areas not yet accessed by the gas pipeline networks – initial gas supply accessibility projects,
- effective investments,
- provision of associated services,
- rationalisation of maintenance activities,
- optimistation of network operations,
- improving the efficiency of claims recovery,
- development of IT resources,
- enhancing employee qualifications.

PGNiG'S GROWTH PROSPECTS

Growth Prospects for Natural Gas Production

The record-breaking financial results achieved in 2005 coupled with the positive impact of the changes implemented within PGNiG Group provide a strong foundation for achievement of the strategic goals. Hence the increase of the domestic gas production represents one of the crucial elements of the strategy, the Company is implementing a program to achieve production volumes at 5.5 bcm in 2008. In order to ensure that objectives of this program are met and the expected level of production is maintained in the coming years, the following investments in the upstream sector will be required:

- development of a new nitrogen removal plant,
- construction of new underground gas storage facilities,
- development of new fields,
- upgrading of the existing infrastructure (installation of compressors, modernisation of production facilities, etc.)

Launching new fields

In the years 2006–2008, PGNiG plans to develop 18 new fields, which will yield the gas production volume of around 870 bcm in 2008 (after conversion to high-methane gas).

In the Branch in Sanok, there are plans to upgrade of the 8 new fields:

- Stobierna – Terliczka,
- Trzebownisko,
- Żołynia W,
- Sarzyna,
- Jasionka,
- Cierpisz,
- Jeżowe,
- Kupno.

The production from the above fields is to achieve around 430 mmcm in 2008. The natural gas will be delivered into the high-methane gas transmission system.

In the Branch in Zielona Góra, there are 10 fields scheduled for production:

- Kaleje,
- Kaleje E,
- Zaniemyśl,
- Paproć W,
- Nowy Tomyśl,
- Wysocko Małe E,
- Pakosław,
- Wielichowo,
- Ruchocice,
- Elżbieciny.

The production from these fields, after conversion to high-methane gas, will reach around 440 mmcm in 2008.

As a part of the investments related to the operation of major fields containing low-methane natural gas in Kościan-Brońsko and the prospects for further discoveries of low-methane gas fields in this region, the Management Board of PGNiG made a decision to build a nitrogen removal plant in the vicinity of Grodzisk Wielkopolski.

Furthermore, the investment program of PGNiG Group includes, for the first time ever in Poland, the construction of two underground gas storage facilities for low-methane gas – UGS Daszewo (in the coastal region, for Ls quality gas) and UGS Bonikowo (for Lw quality gas ring). The plan for further actions in respect of the expansion of the existing UGS facilities and the development of new ones will be prepared based on an analysis of the operation of the transmission system after completion of the above-mentioned storage capacities.

The strategic plans of PGNiG Group also envisage growth of the oil production. According to the current forecast, the production capacity of 1.1 million tones should be reached in 2008. The production increase up to this level is supported by the current assessment of the geological crude oil reserves in the Lubiatów-Międzychód-Grotów (LMG) field and the underlying productivities of the individual boreholes, which are being systematically assessed as a result of the ongoing production tests.

FINANCIAL PERFORMANCE

AUDITOR'S REPORT

To the Shareholders and the Supervisory Board of Polskie Górnictwo Naftowe i Gazownictwo SA

We have audited the consolidated financial statements of Polskie Górnictwo Naftowe i Gazownictwo SA having its registered office in Warszawa, ul. Krucza 6/14, the Parent Company of PGNiG Group, consisting of:

- consolidated balance sheet as at 31 December 2005, with total assets/liabilities and equity amounting to PLN 30,363,665 thousand;
- consolidated income statement for the period from 1 January 2005 to 31 December 2005 with a net profit amounting to PLN 880,663 thousand;
- changes in the consolidated equity for the period from 1 January 2005 to 31 December 2005 with an increase in the equity value by PLN 3,020,807 thousand;
- consolidated cash flow statement for the period from 1 January 2005 to 31 December 2005 with net cash inflow during the reporting period of PLN 2,293,682 thousand;
- notes and explanations;

prepared in accordance with the International Financial Reporting Standards, as adopted by the European Union, and on 30 April 2006 we issued our unqualified opinion pointing out to the information in Note 6, which describes the uncertainty related to the valuation of the shares in SGT EuRoPol Gaz S.A., a co-subsidiary company. The Management of the Parent Company carried out analysis to assess the potential value impairment of the shares held in SGT EuRoPol Gaz S.A. Based on this analysis, the impairment was recognised by decreasing the value of these shares down to 493.8 million. In the above Note, the Management explained the uncertainty as to the assumptions taken in the analysis, which is due to external risks. The financial statements of SGT EuRoPol Gaz S.A. as at 31 December 2005 were audited by another auditor who issued an unqualified opinion on these statements. The statements were prepared in accordance with the Polish Accounting Standards.

Furthermore, we informed in our opinion that the financial statements of fourteen subsidiary companies and two affiliated companies and one co-subsidiary company were audited by other entities authorised to audit financial statements. Our opinion on the audit of the consolidated financial statements with regard to the accounts of these entities is based on the opinions of certified auditors authorised to conduct such audits.

The accompanying summary consolidated financial statements are the responsibility of the Management Board of the Parent Company. Our responsibility is to express an opinion as to the consistency of the summary financial statements with the full financial statements.

In our opinion, the accompanying summary financial statements are presented, in all material respects, in accordance with the full version of the financial statements.

Anna Domosławska
Członek Zarządu
Biegły rewident
nr ewid. 679

Maria Rzepnikowska
Prezes Zarządu
Biegły rewident
nr ewid. 3499

....

Maria Rzepnikowska
Certified Auditor
No. 3499

for the auditor

DELOITTE AUDYT Sp. z o.o.
ul. Piękna 18, 00-549 Warszawa
tel. 511-08-11, fax 511-08-13
NIP 527-020-07-86; REGON 010076870

....

entity authorised to audit financial statements, entered in the list maintained by the National Chamber of Auditors under identification No. 73

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated income statements
at 31 December 2005 and 31 December 2004

	31 December 2005	31 December 2004
	(PLN thousand)	
Revenues from sales	**12,559,988**	**10,908,691**
Changes in inventories	5,834	11,897
Own work capitalised	499,100	507,180
Raw materials and consumables used	(6,438,991)	(5,124,842)
Employee benefits expense	(1,645,850)	(1,613,007)
Depreciation	(1,401,855)	(1,530,771)
External services	(1,779,138)	(1,097,127)
Other net operating expenses	(546,450)	(736,446)
Total operating expenses	**(11,307,350)**	**(9,583,116)**
Operating profit	**1,252,638**	**1,325,575**
Financial revenue	790,093	977,780
Financial expenses	(837,980)	(1,285,954)
Share in profit of companies accounted for using the equity method	49,604	140,367
Profit before tax	**1,254,355**	**1,157,768**
Income tax	(206,839)	(218,880)
Profit before mandatory profit distribution	**1,047,516**	**938,888**
Profit distribution	(166,853)	(145,775)
Profit from continuing operations	**880,663**	**793,113**
Discontinued operations		
Profit for the current financial year on discontinued operations	-	-
Profit for the year	**880,663**	**793,113**
Attributable to:		
Shareholders of the Parent Company	879,749	793,061
Minority interests	914	52
	880,663	793,113

Consolidated Balance Sheets
at 31 December 2005 and 31 December 2004

	31 December 2005	31 December 2004
	(PLN thousand)	
ASSETS		
Non-current assets		
Property, plant and equipment	17,524,429	22,649,791
Investment property	10,553	11,279
Intangible assets	952,698	831,637
Investments in associates	512,076	462,645
Financial assets available for sale	21,358	17,956
Other financial assets	4,107,585	1,371
Deferred tax asset	384,504	462,032
Other non-current assets	17,248	13,891
Total non-current assets	23,530,451	24,450,602
Current assets		
Inventories	815,345	602,989
Trade and other receivables	2,618,350	1 912,925
Income tax receivables	30,883	31,775
Deferred costs	17,501	13,684
Financial assets held for trading	30,391	268,325
Derivative financial instruments	120,273	232,620
Cash and cash equivalents	3,200,471	906,598
Total current assets	6,833,214	3,968,916
Total assets	30,363,665	28,419,518
EQUITY AND LIABILITIES		
Equity		
Share capital	5,900,000	5,000,000
Hedging and translation reserves	(14,086)	(11,993)
Nominal share premium	1,740,093	-
Other capital reserves	2,624,841	2,393,165
Retained earnings	10,509,489	10,359,289
Equity attributable to equity holders of the Parent Company	20,760,337	17,740,461
Minority interest	7,243	6,312
Total equity	20,767,580	17,746,773
Non-current liabilities		
Loans, borrowings and debt securities	2,369,082	322,891
Provisions	981,493	954,873
Deferred income	1,151,115	1,129,231
Provision for deferred tax	2,123,233	2,304,771
Total non-current liabilities	6,624,923	4,711,766
Current liabilities		
Trade and other payables	2,108,806	1,271,265
Loans, borrowings and debt securities	89,218	4,057,003
Derivative financial instruments	173,177	238,193
Current tax liabilities	75,201	4,214
Provisions	426,315	304,823
Deferred income	98,445	85,481
Total current liabilities	2,971,162	5,960,979
Total liabilities	9,596,085	10,672,745
Total liabilities and equity	30,363,665	28,419,518

Consolidated cash flow statements
as at 31 December 2005 and 31 December 2004

	31 December 2005	31 December 2004
	(PLN thousand)	
Operating activities		
Profit for the year	880,663	793,113
Adjustments for:		
Share in profit of associates	(49,604)	(140,367)
Depreciation	1,401,855	1 530,771
Net foreign exchange gain/loss	(283,991)	(566,153)
Net interest and dividends	87,349	412,134
Profit/loss on investing activities	283,959	310,642
Income tax for the year	206,839	218,880
Income tax paid	(239,687)	(290,386)
Other items (net)	(198,440)	631,630
Net cash flow from operating activities before movements in working capital	**2,088,943**	**2 900,264**
Movements in working capital:		
Increase (decrease) in receivables	(537,231)	108,299
Increase (decrease) in inventories	(217,014)	(54,022)
Increase (decrease) in reserves	132,259	73,586
Increase (decrease) is receivables	917,875	(33,308)
Increase (decrease) in deferred costs	(147,882)	(4,282)
Increase (decrease) in deferred icome	162,101	(35,584)
Net cash flow from operating activities	**2,399,051**	**2 954,953**
Investing activities		
Proceeds on disposal of property, plant and equipment and intangible assets	19,376	10,046
Proceeds on disposal of shares in non-consolidated entities	2,570	1,589
Proceeds on disposal of short-term securities	231,638	-
Purchases of property, plant and equipment and intangible assets	(1,320,664)	(1,274,406)
Purchases of shares in non-consolidated entities	(1,698)	-
Purchases of short-term securities	-	(22,077)
Interest received	165,122	21,545
Dividends received	1,506	1,202
Other items (net)	169,897	(18,114)
Net cash used in investing activities	**(732,253)**	**(1,280,215)**
Financing activities		
Proceeds on issue of shares and other capital instruments and additional capital payments	2,640,093	-
New bank loans raised	2,305,445	29,819
Loans and borrowings repaid	(1,164,818)	(741,457)
Proceeds on issue of debt securities	-	-
Debt securities redeemed	(2,799,327)	-
Repayment of obligations under financial lease	(50,757)	(13,562)
Proceeds on futures transactions	277,504	292,900
Expenses related to futures transactions	(281,289)	(576,260)
Dividends paid	(150,572)	(207,533)
Interest paid	(104,578)	(247,497)
Other items (net)	(44,817)	(9,086)
Net cash from financing activities	**626,884**	**(1,472,676)**
Net increase (decrease) in cash and cash equivalents	**2,293,682**	**202,062**
Net effect of foreign exchange rate changes	191	(4,614)
Cash and cash equivalents at the beginning of the year	**911,407**	**709,345**
Cash and cash equivalents at the end of the year	**3,205,089**	**911,407**

Consolidated statement of changes in equity
at 31 December 2005 and 31 December 2004

	Equity (attributable to equity holders of the parent)						Minority interests	Total equity
	Share capital	Hedging and translation reserves	Nominal share premium	Other capital reserves	Retained earnings	Total		
	(PLN thousand)							
Balance at 1 January 2004	5,000,000	(1,517)	-	2,137,252	9,827,579	16,963,314	6,328	16,969,642
Exchange differences arising on translation of foreign operations	-	(10,476)	-	-	-	(10,476)	-	(10,476)
New subsidiary included in consolidation	-	-	-	-	-	-	-	-
Share of minority interest in profit appropriation	-	-	-	-	(1)	(1)	(68)	(69)
Dividend payment to the shareholder	-	-	-	-	(5,437)	(5,437)	-	(5,437)
Transfers			-	255,913	(255,913)	-		-
Net profit for 2004	-	-	-	-	793,061	793,061	52	793,113
Balance at 31 December 2004	5,000,000	(11,993)	-	2,393,165	10,359,289	17,740,461	6,312	17 746,773
Balance at 1 January 2005	5,000,000	(11,993)	-	2,393,165	10,359,289	17,740,461	6,312	17 746,773
Issue of share capital	900,000	-	-	-	-	900,000	-	900,000
Premium from share sale above nominal value	-	-	1,740,093	-	-	1,740,093	-	1 740,093
Exchange differences arising on translation of foreign operations	-	(2,093)	-	-	-	(2,093)	-	(2,093)
Share of minority interest in profit appropriation	-	-	-	-	(1)	(1)	(63)	(64)
Reduction of interest in associate – share of minority interest	-	-	-	-	-	-	80	80
Increase of share capital by minority interest holders in associate	-	-	-	(42)	83	41	-	41
Subsidiary excluded from consolidation	-	-	-	(332)	2,593	2,261	-	2 261
Dividend received from affiliated Company accounted for using the equity method	-	-	-	-	(174)	(174)	-	(174)
Dividend payment to the shareholder	-	-	-	-	(500,000)	(500,000)	-	(500,000)
Transfers	-	-	-	232,050	(232,050)	-	-	-
Net profit for 2005	-	-	-	-	879,749	879,749	914	880,663
Balance at 31 December 2005	5,900,000	(14,086)	1,740,093	2,624,841	10,509,489	20,760,337	7,243	20,767,580

1. GENERAL INFORMATION

Polskie Górnictwo Naftowe i Gazownictwo SA (PGNiG, the Company or the Parent Company) is the Parent Company of PGNiG Group (PGNiG Group or the Group) having its registered office in Poland, 00-537 Warszawa, ul. Krucza 6/14. On 23 September 2005, as a result of the offering of new share issue on the Warsaw Stock Exchange, PGNiG, formerly a joint-stock company with the State Treasury as a single shareholder, became a public Company.

The principal activities of the Company cover exploration and production of oil and gas, gas imports, and transmission and distribution of gas.

2. BASIS FOR PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (EU) at 31 December 2005. As of 1 January 2005, pursuant to the amended Accounting Act, in connection with the request for admission to public trading and the consent of the Securities and Exchanges Commission of 24 May 2005 to the admission of the shares of PGNiG to public trading, the Group has been obliged to prepare its consolidated financial statements in accordance with IFRS. With respect to the statutory separate financial statements, the Company applies the valuation principles set out in the Accounting Act of 29 September 1994 (Journal of Laws No. 76, item 694 of 17 June 2002) (the Act). In accordance with IFS 1 *Presentation of Financial Statements*, IFRS consist of the International Financial Reporting Standards (IFRSs), the International Financial Reporting Standards (IASs) and the Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC). The International Financial Reporting Standards Board issued the International Financial Reporting Standard No. 1 (IFRS 1) *First-time Adoption of International Financial Reporting Standards*, which applies to preparation of financial statements for periods starting on or after 1 January 2004. Apart from first-time adopters, IFRS 1 concerns also the entities, such as PGNiG Group, that applied IFRSs but their financial statements contained qualification with respect to conformity with some IFRSs. Therefore, IFRS 1 requires that the entity recognises in the IFRS financial statements all assets and liabilities that have to be disclosed under IFRS. According to IFRS 1, tangible assets may be measured at their fair value at the opening IFRS balance sheet date and such fair value becomes the “deemed” cost of such asset at that date.

3. STATEMENT OF CONFORMITY

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and in accordance with the relevant IFRSs adopted by the EU. IFRSs incorporate the standards and interpretations approved by the International Financial Reporting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC).

4. BASIS OF CONSOLIDATION

The consolidated financial statements incorporate the financial statements of the Parent Company and entities controlled by the Parent Company (or its subsidiaries) prepared as at 31 December of each financial year. Control is achieved where the Parent Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

At the date of acquisition, the assets and liabilities of the acquired entity are measured at their cost. Any excess of the purchase cost over the fair value of the acquired identifiable net assets of the entity is recognised as goodwill. In case when the purchase cost is lower than the fair value of the acquired identifiable net assets of the entity, the difference is recognised as a profit in the income statement for the period. The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets and equity. In subsequent periods, losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the equity interests of the Parent Company.

Where necessary, adjustments are made to the financial statements of subsidiaries or affiliated companies to bring their accounting policies into line with those used by the Parent Company.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

The financial results of subsidiaries acquired or disposed of during the year are included in the consolidated financial statements from the effective date of acquisition or up to the effective date of disposal, as appropriate.

In case of loss of control over a subsidiary, the consolidated financial statements include the results for the appropriate part of the year when the Parent Company exercised such control.

The minority interests in 2005 included a part of the shares in BSiPG Gazoprojekt S.A., BN Naftomontaż Sp. z o.o., and Naft-Stal Sp. z o.o., which were not held by the Group. In 2004, the minority interests included a part of the shares in BSiPG Gazoprojekt S.A., Naft-Trans Sp. z o.o. and Naft-Stal Sp. z o.o, which were not held by the Group.

List of subsidiary companies included in the consolidated financial statements

Entity name	Country		Share in equity
		31 December 2005	31 December 2004
Subsidiary companies			
GEOFIZYKA Kraków Sp. z o.o.	Poland	100.00%	100.00%
GEOFIZYKA Toruń Sp. z o.o.	Poland	100.00%	100.00%
PNiG Jasło Sp. z o.o.	Poland	100.00%	100.00%
PNiG Kraków Sp. z o.o.	Poland	100.00%	100.00%
PNiG Piła Sp. z o.o.	Poland	100.00%	100.00%
ZRG Krosno Sp. z o.o.[1]	Poland	100.00%	-
Dolnośląska Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Górnośląska Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Karpacka Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Mazowiecka Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Pomorska Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Wielkopolska Spółka Gazownictwa Sp. z o.o.	Poland	100.00%	100.00%
Gazobudowa Zabrze Sp. z o.o.	Poland	100.00%	100.00%
Naftomontaż Krosno Sp. z o.o.	Poland	88.83%	100.00%
Naftomet Krosno Sp. z o.o.	Poland	100.00%	100.00%
Diament Sp. z o.o.	Poland	100.00%	100.00%
Gazoprojekt S.A.	Poland	75.00%	75.00%
PGNiG Finance B.V.	Netherlands	100.00%	100.00%
Geovita Sp. z o.o. Warszawa	Poland	100.00%	100.00%
OGP Gaz-System Sp. z o.o. [2] (formerly PGNiG-Przesył Sp. z o. o. Warszawa)	Poland	-	100.00%
Subsidiaries of Naftomontaż Krosno Sp. z o. o.			
Naft-Trans Krosno Sp. z o.o. in bankruptcy[3]	Poland	-	99.70%
Naft-Stal Krosno Sp. z o.o.[4]	Poland	59.88%	98.50%

[1] Company established following to transformation of a branch of PGNiG (OZRG Krosno) Operates since 1 July 2005.
[2] Company transferred free of charge for the benefit of the State Treasury on 13 May 2005.
[3] Company disposed of on 31 August 2005.
[4] Indirect share at the end of 2005, held through Naftomontaż Krosno Sp. z o.o. (88.83% shareholding of PGNiG), which has 67.42% share in Naft-Stal Krosno Sp. z o.o.

Other subsidiaries are not consolidated due to their minor significance for the financial statements of the Group.

5. INVESTMENTS IN ASSOCIATES

An associate is an entity over which the Group has significant influence by participating in the financial and operating policy decisions but does not exercise the control or participate in a joint venture. The financial interests of the Group in its associates are measured using the equity method, except when the investment has been classified as held for sale (see below). Investments in associates are carried at cost adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate are not recognised.

Any excess of the cost of acquisition over the net fair value of the identifiable assets of the associate at the date of acquisition is recognised as goodwill. In case when the cost of acquisition is lower than the net fair value of the identifiable assets of the associate at the date of acquisition, the difference is recognised in the income statement for the period.

Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the Group's interest in the relevant associate. The balance-sheet dates of the associates and the Group are aligned and both entities apply consistent accounting principles. Where necessary, adjustments are made to the financial statements of the associates to bring their accounting policies into line with those used by the Parent Company. Losses incurred by an associate may indicate an impairment of its assets, as a result of which the appropriate impairment loss has to be recognised.

Valuation of associates using the equity method

	31 December 2005	31 December 2004
SGT EuRoPol Gaz S.A.		
Share of PGNiG Group in the associate's equity*	49.74%	49,74%
Principal activity	Gas transmission	Gas transmission
Valuation of shares using the equity method	1,106,603	928,341
Cost of acquisition	38,400	38,400
Share in changes of equity	1,145,003	966,741
Impairment loss	(651,203)	(521,941)
Carrying value of the investment	493,800	444,800

	31 December 2005	31 December 2004
GAS-TRADING S.A.		
Share of PGNiG Group in the associate's equity	43.41%	43.41%
Principal activity	Trading	Trading
Valuation of shares using the equity method	16,985	16,554
Cost of acquisition	1,291	1,291
Share in changes of equity	18,276	17,845
Impairment loss	-	-
Carrying value of the investment	18,276	17,845

	31 December 2005	31 December 2004
INVESTGAS S.A.		
Share of PGNiG Group in the associate's equity	49.00%	49.00%
Principal activity	Investments related to UGS facilities	Investments related to UGS facilities
Valuation of shares using the equity method	-	-
Cost of acquisition	245	245
Share in changes of equity	245	245
Impairment loss	(245)	(245)
Carrying value of the investment	-	-

Total carrying value of investments	512,076	462,645

* 48% held directly and 1.74% indirectly through Gas-Trading S.A.

The Parent Company estimated its share in the equity of SGT EuRoPol Gaz S.A. based on the equity value resulting from the financial statements of SGT EuRoPol Gaz S.A. as at 31 December 2005, adjusted for the differences in the accounting principles used in the Group and the results on intra-group transactions. The differences in accounting principles concerned recognition of interest expense in the net asset value. The Group applies the benchmark treatment in disclosing the borrowing costs (IAS 23) where the initial asset value does not include the borrowing costs. Subsequently, the Management tested the value of the shares in SGT EuRoPol Gaz S.A. for impairment using the discounted cash flow method and relying on the figures provided in the financial plan of SGT EuRoPol Gaz S.A. for years 2006–2019. The discounted cash flows include all cash flows generated by SGT EuRoPol Gaz S.A., including those related to the service of external sources of financing (interest expense and repayment of the principal under loans and borrowings). As at 31 December 2005, using the equity method, the Parent Company assessed the value of its share in the equity of the co-subsidiary at around EUR 291,958.53 thousand.

The results of the impairment tests vary significantly, depending on the adopted assumptions.

The assumptions taken in valuation of the shares are, due to reasons that are beyond control of the Company, subject to a high degree of uncertainty, driven mainly by substantial variations of foreign exchange rates and the tariff policy.

Considering the above, the Management of the Parent Company decided to recognise an impairment loss of around EUR 166,046.96 thousand to adjust the value of the investment in SGT EuRoPol Gaz S.A.

6. INTERESTS IN JOINTLY CONTROLLED ENTITIES

The Group reports its interests in jointly controlled entities using proportionate consolidation where the proportional share of the assets, liabilities, income and expenses of jointly controlled entities are combined with the equivalent items in the consolidated financial statements on a line-by-line basis.

7. TRANSLATION OF ITEMS IN FOREIGN CURRENCIES

The functional (valuation) currency and the presentation currency for both PGNiG and its subsidiaries is Polish zloty (PLN). Transactions in foreign currencies are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Exchange differences are included in profit or loss for the period, except for exchange differences arising on retranslation of the items of foreign entities. Such gains or losses are recognised directly in equity until disposal of the shares in such entities. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated at the exchange rate prevailing on the original transaction date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined.

In order to hedge its exposure to certain foreign exchange risks, the Parent Company enters into forward contracts and options (see below for details of the Group's accounting policies in respect of such derivative financial instruments).

The functional currencies of the foreign branch (Operating Branch in Pakistan) and the foreign subsidiary (PGNiG Finance BV) are, respectively, Pakistani rupee and EUR. At the balance sheet date, the assets and liabilities of these foreign entities are translated to the presentation currency of PGNiG at the rates prevailing on the balance sheet date, and their profits and losses are translated at the weighted average exchange rates for the year. Exchange differences arising on such retranslation are recognised directly in the equity as a separate component. Upon disposal of a foreign entity, the accumulated deferred exchange gains or losses recognised in the equity and attributable to such foreign entity are included in profit or loss.

8. PROPERTY, PLANT AND EQUIPMENT

In conformity with the requirements under IFRS 1, the entity has assessed the fair value of property, plant and equipment as at the date of adoption of IFRSs and recognised this value as their deemed cost as at that date. The change in value resulting from the revaluation of property, plant and equipment has been recognised under retained profits/losses.

Property, plant and equipment are stated in the balance sheet at their revaluated amounts less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed whenever there is any indication that those assets have suffered an impairment loss.

A decrease in carrying amount arising on the revaluation of assets is charged to profit or loss to the extent that it exceeds the balance, if any, held in the capital reserve relating to a previous revaluation of that asset.

Depreciation on revaluated assets is charged to profit or loss. Properties in the course of construction for production, rental or administrative purposes, or for purposes not yet determined, are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Depreciation of these assets commences when the assets are ready for their intended use, on the same basis as for other assets of the Company. Depreciation is charged for all assets, other than land and properties under construction, over their estimated useful lives, using the straight-line method and the following annual depreciation rates:

Buildings	- 2.5-20%
Machines, equipment, vehicles and other	- 3.33-50%

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Property, plant and equipment

	31 December 2005	31 December 2004
Land	102,852	144,654
Buildings	13,769,416	18,373,341
Technical equipment and machines	2,182,381	2,555,181
Vehicles and other	894,141	999,714
Assets under construction	575,639	576,901
Total	**17,524,429**	**22,649,791**

Balance at 31 December 2005	Land	Buildings	Technical equipment and machines	Vehicles and other	Total
Balance at 1 January 2005, after amortisation	144,654	18,373,341	2,555,181	999,714	**22,072,890**
Additions	23,670	240,904	83,074	45,597	**393,245**
Disposals	(65,824)	(4,807,249)	(437,845)	(96,665)	**(5,407,583)**
Transfers from assets under construction and between asset classes	1,447	798,961	255,986	78,795	**1,135,189**
Impairment loss	10	110,142	18,803	1,278	**130,233**
Depreciation for the year*	(1,105)	(946,683)	(292,818)	(134,578)	**(1,375,184)**
Balance at 31 December 2005, after accumulated depreciation	**102,852**	**13,769,416**	**2,182,381**	**894,141**	**16,948,790**
Balance at 1 January 2005					
Gross carrying amount	145,641	20,276,875	2,887,051	1,152,921	**24,462,488**
Accumulated depreciation and impairment loss	(987)	(1,903,534)	(331,870)	(153,207)	**(2,389,598)**
Net carrying amount	**144,654**	**18,373,341**	**2,555,181**	**999,714**	**22,072,890**
Balance at 31 December 2005					
Gross carrying amount	104,988	16,187,424	2,742,612	1,162,705	**20,197,729**
Accumulated depreciation and impairment loss	(2,136)	(2,418,008)	(560,231)	268,564)	**(3,248,939)**
Net carrying amount	**102,852**	**13,769,416**	**2,182,381**	**894,141**	**16,948,790**

* Depreciation figure in the table of movements excludes depreciation of Gaz - System Sp. z o.o. for the first four months of the year. Depreciation was charged to profit and loss for the year

Balance at 31 December 2004	Land	Buildings	Technical equipment and machines	Vehicles and other	Total
Balance at 1 January 2004, after amortisation	143,544	18,736,329	2,620,175	1,053,003	22,553,051
Additions	1,388	245,519	66,083	48,209	361,199
Disposals	(2,784)	(280,496)	(68,756)	(46,518)	(398,554)
Transfers from assets under construction and between asset classes	3,492	751,939	216,832	79,319	1,051,582
Impairment loss	-	11,620	8,531	853	21,004
Depreciation for the year	(986)	(1,091,570)	(287,684)	(135,152)	(1,515,392)
Balance at 31 December 2004, after accumulated depreciation	144,654	18,373,341	2,555,181	999,714	22,072,890
Balance at 1 January 2004					
Gross carrying amount	143,544	19,592,967	2,680,649	1,073,464	23,490,624
Accumulated depreciation and impairment loss	-	(856,638)	(60,474)	(20,461)	(937,573)
Net carrying amount	143,544	18,736,329	2,620,175	1,053,003	22,553,051
Balance at 31 December 2004					
Gross carrying amount	145,641	20,276,875	2,887,051	1,152,922	24,462,489
Accumulated depreciation and impairment loss	(987)	(1,903,534)	(331,870)	(153,208)	(2,389,599)
Net carrying amount	144,654	18,373,341	2,555,181	999,714	22,072,890

9. BORROWING COSTS

The borrowing costs are recognised in profit or loss when they are incurred in accordance with the benchmark treatment under IAS 23.

10. INVESTMENT PROPERTY

Investment property is the property held to earn rental income and/or for capital appreciation.

Investment property is initially stated at cost including the transaction costs. All investment property is carried in accordance with the requirements set out in IAS 16 for this model, i.e. at cost less accumulated depreciation and impairment. Investment property items are removed from the balance sheet on disposal or when it is withdrawn from use and no future economic benefits are expected from its disposal. The gain or loss arising on withdrawal of an investment property from the balance sheet is recognised in the income statement for the year of withdrawal.

Investment property

	31 December 2005	31 December 2004
Balance at the beginning of the year, after amortization	11,279	12,909
Additions	-	-
Disposals	(459)	(1,227)
Transfers from property, plant and equipment	21	134
Impairment loss	261	-
Depreciation for the year	(549)	(537)
Balance at the end of the year, after accumulated depreciation	**10,553**	**11,279**
Balance at the beginning of the year		
Gross carrying amount	12,080	13,174
Accumulated depreciation and impairment loss	(801)	(265)
Net carrying amount	**11,279**	**12,909**
Balance at the beginning of the year		
Gross carrying amount	11,650	12,080
Accumulated depreciation and impairment loss	(1,097)	(801)
Net carrying amount	**10,553**	**11,279**

11. GOODWILL

Goodwill arising on consolidation represents the excess of the cost of acquisition over the interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary or jointly controlled entity recognised at the date of acquisition.

Goodwill is recognised as an asset and is tested for impairment at least once a year. The potential impairment is recognised directly in the income statement and is not reversed in subsequent periods.

On disposal of a subsidiary or a jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

12. INTANGIBLE ASSETS

Intangible assets are recognised if there is the probability of future economic benefits that can be attributed directly to such assets.

Acquired externally and generated internally

Intangible assets purchased in a separate transaction are recognised at cost.

After initial recognition at the purchase cost, intangible assets are disclosed at a revaluated amount based on the fair value at the valuation date less accumulated amortisation and impairment losses.

A decrease in carrying amount arising on the revaluation of intangible assets is charged to profit or loss to the extent that it exceeds the balance, if any, held in the capital reserve relating to a previous revaluation of that asset.

Amortisation on revaluated intangible assets is charged to profit or loss. Intangible assets are amortised using the straight-line method over their estimated useful lives. The amortisation rates are reviewed at least annually, and the adjustments to the amortisation charges, if any, are made in subsequent periods. The typical useful lives applied for intangible assets are:

Acquired concessions, licenses, patent rights and similar assets	– 2–10 years
Purchased computer software	– 2–5 years

The perpetual land usufruct rights acquired free of charge or for a consideration are recognised as operating lease. Perpetual land usufruct rights acquired for a consideration are disclosed as intangible asset and amortised over their useful lives (leasing term). Perpetual land usufruct rights acquired free of charge, i.e. by virtue of an administrative decision, are treated as operating lease and are not disclosed in intangible assets nor amortised. They are only measured at fair value as an off-balance-sheet item.

Intangible assets with an indefinite useful lives are not amortised.

Intangible assets with finite lives and intangible assets that are not yet in use are regularly (annually) assessed for impairment.

Other intangible assets are assessed for impairment when the circumstances indicate that the carrying value of such assets might not be recoverable.

If the indications of impairment exist, and the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset, or the cash-generating unit that holds such asset, is reduced to its recoverable amount. Recoverable amount is the higher of fair value less costs to sell and value in use.

Research and development expenditure

Research expenditure is not capitalised and is recognised in the income statement as an expense in the period in which it is incurred.

Development expenditure is capitalised only when:
- an identifiable project is implemented (such as software or new processes),
- it is probable that the asset created will generate future economic benefits,
- the cost of the project can be measured reliably.

Development expenditures are amortised on a straight-line basis over their estimated useful lives. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Exploration and evaluation expenditure

Expenditures on exploration for and evaluation of oil and gas in the pre-production phase are recognised based on the geological success method. The cost of exploration and evaluation is recognised as intangible asset until determination of commercial feasibility of the well.

If, as a result of further exploration work, the site proves commercially unviable, the expenditures on exploration and evaluation are charged to profit or loss in the period when it is incurred. Once the asset is ready for use, the underlying expenditure has been already measured, usually as a part of the carrying value of a production well, and starts to be depreciated. The useful live of boreholes is assessed by the Management at each balance sheet date.

Exploration and evaluation expenditure is assessed for potential impairment if the asset is not yet ready for use, or when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount.

Expenditure related to geophysical and seismic work is recognised in profit or loss for the period in which it is incurred.

Intangible assets

Balance at 31 December 2005	Research and development expenditure	Goodwill	Exploration and evaluation expenditure	Other intangible assets	Total
Balance at 1 January 2005, after amortisation	285	-	764,959	66,393	831,637
Increase during the year	834	-	306,976	6,664	314,474
Decrease during the year	-	-	(54,726)	(4,196)	(58,922)
Transfers from assets under construction and between asset classes	- -	-	(117,511) (23,552)	30,355 27	(87,156) (23,525)
Impairment loss	(275)	-	-	(23,535)	(23,810)
Amortisation for the year	844	-	876,146	75,708	952,698
Balance at 31 December 2005, after accumulated amortisation		-			
	428		932,143	81,386	1,013,957
Balance at 1 January 2005	(143)		(167,184)	(14,993)	(182,320)
Gross carrying amount	285	-	764,959	66,393	831,637
Accumulated amortisation and impairment loss		-			
Net carrying amount		-			
	1 262		1,066,882	111,561	1,179,705
Balance at 31 December 2005	(418)		(190,736)	(35,853)	(227,007)
Gross carrying amount	844	-	876,146	75,708	952,698
Accumulated amortisation and impairment loss		-			
Net carrying amount		-			

Balance at 31 December 2004	Research and development expenditure	Goodwill	Exploration and evaluation expenditure	Other intangible assets	Total
Balance at 1 January 2004, after amortisation	428	-	739,550	50,712	790,690
Increase during the year	-	-	284,831	1,467	286,298
Decrease during the year	-	-	(59,953)	(267)	(60,220)
Transfers from assets under construction and between asset classes	- -	-	(81,282) (118,187)	29,180 -	(52,102) (118,187)
Impairment loss	(143)	-	-	(14,699)	(14,842)
Amortisation for the year	285	-	764,959	66,393	831,637
Balance at 31 December 2004, after accumulated amortisation		-			
	428		788,547	51,115	840,090
Balance at 1 January 2004	-		(48,997)	(403)	(49,400)
Gross carrying amount	428	-	739,550	50,712	790,690
Accumulated amortisation and impairment loss		-			
Net carrying amount		-			
	428		932,143	81,386	1,013,957
Balance at 31 December 2004	(143)		(167,184)	(14,993)	(182,320)
Gross carrying amount	285	-	764,959	66,393	831,637
Accumulated amortisation and impairment loss		-			
Net carrying amount		-			

13. LEASES

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.
Revenue from operating leases is recognised on a straight-line basis over the term of the relevant lease.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a a constant rate of interest on the remaining balance of the liability. Finance charges are charged to profit or loss. Amounts payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term and recognised in the income statement.

Obligations under operating leases

	31 December 2005	31 December 2004
Payable within one year	3,268	2,012
In the second to fifth years inclusive	6,517	1,690
After the fifth year	-	-
Total	9,785	3,702

Obligations under finance leases (disclosed in liabilities)

Payable within:	Future value	Finance charges	Discounted value
	31 December 2005		
one year	31,788	4,213	27,576
two years	25,886	2,681	23,205
three years	20,282	1,047	19,235
four years	4,811	288	4,523
five years	2,223	19	2,204
after the fifth year	-	-	-
Total	84,990	8,248	76,743

Payable within:	Future value	Finance charges	Discounted value
	31 December 2004		
one year	21,201	5,455	15,746
two years	43,648	9,578	34,070
three years	7,233	7	7,225
four years	2,749	-	2,749
five years	-	-	-
after the fifth year	-	-	-
Total	74,831	15,040	59,790

14. INVESTMENTS

When contract terms provide for delivery of financial assets within the specific timeframe established by the market concerned, investments in financial assets are recognised and derecognised on a trade date basis.

All investments are initially measured at cost adjusted for the transaction costs. Investments are classified as "held for trading" or "available for sale" and are measured at fair value as at the balance sheet date. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in profit or loss for the period. For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the profit or loss for the period.

Investments with fixed or predictable payments and fixed maturities are classified as "held-to-maturity securities", provided that the Group has the expressed intention and ability to hold them to maturity

Long-term investments held to maturity are measured at amortised cost using the effective interest rate method. The amortised cost takes into account the discount or premium received upon purchase and spread over the holding period until maturity. Gains or losses on investments measured at amortised cost are recognised in the income statement as they are amortised during the period, and upon removal of the investments from the balance sheet or determination of their impairment.

Investments available for sale

	31 December 2005	31 December 2004
Non-listed equity securities (gross carrying amount)	69,802	63,907
Listed equity securities (gross carrying amount)	-	536
Total gross carrying amount	**69,802**	**64,443**
Non-listed equity securities (net carrying amount)*	21,358	17,420
Listed equity securities (net carrying amount)*	-	536
Total net carrying amount	**21,358**	**17,956**

*Less allowance for impairment

Investments held for trading

	31 December 2005	31 December 2004
Non-listed equity securities (gross carrying amount)	11,201	27,105
Listed equity securities (gross carrying amount)	-	-
Short-term deposit (gross carrying amount)	-	11,065
Participation units in investment funds (gross carrying amount)	16,000	-
Treasury bills (gross carrying amount)	12,802	254,221
Total gross carrying amount	**40,003**	**292,391**
Non-listed equity securities (net carrying amount)*	1,589	3,039
Listed equity securities (net carrying amount)*	-	-
Short-term deposit (net carrying amount)	-	11,065
Participation units in investment funds (net carrying amount)	16,000	-
Treasury bills (net carrying amount)	12,802	254,221
Net gross carrying amount	**30,391**	**268,325**

*Less allowance for impairment

Other investments

	31 December 2005	31 December 2004
Finance lease receivables	4,106,207	-
Loans granted	12,990	-
Receivables from disposal of non-current assets	308	401
Receivables due under guarantees and securities	509	711
Long-term deposits	177	14
Other	434	316
Total gross carrying amount	4,120,625	1,442
Allowance for impairment	(13,040)	(71)
Total net carrying amount	4,107,585	1,371

15. NON-CURRENT ASSETS HELD FOR SALE

Non-current assets (or disposal groups) that are classified as held for sale are measured at the lower of carrying amount or fair value less costs to sell.

Non-current assets or disposal groups are classified as held for sale when their carrying amount is more likely to be recovered through sale rather than their continued use. This condition is deemed to be met only when the sale is highly probable, and the asset (or disposal group) is available for immediate sale. Classification of an asset as held for sale implies the commitment of the management to sell within one year of the classification change.

16. INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Inventories of raw materials disclosed in the balance sheet comprise gas and other raw materials. Gas inventory is measured at the weighted average cost of imports, the actual cost of gas production from indigenous sources and the cost of nitrogen removal. The cost of imported gas is based on the exchange rate applied in the SAD document.

Net realisable value represents the estimated selling price achived in the normal course of business less all costs of completion and the costs incurred in making the inventories available for sale or finding the customer (i.e. cost of selling, marketing, etc.)

Inventories

	31 December 2005	31 December 2004
Raw materials		
At cost	809,753	579,296
At net realisable amount	783,827	575,796
Semi-finished goods and work in progress		
At cost	24,908	21,010
At net realisable amount	24,800	20,968
Finished products		
At cost	5,440	4,984
At net realisable amount	5,357	4,679
Goods		
At cost	1,619	1,763
At net realisable amount	1,361	1,546
Total inventories at the lower of: the original cost and the net realisable amount	815,345	602,989

17. TRADE AND OTHER RECEIVABLES

Trade receivables are recognised at the originally invoiced amount less the allowances for irrecoverable amounts. Receivables are adjusted based on the degree of probability that they will be paid.

Allowances for receivables due for gas deliveries to small consumers with low gas consumption, charged in accordance with tariff groups 1-4, are computed on statistical basis. The allowances are determined based on the analysis of historic data of receivables collection for one year period. The collection ratios are calculated and then applied the determine the allowance in accordance with the age structure of receivables. Receivables that are outstanding for more than 365 days and all accrued interest are subject to 100% allowance for irrecoverable amounts.

Allowances for gas deliveries to customers falling to tariff groups 5-7 are recognised for receivables outstanding for more than 90 days. The allowances are computed on case by case basis, based on the knowledge of the financial situation of the debtors.

Allowances for irrecoverable amounts are recognised either as other operating expenses or financial expenses, depending on the type of receivable. Irrecoverable receivables are recognised as losses when classified as irrecoverable.

Writing off or amortisation of receivables due to limitation or irrecoverability results in reduction of the previously recognised allowances for such receivables.

Receivables amortised or written off due to limitation or irrecoverability, for which no or insufficient allowances were made are recognised, as appropriate, under other operating expenses or financial expenses.

Trade and other receivables

	31 December 2005	31 December 2004
Trade receivables	2,537,965	2,559,702
Intra-group trade receivables	44,705	43,065
Tax, custom duties and social insurance receivables	327,150	97,250
Amounts receivable under overpayment of mandatory profit distribution to the shareholder	47,890	35,362
Loan amount due for settlement	254,057	275,089
Receivables from associates accounted for using equity method	3,950	2,899
Receivables under financial lease	262,200	-
Other amounts receivable from affiliated entities	86,538	23,396
Other receivables	187,105	157,150
Total gross receivables	3,751,560	3,193,913
Allowance for doubtful debt	(1,133,210)	(1,280,988)
Total net receivables	2,618,350	1,912,925
of which:		
Trade receivables	1,870,083	1,650,784
Intra-group trade receivables	1,868	3,571
Tax, custom duties and social insurance receivables	326,277	96,776
Amounts receivable under overpayment of mandatory profit distribution to the shareholder	47,890	35,362
Loan amount due for settlement	-	5,076
Receivables from associates accounted for using equity method	3,931	2,899
Receivables under financial lease	262,200	-
Other amounts receivable from affiliated entities	2,933	20,799
Other receivables	103,168	97,658

Trade receivables are mainly related to sales of gas and distribution services.

Allowances for irrecoverable amounts

	31 December 2005	31 December 2004
Impairment allowance, opening balance	(1,280,988)	(1,272,274)
Allowance created	(167,365)	(233,898)
Allowance dissolved	210,319	199,495
Allowance used	91,635	29,299
Transfers between current and non-current portion	13,189	(3,610)
Impairment allowance, closing balance	(1,133,210)	(1,280,988)

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents disclosed in the balance sheet comprise cash at bank and on hand, and other short-term highly liquid investments with original maturity up to three months that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Balance of cash and cash equivalents in the consolidated cash flow statement includes the above items less outstanding bank overdrafts.

Cash and cash equivalents

	31 December 2005	31 December 2004
Cash on hand and at bank	197,357	165,632
Bank deposits	996,921	548,597
Short-term highly liquid investments*	1 998,290	184,957
Other cash equivalents**	7,903	7,412
Total	3,200,471	906,598

* Includes bills (commercial, treasury, National Bank of Poland, etc.), deposit certificates with maturity of less than 3 months.
** Includes cash in transfer and third-party cheques and promissory notes with maturity of less than 3 months.

Companies of PGNiG Group keep cash deposits at reputable Polish and international banks, and therefore the concentration of risk related to cash deposits is limited.

19. IMPAIRMENT

At each balance sheet date the Group reviews its assets to look for any indication that an asset may be impaired. If there is such indication, the asset's recoverable amount is estimated in order to determine the potential allowance for impairment. When an asset does not generate cash inflows that are largely independent of the cash inflows from other assets, the review is carried out for a group of assets such asset belongs to.

For intangible assets with indefinite useful lives the impairment test is run annually and, in addition, whenever there is any indication that the asset may be impaired.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. The later value corresponds to the present value of estimated future cash flows discounted using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount is lower than the carrying value of an asset (or a group of assets) the carrying value is reduced to the recoverable value. The impairment loss is recognised as cost in the period when it occurred, except when the asset was stated at revaluated amount (in such case the impairment is treated as reduction of the earlier revaluation).

When impairment is reversed, the carrying value of an asset (or a group of assets) is increased up to the new assessed recoverable amount, which, however, must not be more than what the depreciated historical cost would have been if the impairment had not been recognised. Reversal of an impairment loss is recognised as income in the income statement.

20. EQUITY

Equity is disclosed by type and in accordance with the principles set out in the legal regulations and the articles of association of the Parent Company.

Share capital is recognised at nominal value as stated in the articles of association of the Parent Company and an extract from the commercial register.

Equity contributions declared but unpaid are recognised as called-up share capital. Own shares and called-up share capital reduce the equity of the Parent Company. Nominal share premium resulting from share issue above the nominal value is recognised in the amount corresponding to the excess of the share issue price over the nominal value less the cost of such issue.

Cost of share issue incurred upon incorporation or share capital increase is charged to the share premium up to the amount of the excess of the issue value over the nominal share value, and the remainder is charged to other capital reserves.

Amounts arising on revaluation and any changes in revaluated non-current tangible and intangible assets are recognised in retained earnings/losses.

Amounts arising on profit distribution, undistributed earnings from previous years and the result for the current year are disclosed in the financial statements as retained earnings.

Equity

	31 December 2005	31 December 2004
Total shares (thousand)	5,900,000	5,000,000
Nominal value on one share PLN	1	1
Total equity	5,900,000	5,000,000

21. BANK LOANS AND BORROWINGS

Interest-bearing bank loans are measured at the amount equal to the proceeds less direct cost of raising the funds. Subsequently, interest-bearing loans and borrowings are measured at amortised cost, using the effective interest rate method. The amortised cost takes into account the cost related to raising the loan or borrowing and the discounts or premiums arising upon settlement.

Gains and losses are recognised in the income statement upon removal of the liability from the balance sheet or impairment recognition, also as a result of depreciation.

Loans and borrowings

	31 December 2005	31 December 2004
Non-current	2,369,082	322,891
Current	89,218	4,057,003
Total	2,458,300	4,379,894

22. PROVISIONS

Provisions are recognised whenever there is an obligation (legal or constructive) resulting from past events that can be estimated reliably, which in the future is likely to result in an outflow of assets generating economic benefits from the Company. The amount of provisions is reviewed at each balance sheet date in order to adjust them to the level of the current projection. Where the effect of the time value of money is material, the provision is discounted to the present value of the expected where expenditure required to settle the present obligation where the discount rate corresponds to the estimated risk-free rate. If the discounting method was used, increase in the provision over time is recognised as external finance cost.

Provisions

	Jubilee awards and retirement benefits	Provision for gas allowances	Special funds	Provision for redundancy benefits	Provision for well abandon-ment costs	Provision for antitrust penalty	Other	Total
Balance at 31 December 2004	309,335	112,424	102,454	14,466	538,632	52,656	129,729	1,259,696
Provisions created during the year	30,306	39,404	61,728	14,274	114,018	7,450	177,349	444,529
Provisions used	(41,950)	(49,145)	(61,781)	(3,019)	(80,372)	(8)	(60,142)	(296,417)
								-
Balance at 31 December 2005	297,691	102,683	102,401	25,721	572,278	60,098	246,936	1,407,808
Non-current at 31 December 2005	249,381	78,354	25,764	15,219	537,530	-	75,245	981,493
Current at 31 December 2005	48,310	24,329	76,637	10,502	34,748	60,098	171,691	426,315
	297,691	102,683	102,401	25,721	572,278	60,098	246,936	1,407,808
Non-current at 31 December 2004	265,319	88,366	17,005	5,848	493,037	-	85,298	954,873
Current at 31 December 2004	44,016	24,058	85,449	8,618	45,595	52,656	44,431	304,823
	309,335	112,424	102,454	14,466	538,632	52,656	129,729	1,259,696

Provision for jubilee awards and retirement benefits

The Group entities operate defined plans for payment of jubilee awards and retirement benefits. The payments are charged to profit or loss in such a manner as to spread the cost of jubilee awards and retirement benefits over the entire term of employment in the respective entity. The cost of the above benefits is determined using actuarial valuation of the projected individual entitlements.

Provision for gas allowance paid to former employees

The Company has the obligation to pay gas allowance for personnel employed until the end of 1995. The payment scheme will remain in force until 2010 and thereafter the Company will stop paying the allowances. The provision for allowance payments is determined based on the principles of actuarial valuation applied in valuation of the provision for jubilee awards and retirement benefits. Allowance payments are recognised as an expense in the income statement.

Special funds

The Company Social Benefits Fund is made of discretionary profit distributions and mandatory contributions. Mandatory contributions are determined by the employer in accordance with a formula defined in the law, which is takes into account the number of employees and the minimum monthly salary in Poland. The Social Benefits Fund may be used exclusively for employee benefits.
The Mine Decommissioning Fund has been established pursuant to the Act of 27 July 2001 amending the Geological and Mining Law. The contributions to the fund and made correspondence with other operating expenses.

Provision for redundancy benefits

The Group entities create a provision for redundancy benefits paid to the employees laid off under the employment restructuring program. The provision is calculated based on the expected reduction of the employment level and the amount of one-time redundancy benefit. The provision for restructuring costs is recognised only once the Group announced a specific formal restructuring plan to all interested parties.

Provision for well abandonment costs

The Company creates a provision for future well abandonment costs. Initial value of the provision increases the value of the corresponding asset. Subsequent adjustments to the provisions resulting from changes in the estimates are also treated as an adjustment to the asset value.
The provision for well abandonment costs is calculated based on the average well abandonment cost in the respective production facilities over the last three years, adjusted for the projected consumer price index and time value of money. The reference period of tree years is taken due to varying number of abandoned boreholes and the underlying abandonment cost in each year.

Provision for penalty of the Office of Competition and Consumer Protection (OCCP)

The provision for the penalty imposed on PGNiG by the President of OCCP is the largest item in this provision class. According to OCCP, PGNiG abused its dominant position by delaying issuance of the technical conditions for the connection of the existing boiler plant owned by the Municipality in Wysokie Mazowieckie to the existing metering station. The Company appealed against the decision of the President of OCCP to the District Court in Warsaw, the Competition and Consumer Protection Court, claiming that the decision was issued in breach of substantive law and procedure regulations and based on erroneous consideration of evidence, and requested its reversal or change.

Other provisions

The Group entities create also other provisions for future probable expenses related to their commercial activities.

23. DEFERRED COSTS AND INCOME

The Group entities recognise deferred costs when they concern expenses relating to future reporting periods. They are presented in the balance sheet as a separate asset item.

Deferred costs

	31 December 2005	31 December 2004
Property insurance	3,094	3,140
Contribution to Company Social Benefits Fund	2,997	112
Property tax	2,393	-
Mining usufruct fees	143	2,421
Materials spread over time	599	1,309
Subscriptions	524	906
Valuation of long-term contracts	3,216	2,015
Other costs spread over time	4,535	3,781
Total	17,501	13,684

Accrued expenses are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (e.g. accrued annual leave compensation). Accrued expenses are recognised in the balance sheet together with trade and other payables.

The Group entities recognise deferred income in order to credit such income to subsequent reporting periods at the time when such income will be realised.

Under deferred income, the Parent Company and the Gas Distribution Companies report the value of gas infrastructure received free of charge (since 1998) and the connection fee. The corresponding income is realised along with depreciation charges applied in respect of such connection lines. Deferred income is disclosed as a separate liability item in the balance sheet.

Przychody przyszłych okresów

	31 December 2005	31 December 2004
Non-current		
Non-depreciated amount of gas service lines financed by customers	754,612	826,777
Connection fee	325,487	299,356
Deferred income from leased assets	65,565	-
Other	5,451	3,098
Total non-current	1,151,115	1,129,231
Current		
Non-depreciated amount of gas service lines	59,462	66,247
financed by customers Connection fee	15,002	14,088
Deferred income from leased assets	4,253	-
Other	19,728	5,146
Total current	98,445	85,481

24. TRADE AND OTHER PAYABLES

Trade and other payables are liabilities to pay for goods or services that have been received or supplied and have been paid, invoiced or formally agreed with the supplier.

Other payables principally comprise liabilities arising in the course of current operations of the Group entities, i.e. salaries and other current employee benefits, as well as accrued expenses and public and legal obligations.

Trade and other payables

	31 December 2005	31 December 2004
Trade payables	807,088	580,162
Trade payables to affiliated entities	11,779	23,132
Tax, custom duties and social insurance payable	810,454	403,324
Mandatory profit distribution payable to the shareholder	28,800	1
Salaries payable	28,511	37,699
Amounts payable for unused annual leave entitlements	16,473	19,860
Amounts payable to associates accounted for using the equity method	54,680	58,263
Amounts payable to other affiliated entities	104 885	17,455
Accrued expenses and prepayments for deliveries	4,571	11,024
Other	241,565	120,345
Total	2,108,806	1,271,265

25. SALES REVENUE

Revenue is measured at the amount corresponding to the probable economic benefits associated with the transaction that will flow to the Group, and when the amount of revenue can be measured reliably. In addition, other criteria apply to revenue recognition.

Sale of goods and products

Revenue from sale is measured at the fair value of the consideration received or receivable and represents amounts receivable for products, goods and services provided in the normal course of business, net of discounts, value-added tax and other sales related taxes (excise tax). Sales of goods are recognised when goods are delivered and title has passed.

Rendering of services

For revenue arising from the rendering of services, revenue is recognised by reference to the stage of completion at the balance sheet date. When the rendering of services consists in an undefined number of actions to be performed over a specific time period, the revenue is recognised on a straight-line basis (spread) over such time period. When a specific performance is more significant than the others, recognition of the revenue is postponed until completion of such performance. In case when the outcome of the transaction with regard to rendering of services cannot be measured reliably, revenue arising from the transaction is recognised only to the extent of the expenses recognised that are recoverable.

Rental revenue

Revenue from rental of investment property is recognised in accordance with the terms of the rental agreements.

	31 December 2005	31 December 2004
High-methane gas	9,933,581	8,877,671
Low-methane gas	921,399	787,440
Crude oil	783,622	596,453
Helium	34,443	37,069
Propane butane gas	36,885	30,588
Gasoline	13,881	10,555
Decompressed gas	9,771	1,436
Geophysical and geological services	223,184	115,025
Exploration services	213,062	198,264
Construction and assembly production	26,464	16,143
Engineering design services	16,580	11,220
Hotel services	31,203	28,114
Other services	280,516	162,897
Other products	14,874	13,002
Goods and materials	20,523	22,814
Total	12,559,988	10,908,691

Interest

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

Dividends

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Financial revenue

	31 December 2005	31 December 2004
Financial revenue	790,093	977,780
Income from forward and swap option valuation	277,504	298,186
Interest income	270,906	83,630
Foreign exchange gains	158,890	577,198
Discount of well abandonment provision	3,602	-
Investment revaluation	60,715	7,596
Gain on disposal of investments	-	3,614
Other financial revenue	18,476	7,556

26. CONSTRUCTION CONTRACTS

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. The stage of completion is measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable.

Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

27. GOVERNMENT GRANTS

Government grants towards staff re-training costs are recognised as income over the periods necessary to match them with the related costs.

Government grants related to assets are presented in the balance sheet as deferred income, and subsequently charged to profit or loss in equal annual amounts spread over the expected useful life of the assets.

28. INCOME TAX

Mandatory charges represent the sum of the tax (CIT) currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The tax liability is calculated using tax rates applicable in the tax year.

Deferred tax is accounted for using the balance sheet liability method as tax payable or reimbursable in the future on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Provision for deferred tax liability is created for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Provision for deferred tax liability is recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the asset realised or the liability becomes due. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity. In such case the deferred tax is also dealt with in equity.

PGNiG Group is not a tax group within the meaning of Polish regulations. Each entity of the Group is a separate tax payer.

	31 December 2005	31 December 2004
Profit before taxation	1,254,355	1,157,768
Tax rate applicable in the year	19%	19%
Tax at applicable rate	(238,327)	(219,976)
Differences between profit before taxation and taxable profit	31,488	1,096
Current income tax	(311,566)	(183,868)
Effective tax rate	16%	19%
Deferred tax	104,727	(35,012)
Tax rate used for deferred tax calculation	19%	19%
Tax expense reported in the consolidated income statement	(206,839)	(218,880)

Deferred tax assets

	31 December 2005	31 December 2004
Provisions for retiree allowances	19,510	21,361
Provisions for severance payments and jubilee awards	52,242	56,021
Provision for redundancy benefits	4,262	2,751
Provision for unused annual leave entitlements	3,945	4,333
Provision for well abandonment	105,177	102,340
Revaluation of non-current assets	59,036	57,814
Revaluation of shares	10,698	12,827
Revaluation of interest on loans	0	5,790
Revaluation of interest on receivables	730	27,739
Valuation of forward transactions	32,904	45,257
Expenses related to foreign exchange and interest rate hedging transactions	3,924	10,781
Foreign exchange losses	4,854	59,326
Interest on loans and payables	1,617	1,645
Connection fee	28,210	21,495
Unpaid salaries including social insurance premiums	13,977	0
Tax loss	8,842	5,528
Other	34,576	27,024
Total	384,504	462,032

Provision for deferred tax liabilities

	31 December 2005	31 December 2004
Foreign exchange gains	8,880	40,823
Interest accrued	803	33,548
Valuation of financial instruments	22,852	44,198
Income from tax liability arising in the following month	72,397	66,123
Tax depreciation in excess of accounting depreciation	20,723	11,889
Income from finance lease	8,275	-
Provision for accrued interest on received loan	-	8,937
Revaluation of non-current assets	1,985,850	2,098,253
Other	3,453	1,000
Total	2,123,233	2,304,771

29. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The Group's activities expose it primarily to the financial risks of changes in foreign exchange rates and interest rates. In order to hedge its exposure to these risks, the Group enters uses derivative financial instruments such as swaps, foreign currency forward contracts, and options, foreign currency option strategies and cross currency interest rate swaps. They are used to hedge the risk associated with foreign currency fluctuations relating to certain assets, commitments and forecasted transactions.

Derivative financial instruments of this kind are measured at fair value.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity. The ineffective portion of the changes in the fair value of derivative financial instruments that are designated as hedges of future cash flows is recognised immediately in profit or loss.

If the cash flow hedge (relating to a firm commitment or forecasted transaction) results in the recognition of an asset or a liability, then, at the time the asset or liability is initially recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in profit or loss in the same period in which the hedged item affects profit or loss.

When the fair value is effectively hedged, the hedged item is adjusted for changes in the fair value associated with the hedged risk and recognised in profit or loss. Gains and losses arising on revaluation of a derivative instrument or revaluation of other currency components of the balance sheet are recognised in profit or loss.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in profit or loss as they arise.

Hedging instruments used by the Company do not meet the criteria for application of specific hedge accounting policies. Therefore, gains and losses arising from changes in fair value of derivative financial instruments are recognised in profit or loss for the year.

Fair value of foreign currency forward transactions is calculated based on the exchange rate forecasted at the balance sheet for forward transactions with similar maturity profile.

Fair value of interest rate swaps is measured based on discounted cash flows until the expiry date of the transaction.

Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when the risks and characteristics of the embedded instrument are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised gains or losses reported in profit or loss.

30. INFORMATION ON BUSINESS SEGMENTS

The principal classification into business segments is based on industry segment. The Group operates in four segments:

- production – supply of natural gas, oil, geophysical and exploration services. This segment covers the entire process of oil and gas production, starting from geophysical surveys preceding exploration until extraction and preparation of the product for sale,
- trade, storage and transmission – purchasing of gas, its storage and transmission through the transmission network system and sale of gas,
- distribution – purchasing, sale and delivery of gas to end consumers, mainly individual ones,
- other – delivery of engineering design services, manufacturing of machines for gas appliances and facilities and the upstream industry.

Segment assets include all operating assets used by the segment, which include principally cash, receivables, inventories, non-current assets adjusted for depreciation and amortisation. While majority of assets can be directly allocated to individual segments, assets used by two or more segments are allocated to individual segments to the extent they are used by the respective segments.

Segment liabilities comprise all operating liabilities, principally trade liabilities, tax and salary liabilities, both payable and accrued, and all provisions for liabilities that are attributable to the segment.

Both assets and liabilities of the segment exclude deferred tax. Intra-segment transactions are eliminated.

All inter-segment transactions are based on prices set internally.

Revenue, profit and selected assets and liabilities by industry segment of the Group for the years ended 31 December 2005 and 31 December 2004 are presented in the following tables.

FINANCIAL PERFORMANCE

Year ended 31 December 2005	Production	Trade and storage	Distribution	Other	Elimination	Total
Income statement						
External sales	1,630,297	3,405,000	7,432,826	91,865	-	12,559,988
Intra-segment sales	952,363	5,316,520	22,311	173,084	(6,464,278)	-
Total segment revenue	2,582,660	8,721,520	7,455,137	264,949	(6,464,278)	12,559,988
Depreciation and amortisation	(450,616)	(290,610)	(649,276)	(11,353)	-	(1,401,855)
Other expenses	(1,376,171)	(8,044,889)	(6,672,670)	(258,633)	6,446,868	(9,905,495)
Total segment expenses	(1,826,787)	(8,335,499)	(7,321,946)	(269,986)	6,446,868	(11,307,350)
Operating profit by segment	755,873	386,021	133,191	(5,037)	(17,410)	1,252,638
Income tax						(47,887)
Profit disbursement		49,604				49,604
Profit before tax						1,254,355
Income tax						(206,839)
Profit from discontinued operation						-
Profit disbursement						(166,853)
Profit for the year						880,663
Balance sheet						
Segment assets	7,584,199	11,650,318	11,241,439	247,919	(1,400,088)	29,323,787
Investments in associates		512,076				512,076
Unallocated assets						143,298
Deferred tax assets						384,504
Total assets						30,363,665
Total equity						20,767,580
Segment liabilities	1,308,303	2,254,774	2,454,086	97,210	(1,343,901)	4,770,472
Unallocated liabilities						2,702,380
Deferred tax provision						2,123,233
Total equity and liabilities						30,363,665
Other segment information						
Capital expenditures	(220,246)	(513,296)	(580,453)	(6,669)		(1,320,664)
Depreciation, amortisation and impairment write-downs for the segment	(319,556)	(1,851,614)	(467,629)	(3,371)		(2,642,170)
Depreciation, amortisation and impairment write-downs for unallocated assets						(58,056)

Year ended 31 December 2004	Production	Trade and storage	Distribution	Other	Elimination	Total
Income statement						
External sales	1,208,473	2,918,138	6,706,820	75,260	-	10,908,691
Intra-segment sales	842,152	4,658,844	38,945	159,641	(5,699,582)	-
Total segment revenue	2,050,625	7,576,982	6,745,765	234,901	(5,699,582)	10,908,691
Depreciation and amortisation	(437,402)	(441,880)	(639,881)	(11,608)	-	(1,530,771)
Other expenses	(1,242,814)	(6,283,179)	(5,962,250)	(243,055)	5,678,953	(8,052,345)
Total segment expenses	(1,680,216)	(6,725,059)	(6,602,131)	(254,663)	5,678,953	(9,583,116)
Operating profit by segment	370,409	851,923	143,634	(19,762)	(20,629)	1,325,575
Income tax						(308,174)
Profit disbursement		140,367				140,367
Profit before tax						1,157,768
Income tax						(218,880)
Profit disbursement						-
						(145,775)
Profit for the year						
						793,113
Balance sheet						
Segment assets						
Investments in associates	7,539,543	9,673,121	10,951,268	237,489	(1,160,195)	27,241,226
Unallocated assets		462,645				462,645
Deferred tax assets						253,615
						462,032
Total assets						
						28,419,518
Total equity						
Segment liabilities						17,746,773
Unallocated liabilities	1,099,977	1,142,835	2,221,840	88,186	(1,160,195)	3,392,643
Deferred tax provision						4,975,331
						2,304,771
Total equity and liabilities						
						28,419,518
Other segment information						
Capital expenditures						
Depreciation, amortisation and impairment write-downs for the segment	(351,330)	(468,129)	(451,471)	(3,476)		(1,274,406)
Depreciation, amortisation and impairment	(342,018)	(1,832,285)	(446,552)	(3,534)		(2,624,389)
write-downs for unallocated assets						(68,077)

The Group operates predominantly in the domestic market. Revenues from sales of exported products, goods and materials account for 5.8% of the total net revenue from sales of products, goods and materials. Operations of the Group entities within Poland are not characterised by any material regional diversification in terms of risk and level of returns on capital investments. Accordingly, the Group only presents data breakdown into industry segments.

31. OTHER EXPENSES

Employee benefits

	31 December 2005	31 December 2004
Salaries	(1,245,006)	(1,223,950)
Social insurance and other benefits	(400,844)	(389,057)
Total	(1,645,850)	(1,613,007)

Other net operating expenses

	31 December 2005	31 December 2004
Change in provisions (net)	(89,270)	(72,868)
Change in depreciation, amortisation and impairment write-downs (net)	17,811	(195,944)
Taxes and charges	(407,178)	(396,212)
Interest on non-financial items (net)	103,898	66,476
Exchange differences on non-financial items (net)	(34,818)	29,521
Value of goods and materials sold	(26,129)	(54,626)
Other income from previously recognised deferred income	91,753	118,958
Loss on disposal of non-financial assets	(125,423)	(139,660)
Difference arising on valuation of assets transferred as dividend	48,759	-
Other expenses (net)	(125,853)	(92,091)
Total	(546,450)	(736,446)

Finance costs

	31 December 2005	31 December 2004
Finance costs	(837,980)	(1,285,954)
Cost of forward and swap transactions	(396,237)	(936,272)
Interest expense	(336,596)	(295,953)
Foreign exchange losses	-	-
Discount of well abandonment provision	-	(16,216)
Investment revaluation	(60,357)	(14,506)
Loss on disposal of investments	(13,756)	-
Commissions on loans	(20,189)	(8,970)
Other finance costs	(10,845)	(14,037)

32. DISCONTINUED OPERATIONS

In compliance with EU legislation, as of 7 July 2005 PGNiG discontinued its operation in respect of gas transmission by high-pressure gas pipelines. In accordance with the provisions of the Governmental Restructuring and Privatisation Programme for PGNiG, this activity was taken over by OGP Gaz–System Sp. z o.o., a company that is currently under direct control of the State Treasury.

As a result of transmission unbundling, PGNiG transferred transmission assets worth PLN 5 billion to OGP Gaz–System Sp. z o.o. (including PLN 500 million as non-cash divided payable to the Ministry of State Treasury and PLN 4,500 million under finance lease).

The unbundling of the transmission activity had a major impact on the structure of financial results of PGNiG. As of 8 July 2005, OGP Gaz–System Sp. z o.o. became the provider of the transmission service while PGNiG started generating revenue under the lease of a part of the transmission assets.
To sum up, following to the unbundling of the transmission activity, PGNiG stopped disclosing the related margin in the sales result for the second half of 2005. Instead, it was replaced by other operating revenue achieved from the lease of a part of the transmission assets. Based on the historic actual figures for the first half of 2005, the estimated impact of the unbundling of the transmission activity is as follows:

No.	Item	For the period from 1 January 2005 until 30 June 2005 in PLN million	For the period from 1 January 2004 until 31 December 2004 in PLN million
1.	Forfeited revenue from transmission tariffs	(842)	(1,562)
2.	Estimated reduction in operating expenses (excluding depreciation)	264	556
	Result I	**(578)**	**(1,006)**
3.	Accounting reduction of depreciation	153	300
	Result II	**(425)**	**(706)**
4.	Estimated revenue from lease payments in the period	272	578
	Result III	**(153)**	**(128)**

In the first half of 2005, PGNiG generated PLN 842 million of revenue from the unbundled activity (gas transmission tariffs), against PLN 1,562 million in the preceding year (1).

The operating expenses associated with the transmission activity in the first half of 2005 (both direct and allocated) totalled PLN 565 million, and PLN 1,092 million in 2004.

It should be noted, however, that the scope of the transmission service under those tariffs also comprised gas storage. Given that the storage infrastructure and activity remained within PGNiG, it is now a standalone service offered under separate tariffs.

The revenue from transmission tariffs, as presented above, covered also the cost of gas transport service through the transit pipeline operated by SGT EuRoPol Gaz S.A. (Yamal pipeline) in the territory of Poland. PGNiG will remain the buyer of this service. As a result of transmission unbundling, PGNiG forfeited the revenue from this activity while the expenses, which used to be allocated to it, were only partly transferred to OGP Gaz-System Sp. z o.o.

Out of the total expenses allocated to the transmission activity in the first half of 2005, the expense categories that have been transferred (excluding depreciation) are estimated at approx. PLN 264 million in the first half of 2005 and, respectively, around PLN 556 million in the preceding year. (2).

Depreciation of the transmission assets (excluding depreciation of the storage infrastructure) has been considered as a separate item. The depreciation for the first half of 2005 was PLN 153 million, against PLN 300 million in the preceding year (3). In accordance with IFRS classification of leases, despite that PGNiG remains the formal owner of the majority of transmission assets and continues to disclose their depreciation for tax purposes, the carrying value and depreciation of the assets are recognised in the financial statements of OGP Gaz–System Sp. z o.o., the entity that is the actual user of these assets under the lease. From the formal perspective, as a result of the unbundling of the transmission activity, the expense of PGNiG, as disclosed in the financial statements, will be reduced by the depreciation of the transmission assets.

The revenue forfeited due to the unbundling of the transmission activity will also be offset by the proceeds from the lease of the majority of transmission assets, which will continue to be owned (by the end of the lease term) by PGNiG. Under the current interest rate conditions, the lease payments for the first year of the lease amount to PLN 578 million, and for the first six months of the lease – PLN 272 million (4).

It should be noted that the above calculation does not take into account the additional revenue to be generated by PGNiG to recover the cost of storage and purchase of transmission service through the transit system operated by SGT EuRoPol Gaz S.A., which used to be recovered from the transmission tariff. The underlying expenses in the first half of 2005 amounted to PLN 150 million, and PLN 249 million in 2004. Appropriate charges necessary to recover these expenses have been incorporated in Tariff no. 4/2006 of PGNiG.

33. EARNINGS PER SHARE

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the Parent Entity by the weighted average number of ordinary shares outstanding during the reporting year.

Diluted earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders (after deducting interest on redeemable privileged shares convertible to ordinary shares) by the weighted average number of ordinary shares outstanding during the reporting year (adjusted for the effects of dilutive options and other dilutive redeemable privileged shares convertible to ordinary shares).

	31 December 2005	31 December 2004
Profit for the year attributable to equity holders of the parent	879,749	793,061
Profit for the year attributable to equity holders of the parent for the purposes of diluted earnings per share	879,749	793,061
Weighted average number of ordinary shares for the purposes of basic earnings per share (thousand)	5,258,904	5,000,000
Weighted average number of ordinary shares for the purposes of diluted earnings per share (thousand)	5,258,904	5,000,000
Basic earnings per share attributable to common equity holders of the parent	0.17	0.16
Diluted earnings per share attributable to common equity holders of the parent	0.17	0.16

Weighted average number of shares was calculated as follows:

Staring date	Ending date	Ordinary shares outstanding	Days	Weighed average number of shares
31 December 2005				
2004.12.31	2005-09-17	5,000,000	260	3,561,644
2005.09.17	2005-12-31	5,900,000	105	1,697,260
Total			365	5,258,904
31 December 2004				
2003.12.31	2004-12-31	5,000,000	365	5,000,000
Total				5,000,000

Dividends paid and declared

	31 December 2005	31 December 2004
Dividends paid during the year		
Declared dividend per share in PLN	0.10	0.00*
Number of shares (thousand)**	5,000,000	5,000,000
Declared dividend in PLN thousand	500,000	5,437

* Dividend for 2003 paid in 2004 was below PLN 0.01 per share
** Number of shares eligible to dividend for years 2004 and 2003 paid, respectively, in 2004 and 2005.

34. CONTINGENT LIABILITIES

Off-balance-sheet items comprise primarily commitments under guarantees and sureties given, for the total amount of PLN 5,734.7 million, of which 98% per cent is constituted by:

- contingent liabilities related to bank guarantees given by the Gas Distribution Companies to PGNiG, for total amount of PLN 4,824.8 million.
- contingent liabilities related to bank guarantees issued on request of PGNiG for the amount of PLN 803.2 million; the beneficiary of the guarantee is Gazexport Ltd.

The liabilities concern joint and several guarantee given by all six Gas Distribution Companies to secure repayment of the syndicated loan obtained by PGNiG under the agreement signed on 27 July 2005 between PGNiG and Bank Handlowy w Warszawie S.A., Bank Polska Kasa Opieki S.A., Caylon S.A., Fortis Bankiem N. V., Powszechna Kasa Oszczędności Bank Polski S.A. and Société Générale S.A. Branch in Poland. In accordance with the syndicated loan agreement, the guarantees given by the companies will expire on 27 January 2012.

35. REMUNERATION OF THE MEMBERS OF THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD OF THE PARENT COMPANY

Remuneration of the members of the Management Board and the Supervisory Board

	31 December 2005	31 December 2004
The Management Board	4,480	3,387
Supervisory Board	1,019	652
Total	5,499	4,039

The table presents the total remuneration including additional benefits and bonuses, as well as the compensation for functions held in subsidiary entities.

36. JOINT VENTURES

Following to the withdrawal, as of 31 January 2005, of Apache Poland Sp. z o.o. from the Joint Operating Agreement concerning Block 255 and an assignment of rights, PGNiG acquired additional interests and set out, jointly with FX Energy Poland Sp. z o.o. (81.82% interest) do develop gas and condensate field known as “Wilga” in Block 255, with estimated gas reserves of 194 mmcm.

In 2005, joint activities with FX Energy Poland Sp. z o.o. were continued in the following areas:
- "Płotki" (Joint Operating Agreement dated 12 May 2000, as amended),
- "Poznań" (Joint Operating Agreement dated 1 January 2004).

PGNiG held 51.0% interest in both ventures.

On 26 October 2005, Operating Agreement of Mining Usufruct Holders was signed for "Płotki – PTZ" area (so-called Extended Zaniemyśl Area) where development work is underway in Zaniemyśl natural gas field with extractable reserves of approx. 750 mmcm.

In accordance with the agreement, the respective interests in this undertaking are as follows:
- PGNiG – 51.0%,
- FX Energy Poland Sp. z o.o. – 24.5%,
- CalEnergy Resources Poland Sp. z o.o. – 24.5%.

In 2006 the joint venture activities in all areas are expected to continue.

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Parent Company's business activities expose it primarily to the financial risks, and specifically: of changes in foreign exchange rates and interest rates.
- currency risk,
- interest rate risk,
- commodity risk,
- credit risk.

The Parent Company manages its exposure to different types of risk in order to reduce it to acceptable levels.
To achieve this, the Parent Company uses, inter alia, hedging transactions based on derivative financial instruments.

Currency risk

The non-current portion of financial liabilities of the Parent Company is denominated in EUR, while the trade payables under long-term commercial contracts for gas purchase are denominated in USD and EUR.

The main purpose of the measures used by the Parent Company to hedge against currency risk is to mitigate the exchange rate fluctuations associated with principal and interest payments as well as payments for gas deliveries. To hedge its liabilities, the Parent Company uses primarily forward transactions, options and cross currency swaps with maturities up to 5 years.

Commodity risk

The price risk related to contracts for gas deliveries is significant. The risk is associated the variability of the oil product prices in the commodity markets. In some contracts, the formula used for calculation of the gas price limits the variability by application of weighted average prices for the previous months. In addition, the Energy Law allows the Company to apply for a tariff adjustment in case when the cost of gas sourcing increases during a quarter by more than 5%.

Credit risk

The credit risk resulting from a third party default in fulfilling the terms of a contract in respect of financial instruments of the Parent Company is in principle limited to the potential amounts by which the obligations of such third parties exceed the liabilities of the Parent Company. The policy of the Parent Company is to enter to transactions in respect of financial instruments with multiple entities that demonstrate high credit ratings. Consequently, the Parent Company does not expect to incur any material losses due to credit risk.

Derivative financial instruments

The Parent Company has been applying policies consistent with the International Financial Reporting Standards since 2001. The standards require that all derivative financial instruments be measured at fair value.

When a derivative instrument is a hedging instrument, then, depending on the nature of the hedging instrument, changes in fair value are either offset in changes in fair value of assets or liabilities, or recognised as a separate equity item, as long as the hedged item is not recognised in profit or loss.
The ineffective portion of the derivative instrument is recognised immediately in profit or loss.

In 2005, the Parent Company did not apply specific hedge accounting policies. Therefore, gains and losses arising from changes in fair value of derivative financial instruments and hedging instruments are recognised in profit or loss for the year.

Fair value hedges and cash flow hedges

The Parent Company hedges the fair value and cash flows for some of its credit and commercial obligations denominated in USD and EUR. For this purpose, it enters into derivative transactions with recognised financial institutions, which consist in future currency purchase or an option to make such purchase (options). As a result of the debt restructuring carried out in 2005, the terms of some hedging transactions in respect of credit obligations will have to amended in order to align them with the new debt structure. The Company's intention is to maintain the hedging ratio for its exposure to currency risk at the same level as in 2005.

38. AVERAGE EMPLOYMENT BY PERSONNEL GROUP (PERSONS)

	31 December 2005	31 December 2004
Fully consolidated entities:	29,832	30,252
Blue-collar positions	15,292	15,823
White-collar positions	11,706	11,517
Managerial positions	2,834	2,913
Entities consolidated using the equity method	344	287
Total	30,176	30,539

39. ADJUSTMENTS TO CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH POLISH ACCOUNTING STANDARDS (PAS)

Entities of PGNiG Group keep their accounts in accordance with the provisions of the Accounting Act of 29 September 1994 (Journal of Laws No. 76 of 17 July 2002).

Since the Parent Company is obliged to prepare consolidated financial statements of PGNiG Group in accordance with IFRS, the Company calculates adjustments to translate PAS consolidated financial statements into IFRS consolidated financial statements. Reconciliation of equity upon transition to IFRS and of equity and profit for the comparable period is presented below:

	Notes	31 December 2004	1 January 2004
Equity according to PAS		8,797,869	7,727,909
Revaluation of non-current assets at 01.01.2004	a)	11,043,436	11,405,333
Adjustment to actuarial gains	b)	(3,498)	(3,912)
Deferred tax on IFRS adjustments	c)	(2,097,346)	(2,166,016)
Profit distribution payments to employees	d)	-	-
Minority interest	e)	6,312	6,328
Equity according to IFRS		17,746,773	16,969,642

	Notes	31 December 2004
Profit according to PAS		1,109,512
Revaluation of non-current assets at 01.01.2004	a)	(361,897)
Adjustment to actuarial gains	b)	414
Deferred tax on IFRS adjustments	c)	68,670
Profit distribution payments to employees	d)	(23,638)
Share of minority interest in the profit	e)	52
Profit according to IFRS		793,113

a. Revaluation of non-current assets at 1 January 2004

The adjustment takes into account all changes resulting from application of IAS 38 *Intangible Assets*, IAS 16 *Property, Plant and Equipment*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*.

The adjustment amount comprises mainly the value of asset revaluation carried out by the Company as at 1 January 2004.

According to IFRS 1, the Company prepares its consolidated financial statements in accordance with IFRS for the first time. Therefore, using the solution available under IFRS 1, the Group made a one-time revaluation of non-current assets to fair value at the date of IFRS adoption, based on an assessment by an independent expert. The so-derived fair value has been taken as the basis for depreciation in subsequent periods.

b. Adjustment of actuarial gains
Group entities recognise provisions for jubilee awards and retirement benefits in the amount calculated by an actuary, without taking into account actuarial gains and losses. In accordance with IASs, all costs related to valuation of such provisions should be recognised in the income statement. Accordingly, actuarial gains were recognised in the financial statements and an additional expense in the period.

c. Deferred tax on IFRS adjustments
The method of deferred tax calculation is identical under PAS and IFRS. The need for adjustment for deferred tax is related to other adjustments reconciling PAS and IFRS figures, which affect the temporary differences taken as the basis for calculation of deferred tax.

d. Profit distribution payments to employees
In accordance with accounting policies applied to date, the Group entities have recognised the amounts transferred under the resolution on profit distribution to the Company social benefits fund and the bonus fund as profit distribution. According to IAS, the contributions to the Company social benefits fund and the bonus fund are not considered profit distribution but an expense.
Consequently, all contributions to the Company social benefits fund and the bonus fund are recognised as an expense at the moment when the obligation arises, i.e. upon adoption of the resolution on profit distribution. As a result of this adjustment, the employee benefits expense increased and the profit for the year was reduced.

e. Share of minority interest
According to Polish regulations, minority interest is presented under separate line item of consolidated balance sheet and the share of minority interest in the profit for the year is charged to the profit. Under IAS, minority interest is disclosed under equity and broken down to equity attributable to shareholders of the Parent Company and minority interest, while the profit includes both the profit attributable to the shareholders of the Parent Company and to the minority interest. Therefore, reclassification adjustments were made to presentation of minority interest in the consolidated accounts.

DEFINITIONS AND EXPLANATIONS

Transmission – transportation of gas through transmission networks for delivery to distribution network of end consumers connected to a transmission network.

Distribution – transportation of gas through distribution networks for delivery to consumers.

Transmission network – high-pressure gas network, excluding upstream gas pipelines and dedicated gas pipelines, operated by a transmission network operator.

Distribution network – high-, medium- or low-pressure gas network, excluding upstream gas pipelines and dedicated gas pipelines, operated by a distribution network operator.

Dedicated gas pipeline – a gas pipeline designed for direct delivery of gas to consumer's facilities, circumventing the gas system.

Transmission system operator – an energy company engaged in transmission of gas and responsible for management of network flows within a gas transmission system, as well as for day-to-day and long-term system safety, and the operation, maintenance and repairs of the transmission network, including the necessary expansion of the system and its connections with other gas systems.

Distribution system operator – an energy company engaged in distribution of gas and responsible for management of network flows within a gas distribution system, as well as for day-to-day and long-term system safety, and the operation, maintenance and repairs of the distribution network, including the necessary expansion of the system and its connections with other gas systems

UGS – underground gas storage.

Natural gas volumes in the report are stated after conversion to high-methane natural gas.

1 cm – cubic metre of gas after conversion to high-methane natural gas with calorific value of 39.5 MJ/m^3.

CONTACT INFORMATION

Head Office
00-537 Warszawa, ul. Krucza 6/14
Poland
tel.: +4822 583 5000
tel.: +4822 691 7900
fax: +4822 691 8273

Branch in Sanok
38-500 Sanok, ul. Sienkiewicza 12
Poland
tel.: +4813 465 2100
fax: +4813 463 5555

Branch in Odolanów
63-430 Odolanów, ul. Krotoszyńska 148
Poland
tel.: +4862 736 4441
fax: +4862 736 5989

Branch in Zielona Góra
65-034 Zielona Góra, ul. Bohaterów Westerplatte 15
Poland
tel.: +4868 329 1400
fax: +4868 329 1430

Operating Branch in Pakistan
House No 321, Street 17
Sector E-7, Islamabad
44000, Pakistan
tel.: +9251 265 4591
fax: +9251 265 4594

The Central Measurement and Research Laboratory
01-224 Warszawa, ul. Kasprzaka 25
Poland
tel.: +4822 691 8718
fax: +4822 632 2545

Department of Communication and Investor Relations
01-224 Warszawa, ul. Kasprzaka 25
Poland
tel.: +4822 589 4640
tel.: +4822 691 7955
mobile: +48 609 990212
fax: +4822 589 4643
e-mail: ri@pgnig.pl
www.ri.pgnig.pl