

POLSKIE GÓRNICTWO NAFTOWE I GAZOWNICTWO S.A.



**FINANCIAL STATEMENTS FOR THE PERIOD ENDED
31 December 2005**

WARSAW, 31 March 2006

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SELECTED FINANCIAL DATA TRANSLATED INTO EUR

	in PLN '000		in EUR '000	
	2005	2004	2005	2004
I. Net revenues from sales of products, goods and materials	9 867 803	8 447 521	2 452 178	1 869 665
II. Profit (loss) on operating activities	1 591 980	1 388 736	395 612	307 365
III. Gross profit (loss)	1 551 773	1 118 252	385 620	247 499
IV. Net profit (loss)	1 132 228	746 713	281 583	165 268
V. Net cash flows from operating activities	1 529 577	2 017 183	380 104	446 457
VI. Net cash flows from investment activities	51 170	-488 289	12 716	-108 072
VII. Net cash flows from financial activities	645 766	-1 498 601	160 475	-331 681
VIII. Total net cash flows	2 226 513	30 295	553 295	6 705
IX. Total assets	19 203 888	14 564 654	4 975 358	3 570 643
X Liabilities and provisions for liabilities	7 836 845	6 442 424	2 030 145	1 579 413
XI. Long-term liabilities	2 317 096	304 596	600 315	74 674
XII. Short-term liabilities	1 852 702	5 067 740	479 769	1 242 398
XIII. Equity	11 367 043	8 122 230	2 945 213	1 991 231
XIV. Share capital	5 900 000	5 000 000	1 528 577	1 225 791
XV. Number of shares (average weighted in '000)	5 258 904	5 000 000	5 258 904	5 000 000
XVI. Profit (loss) per ordinary share (in PLN/EUR)	0,22	0,15	0,05	0,03
XVII. Diluted profit (loss) per ordinary share (in PLN/EUR)	0,22	0,15	0,05	0,03
XVIII. Book value per one share (in PLN/EUR)	2,16	1,62	0,56	0,40
XIX. Diluted book value per one share (in PLN/EUR)	2,16	1,62	0,56	0,40
XX. Dividend per one share declared or paid (in PLN/EUR)	0,10	0,00	0,02	0,00

* The dividend on profit for 2003 paid in 2004 amounted to PLN 5,438 thousand, which gives less than 1 grosz per share.

A. INTRODUCTION TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.) with registered office in Warsaw, ul. Krucza 6/14, was established as a result of the transformation of the State Enterprise PGNiG into a joint-stock company wholly owned by the State Treasury based on Article 6 of the Commercialization and Privatization Act of 30 August 1996 (Dz. U. of 2002, No. 171, item 1397 as amended) and Prime Minister's Ordinance on transformation of the enterprise Polskie Górnictwo Naftowe i Gazownictwo with registered office in Warsaw into a joint-stock company wholly owned by the State Treasury (Dz. U. No. 116 from 1996, item 553). Based on the above ordinance on 21 October 1996 a Transformation Deed was made.

The Company was registered in the commercial register kept by the District Court for the capital city of Warsaw, XVI Business Division on 30 October 1996, under number RHB 48382. On 14 November 2001 by the decision of the District Court for the capital city of Warsaw, XIX Business Division of the National Court Register; PGNiG S.A. was entered to the register of entrepreneurs of the National Court Register under number KRS 0000059492. The Company was assigned the statistical number REGON 012216736.

Based on the decision of the Warsaw Stock Exchange of 16 September 2005, A and B series shares and title to shares of B series of PGNiG S.A. were allowed to stock exchange turnover on the main market. The first listing of title to ordinary bearer shares of B series took place during the stock exchange session on 23 September 2005. On 18 October 2005 the Warsaw Stock Exchange took a decision to introduce A and B series shares of PGNiG S.A. to the stock exchange turnover on the main market. The first listing of the above shares took place during the stock exchange session on 20 October 2005.

In accordance with its Articles of Association of PGNiG S.A., the Company fulfils the following tasks aimed at ensuring national energy security:

- 1) continuous natural gas deliveries to customers and maintenance of necessary reserves;
- 2) save exploitation of gas networks;
- 3) balancing gas fuels and controlling the operations and capacity of power units connected to the common gas network;
- 4) gas production activities.

In accordance with the Articles of Association, the Company undertakes production, service and commercial activities within the following scope:

- 1) production of crude oil;
- 2) production of natural gas;
- 3) services related to exploration of crude oil and natural gas fields;
- 4) mining of sulphur-bearing materials;
- 5) other mining, not classified anywhere else;
- 6) manufacturing of crude oil refined products;
- 7) reprocessing of crude oil refined products;
- 8) services related to installation, repair and maintenance of machines for mining and building industry;
- 9) production of electricity;
- 10) transmission of electricity;
- 11) distribution of electricity;
- 12) production of gas fuels;
- 13) distribution of gas fuels through the network;
- 14) production of heat (steam and hot water);
- 15) distribution of heat (water steam and hot water);
- 16) geological and engineering excavations and drillings;
- 17) general line construction works: pipelines, electric energy lines, electrical traction and telecommunication lines;
- 18) construction of central heating and ventilation installations;
- 19) construction of gas installations;
- 20) service and repair of motor vehicles;
- 21) retail sale of fuels;
- 22) wholesale of solid, liquid and gas fuels as well as derivative products;
- 23) wholesale of semi-finished products;
- 24) other specialized wholesale;
- 25) hotels and motels with restaurants;
- 26) hotels and motels without restaurants;
- 27) freight road transport, using specialized vehicles;
- 28) freight road transport using general-purpose vehicles;
- 29) pipeline transport;
- 30) warehousing and storage in other storage facilities;
- 31) travel agency activities;
- 32) fixed line telephony and telegraphy;
- 33) mobile telephony;
- 34) data transmission; information and communication technology;
- 35) radio communications;

- 36) research and development work in technical science;
- 37) geological and exploration activity;
- 38) surveying and map making;
- 39) rental of real property on own account;
- 40) management of residential real property;
- 41) management of non-residential real property;
- 42) purchase and sales of real property on own account;
- 43) activity of non-public libraries;
- 44) archive activity;
- 45) activity of museums;
- 46) technical tests and analyses;
- 47) lease of the Company's assets dedicated to transfer of energy and gas.

2. DURATION OF THE COMPANY

Duration of the Company: unlimited

3. PERIOD COVERED BY THE FINANCIAL STATEMENTS

The financial statements cover the period from 1 January 2005 to 31 December 2005.

4. INFORMATION ABOUT THE COMPOSITION OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD

According to the Company's Articles of Association the Management Board of PGNiG S.A. is composed of two to seven persons. The number of members of the Management Board is determined by the authority appointing the Management Board. Members of the Management Board are appointed for the period of common term of office, which lasts three years. Members of the Management Board or the Management Board itself are appointed by the Supervisory Board. Each member of the Management Board can be dismissed or suspended by the Supervisory Board or the Shareholders' Meeting. As long as the State Treasury is the Company's shareholder and the Company's annual average employment is over 500 employees, the Supervisory Board appoints one person among the Company's staff to become a member of the Management Board for the term of the office.

As of 31 December 2005 the Management Board of PGNiG S.A. was composed of four persons:

- Jan Anysz - Vice Chairman of the Board;
- Marek Foltynowicz - Vice Chairman of the Board;

- Mieczysław Jakiel - Vice Chairman of the Board;
- Franciszek Krok - Vice Chairman of the Board.

however, on 25 November 2005 the Supervisory Board of PGNiG S.A. suspended Mr. Marek Foltynowicz.

The following changes in composition of the Management Board of PGNiG S.A. took place in 2004:

As of 10 January 2005, the Supervisory Board appointed Jan Anysz (elected by employees) to the Management Board of PGNiG S.A.

On 29 April 2005, due to expiration of the mandate, Mr. Jerzy Staniewski – Vice Chairman of the Board was dismissed from the position of member of the Board of PGNiG S.A.

On 25 November 2005 Mr. Marek Kossowski – Chairman of the Board and Mr. Paweł Kamiński – Vice Chairman of the Board resigned from their positions in the Management Board of PGNiG S.A.

Based on the resolution of the Shareholders Meeting of 12 December 2005 on 1 January 2006 Marek Foltynowicz and Mieczysław Jakiel were dismissed from the Management Board.

On 29 November 2005 the Management Board of PGNiG appointed proxies: Mr. Zenon Kuchcik and Mr. Bartłomiej Pawlak.

In 2006 until the moment the financial statements were drawn the following changes in the Company's Management Board took place:

On 17 February 2006 the Supervisory Board of PGNiG appointed the following persons to the Management Board of PGNiG:

- Mr. Stanisław Niedbalec, to the position of Vice Chairman of the Board in charge of Technical and Investment Affairs
- Mr. Bogusław Marzec, to the position of Vice Chairman of the Board in charge of Economic and Financial Affairs

On 3 March 2006 the Supervisory Board of PGNiG dismissed Mr. Franciszek Krok, Vice Chairman of the Board in charge of Trade and Marketing from the Management Board. The position of the Chairman of the Board was entrusted to Mr. Bogusław Marzec, Vice Chairman of the Board in charge of Finance.

Pursuant to the Company's Articles of Association, the Supervisory Board of PGNiG S.A. consists of five to nine members, appointed by the General Meeting of Shareholders for the mutual term of office lasting three years. As long as the State Treasury remains the Company's shareholder, the State Treasury represented by the Minister in charge of

State Treasury affairs, acting in cooperation with the minister in charge of economic affairs, is entitled to appoint and recall one member of the Supervisory Board.

One of members of the Supervisory Board appointed by the Shareholders Meeting should meet the following conditions:

1. has to be elected in line with the procedure referred to in § 36 clause 3 of the Articles of Association of PGNiG S.A.;
2. cannot be the Company's Related Party or subsidiary to the Company;
3. cannot be a Related Party to the holding company or other subsidiary to the holding company, or
4. cannot be a person in any relationship with the Company or any of the entities listed in point 2) and 3), which could significantly affect the ability of such person holding the position of member of the Supervisory Board to pass unbiased decisions.

The relationships referred to above do not apply to membership on the Supervisory Board of PGNiG S.A.

Pursuant to § 36 clause 3 of the By-Laws of PGNiG S.A. Supervisory Board Members, who are to fulfill the conditions stated above, are selected in a separate vote. The right to submit nominations of candidates to the Supervisory Board who must meet the above conditions to the Chairman of the General Shareholders Meeting is reserved for shareholders who are presented at the General Shareholders Meeting, who subject is selecting such a Member. If candidates are not nominated by shareholders, candidates for Supervisory Board Members that must meet the above conditions are nominated by the Supervisory Board.

Two-fifths of Supervisory Board Members are appointed from persons designated by the Company's employees.

As of 31 December 2005, the Supervisory Board consisted of the following eight members:

- Krzysztof Głogowski - 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;
- Andrzej Rościszowski - Member of the Supervisory Board;
- Mirosław Szkałuba - Member of the Supervisory Board;
- Piotr Szwarc - Member of the Supervisory Board.

The following changes took place in the Supervisory Board of PGNiG S.A. in 2005:

On 16 February 2005 Stanisław Speczik resigned as Member of the Supervisory Board. Mr. Speczik resigned as he took up a government position.

On 18 February 2005 the General Shareholders Meeting appointed Zbigniewa Macioszka as Member of the Supervisory Board.

On 25 March 2005 Stanisław Perek and Zbigniew Macioszek were dismissed as Members of the Supervisory Board and the General Shareholders Meeting decided to appoint Bogusław Kasprzyk and Dawid Sukacz in their place.

The Ordinary Shareholders Meeting which took place on 29 April 2005 passed a resolution pursuant to which the following individuals were dismissed from the Supervisory Board: Magdalena Bąkowska, Bogusław Kasprzyk and Dawid Sukacz, while at the same time appointed the above mentioned individuals together with Tadeusz Soroka, Zbigniew Kamieński and Andrzej Arendarski for a new joint three year term.

On 27 October 2005 the General Shareholders Meeting appointed the following individuals nominated by the Company's employees to the Supervisory Board: Kazimierz Chrobak, Mieczysław Kawecki and Mirosław Szałuba.

On 17 October 2005 Bogusław Kasprzyk resigned from the function of Member of the Supervisory Board.

Mieczysław Puławski was appointed to the Supervisory Board on 18 November 2005 in the manner defined in § 36 clause 3 of the By-Laws of PGNiG S.A.

On 12 December 2005 the General Shareholders Meeting dismissed the following individuals from the Supervisory Board: Andrzej Arendarski, Zbigniew Kamieński, Tadeusz Soroka and Dawid Sukacz, while simultaneously appointing: Krzysztof Głogowski, Piotr Szwarc, Andrzej Rościszowski and Wojciech Arkuszewski, however Mr. Arkuszewski's nomination became effective on 1 January 2006.

5. CHANGES IN SHARE CAPITAL

As at 1 January 2005, the Company's share capital was divided into 5,000,000,000 (five billion) registered shares with a face value of PLN 1 (one) each, which were A series shares numbered from A 00.000.000.001 to A 05.000.000.000.

On 30 March 2005 the Extraordinary Shareholders Meeting passed Resolution No. 2 concerning the increase of the share capital of PGNiG S.A. by issuing B series shares, depriving the existing shareholder of privileged rights to shares and the amendment of the Company's By-Laws, which were amended on 16 May 2005 by way of Resolution No. 3 and Resolution No. 5 passed by the Extraordinary Shareholders Meeting. Pursuant to the above-mentioned resolutions passed by the Company's General Shareholders Meetings and the Management Board's representation submitted on 23 September 2005 and foreseen by Article 310 § 2 and § 4 in connection with Article 431 § 7 of the Code of Commercial Companies the increase in the share capital of PGNiG S.A. was registered based on the decision issued by the District Court for Warsaw, XIX Business Division of the National Court Register on 6 October 2005.

At present the Company's share capital is equal PLN 5,900,000,000 (five billion nine hundred million) and is divided into:

- 4,250,000,000 "A" series bearer shares numbered from 00 000 000 001 to 04 250 000 000 with a face value of PLN 1 each and a total face value of PLN 4,250,000,000;
- 750,000,000 "A1" series bearer shares numbered from 0 000 000 001 to 0 750 000 000 with a face value of PLN 1 each and a total face value of PLN 750,000,000;
- 900,000,000 "B" series bearer shares numbered from 0 000 000 001 to 0 900 000 000 with a face value of PLN 1 each and a total face value of PLN 900,000,000;

6. FINANCIAL STATEMENTS CONTAIN AGGREGATED DATA

PGNiG S.A. draws up aggregated financial statements. As of 31 December 2005 PGNiG S.A. consisted of: the Company's Head Office, 10 domestic branches and a foreign branch in Pakistan.

Until 30 June 2005 there was one additional branch - ZRG Krosno, which on 1 July 2005 was contributed in kind into the subsidiary ZRG Krosno Sp. z o.o., in which PGNiG S.A. holds 100% of shares.

The branches prepare internal financial statements.

The aggregated financial statements of PGNiG S.A. were prepared based on the financial statements of the branches of PGNiG S.A. When preparing aggregated financial statements, the following items are excluded:

- separate funds and capitals;
- balances of internal settlements between entities,
- sales and costs between PGNiG S.A. entities.

PGNiG S.A., as a holding company, also prepares consolidated financial statements, which contain the data of 19 direct subsidiaries, 1 co-subsidiary, 2 associated entities and 1 indirect subsidiary.

7. GOING CONCERN ASSUMPTION

The Company's financial statements were prepared assuming that the Company would continue business activities for 12 months after the balance sheet date, i.e. until 31 December 2005. According to the Company's Management Board, on the date of signing the financial statements no facts and circumstances indicated a risk to the going concern of the Company during 12 months after the balance sheet date due to intended or forced discontinuation or material limitation of its activities.

8. BUSINESS COMBINATIONS

No business combinations took place during the financial year.

9. COMPARABILITY OF FINANCIAL DATA FOR THE PREVIOUS PERIOD WITH THE FINANCIAL STATEMENTS FOR THE CURRENT FINANCIAL PERIOD

The financial statements for the period ended 31 December 2004 included the data of 12 domestic branches and one foreign branch in Pakistan. An additional branch - Geovita Warszawa, functioned until the end of the first quarter of 2004 and on 31 March 2004 was contributed in kind into the subsidiary Geovita Sp. z o.o.

On 29 April 2004, PGNiG S.A. made a non-cash contribution in kind, whose value was equal PLN 37,870.0 thousand, of assets separated from six Regional Transmission Branches to the capital of PGNiG – Przesył Sp. z o.o.

The aggregated financial statements of PGNiG S.A. for the current reporting period were prepared based on financial statements of the Head Office, 10 domestic branches and a foreign branch in Pakistan.

10. INFORMATION ON ADJUSTMENTS ARISING FROM QUALIFICATIONS PRESENTED IN OPINIONS OF ENTITIES AUTHORIZED TO AUDIT FINANCIAL STATEMENTS FOR THE YEARS FOR WHICH THE FINANCIAL STATEMENTS AND COMPARABLE INFORMATION ARE PRESENTED

The financial statements for 2004 were audited by Deloitte & Touche Audit Services Sp. z o.o. (currently - Deloitte Audyt Sp. z o.o.). The opinion and report issued by the auditors did not contain any qualifications. Due to the above, there are no respective adjustments in the financial statements for 2005 and comparable financial data for 2004.

11. ACCOUNTING PRINCIPLES (POLICY) APPLIED, INCLUDING THE METHOD OF MEASURING ASSETS AND LIABILITIES (TOGETHER WITH DEPRECIATION), DETERMINING THE FINANCIAL RESULT AND PREPARING THE FINANCIAL STATEMENTS

11.1. Format and basis for preparing the financial statements

The financial statements were prepared in accordance with Polish Accounting Standards (PAS) defined in:

- Accounting Act of 29 September 1994 (consolidated text - Dz.U. from 2002, No. 76 item 694);
- Act of 29 July 2005 on Public Offerings and Conditions of Introducing Financial Instruments into an Organized Trading System and on Public Companies (Dz. U. No. 184, item 1539);
- (Dz. U. No. 209, item 1743);
- Minister of Finance's Ordinance of 19 October 2005 on ongoing and periodic information provided by issuers (Dz. U. No. 209, item 1744).

The financial statements were drawn up in accordance with the historical cost principle, with the exception of the measurement of derivatives, as described in point 11.18 in the introduction to the financial statements.

11.2. Intangible assets

Intangible assets are recognized when they are likely to cause an inflow of economic benefits closely related to those assets. Intangible assets are measured at acquisition price or manufacturing cost less accumulated amortization and permanent impairment write-downs. Intangible assets are amortized using the straight line method, in line with the Accounting Act of 29 September 1994, by regular and scheduled spreading of their value over the expected useful life.

If their gross value is equal or lower than PLN 3,500, the assets are amortized on a one-off basis in the month of commissioning.

The following amortization rates are applied to intangible assets:

Other intangible assets	10,0 – 50,0%
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11.3. Fixed assets

Tangible fixed assets are measured at acquisition price or manufacturing cost after revaluation, less accumulated depreciation. The costs incurred after the date of commissioning, such as maintenance and repair, are charged to the profit and loss account on the date on which they are incurred. Whenever, as a result of incurred expenses, the useful value of the tangible fixed asset after improvement exceeds its useful value upon commissioning, the expenses are capitalized in the asset's value. Financial expenses in the period of delivery are added to the value of tangible fixed assets.

In line with the valid regulations, tangible fixed assets are subject to revaluation using indexes defined by the President of the Central Statistical Office (GUS). Last revaluation of fixed assets was performed on 1 January 1995. The amount arising from revaluation, in connection with the transformation of the enterprise into a joint-stock company, was allocated to share capital and the revaluation reserve.

The Company applies various depreciation methods depending on the intensity with which assets are used, but it assumes that the straight line method is the fundamental depreciation method. If the gross value of fixed assets is equal or lower than PLN 3,500, they are depreciated on a one-off basis in the month of commissioning.

The following depreciation rates are applied to fixed assets:

Perpetual usufruct of land	5.0 – 20.0%
Buildings and structures	2.5 – 10.0%
Technical equipment and machinery	4.5 – 30.0%
Vehicles	14.0 – 20.0%
Other fixed assets	10.0 – 25.0%

Depreciation rates applied for tax purposes are consistent with Attachment no. 1 to the Corporate Income Tax Act of 15 February 1992.

Perpetual usufruct of land acquired free of charge before 1 January 2002, was measured at the amount defined in the decision issued before 1 January 2002 by the authority granting the usufruct. Perpetual usufruct of land acquired after 1 January 2002 is recognized at the amount arising from the decision of the granting authority, determined in the amount of the last annual fee for perpetual usufruct.

The equivalent of the value of perpetual usufruct is simultaneously recorded in accounting records under deferred income. For presentation purposes, the value of recognized perpetual usufruct of land is reduced by respective deferred income.

When creating depreciation charges on the perpetual usufruct, the Company simultaneously recognizes the equivalent amount of deferred income in the profit and loss account.

Cushion gas and gas used for the first filling of the gas pipeline are also classified by the Company as fixed assets.

Tangible fixed assets with expected useful life not exceeding one year are depreciated on a one-off basis and charged to expenses upon commissioning.

11.4. Fixed assets under construction

Fixed assets under construction are measured at the amount of total expenses directly connected with their acquisition or manufacture, including financial expenses, less permanent impairment write-downs. Cushion gas and gas used for the first filling of the gas pipeline are also classified by the Company as fixed assets.

Fixed assets under construction are not depreciated before completion of construction and commissioning.

11.5. Outlays for exploration and appraisal projects

The costs related to geophysical and geoseismic research are recorded in the profit and loss account in the period incurred.

The costs of exploration and appraisal of oil and gas in the pre-production phase are capitalized upon the commencement of work.

If, following further research, the given area proves unsuitable for industrial use, the outlays for exploration and appraisal are charged to the profit and loss account for the given period. The usefulness of explored areas is verified by the Company as at each balance sheet date.

11.6. Long-term investments

11.17.1. Real property investments

The Company does not conduct investment activities aimed at gaining economic benefits from trade or rental of real property.

11.17.2. Investments in controlled entities

Investments in subsidiaries and in associated entities excluded from consolidation are measured at acquisition price less permanent impairment write-downs.

11.17.3. Investments in other entities

Investments in other entities are measured at acquisition price less permanent impairment write-downs.

11.7. Short-term investments

Short-term investments disclosed in the balance sheet include short-term installments on the loan granted to related parties, measurement of financial instruments and cash. The recording principles are presented in principles applicable to respective items.

11.8. Leasing

Leasing is classified as financial leasing, when the terms and conditions of the agreement in principal transfer all potential benefits as well as risk resulting from being the owner onto the lessee. All other forms of leasing are treated as operating lease.

11.17.4. The Company as a Lessor

Accounts receivable for financial leasing are recognized under receivables in the net value of the Company's investment in leasing.

Revenues from financial leasing are recognized in appropriately periods taking into account the fixed rate of return on the net value of the Company's investment on leasing.

Revenues from operating lease are recognized in the profit and loss account using the linear method during the period resulting from the leasing agreement.

11.17.5. The Company as a Lessee

Assets used based on financial leasing agreements are treated as the Company's assets and are measured at fair value upon their acquisition, no higher however than the current value of minimal leasing fees. The resulting liabilities toward the Lessor are presented in the balance sheet under financial leasing liabilities. Leasing payments have been broken down into interest and the principal, so that the interest rate on the remaining liability would be fixed. Financial expenses are recorded in the profit and loss account. Revenues from operating lease are recognized in the profit and loss account using the linear method during the period resulting from the leasing agreement.

Benefits obtained or due as incentives for concluding the operating lease agreement are recorded in the profit and loss account using the linear method during the period resulting from the leasing agreement.

11.9. inventory

Inventory is measured at acquisition price or manufacturing cost, however at amounts not exceeding their net realizable value. The net realizable value represents the realizable sales price excluding VAT and excise duty, less rebates, discounts and the cost of making the asset suitable for sale and of executing the transaction.

The balance sheet inventory of materials includes gas in stock and other materials in stock. Gas in stock in domestic storage facilities is measured at the average weighted acquisition

price of imported gas, actual technical manufacturing cost from domestic sources and denitration costs.

The valuation of imported gas is performed using the exchange rate applied in the Single Administrative Document.

The Company creates revaluation write-down on obsolete, surplus and slow-moving stock.

11.10. Short- and long-term receivables

Receivables are stated at the amount due reduced by write-downs. Receivables are written down based on the probability of their payment. The Company creates revaluation write-downs on receivables overdue by over 90 days from all customers. At the same time, in case of receivables from industrial customers using significant daily volume of gas, the financial position of which is poor (steelworks, nitration plants), the Company calculates revaluation write-downs individually for each customer.

Write-downs on receivables are charged to other operating expenses or financial expenses, according to the type of receivables.

The writing-off or redemption of receivables due to expiry or irrecoverability results in the reduction of previously created write-downs.

Receivables redeemed or written-off due to expiry or irrecoverability which were not written down or were partially written down are classified as other operating expenses or financial expenses, as appropriate.

11.11. Foreign currency transactions

Transactions denominated in foreign currencies are translated into PLN using the exchange rate from the transaction date; in case of gas purchases, transactions are measured at the exchange rate indicated in Single Administrative Document from the customs clearance date. On the balance sheet date, assets and liabilities denominated in foreign currencies are translated into PLN using the average NBP exchange rate as at that date. Exchange differences arising from translation are recorded in financial revenues or financial expenses, as appropriate.

The following average exchange rates determined by the National Bank of Poland and published on 30 December 2005 in Table No. 252/A/NBP/2005 were applied for the purpose of valuation as at 31 December 2005:

1 USD = PLN 3.2613

1 EUR = PLN 3.8598

1 GBP = PLN 5.6253

11.12. Cash and cash equivalents

Cash in bank and at hand and short-term deposits held to maturity are measured at nominal value.

Cash and cash equivalents disclosed in the cash flow statement include cash in hand, cash at banks and bank deposits maturing in up to 3 months, not classified as investments.

11.13. Prepayments and accruals

The Company recognizes prepayments for costs if they are related to future reporting periods.

Accruals are created in the amount of probable liabilities pertaining to the current reporting period.

The Company recognizes deferred income in order to allocate revenues to future reporting periods upon realization.

The Company classifies the surplus of the value of leased assets over their book value to deferred income. The resulting revenues are realized along with the repayment of receivables resulting from the above mentioned lease.

11.14. Share capital

At present the Company's share capital is equal PLN 5,900,000,000 (five billion nine hundred million) and is divided into:

- 4,250,000,000 "A" series bearer shares numbered from 00 000 000 001 to 04 250 000 000 with a face value of PLN 1 each and a total face value of PLN 4,250,000,000;
- 750,000,000 "A1" series bearer shares numbered from 0 000 000 001 to 0 750 000 000 with a face value of PLN 1 each and a total face value of PLN 750,000,000;
- 900,000,000 "B" series bearer shares numbered from 0 000 000 001 to 0 900 000 000 with a face value of PLN 1 each and a total face value of PLN 900,000,000.

11.15. Provisions

Provisions are recognized, if the Company is subject to (legal or customary) liability resulting from past events and it is certain or highly probable that the fulfillment of this liability would result in an outflow of resources generating economic benefits, and the value of such liability can be reliably estimated.

The Company has established a jubilee bonuses and retirement benefits scheme. Respective payments are charged to the profit and loss account so as to enable the spreading of jubilee bonuses and retirement benefits costs over the entire period of employment in the Company. The costs due to the aforesaid benefits are determined by measuring forecasted individual entitlements using the actuarial method.

PGNiG S.A. pays allowances for gas to its employees who retired by the end of 1995. This system will be in force until 2010; thereafter the Company will cease to pay

the allowance. The valuation method applied to gas allowance liabilities is consistent with the actuarial valuation principles used for estimating the provision for jubilee bonuses and retirement benefits.

The Company's employees are entitled to vacations in line with the terms and conditions defined in the Labor Code. The Company recognizes the cost of employee vacation on an accrual basis. The liability for paid vacations is determined based on the estimated cost of paid vacations that have not been used by the end of the financial year.

The Company creates a provision for severance benefits paid to employees laid off in connection with the employment restructuring program, described in detail in points 1 and 11 of the additional information and explanations. This provision is calculated based on planned reduction in employment and the amounts of one-off severance benefits and the amounts of severance payments defined in the Act of 13 March 2003 on the special terms and conditions of terminating employment contracts due to reasons not related to employees (Dz.U. of 22 May 2003 with subsequent amendments).

The Company creates a provision for the cost of well reclamation. The provision is calculated based on the average cost of well reclamation in individual mines over the last three years, adjusted by forecasted CPI and changes in the value of money over time. The three year time horizon is used due to the different number of reclaimed wells and the reclamation cost in particular years.

During the financial year, the outlays connected with created write-downs are recorded in the profit and loss account (under operating expenses or in case of allowances for retired employees under other operating expenses). As at the balance sheet date the companies from the Capital Group analyze balances of all provisions to verify their value. Calculated changes in provisions are recognized in correspondence with other operating expenses or other operating revenues.

11.16. Bank loans

At the moment of initial recognition, bank credits and loans are recognized at cost equal to the value of received cash and including costs of obtaining the credit/loan. All bank credits and loans are then measured at adjusted acquisition price (amortized cost), using the effective interest rate.

Liabilities held for trading are measured at fair value. Gains or losses on remeasurement to fair value are recorded in the profit and loss account for the current period.

11.17. Taxation

11.17.1. Income tax

The current CIT liability is calculated in line with valid tax regulations.

11.17.2. Deferred income tax

The Company performs valuation of deferred tax asset and liability by recognizing both the balance of deferred tax asset and the provision for deferred tax in the financial statements. Deferred tax is calculated based on all positive and negative items differentiating the financial result and the result for tax purposes.

The deferred tax asset is recognized with regard to all negative temporary differences and unused tax losses carried forward to subsequent years in the amount corresponding to the probability of generating taxable income that will enable the aforesaid differences and losses to be realized.

The carrying value of deferred tax asset is verified at each reporting date and reduced as appropriate to reflect the reduction in probability of generating taxable income sufficient to partly or wholly realize the deferred tax asset.

The deferred tax asset and provision are measured using tax rates expected to apply in the period in which the tax asset will be realized or provision released.

The deferred tax asset and provision are presented separately in appropriate items of the balance sheet.

11.17.3. Payments from profit

Until 17 September 2005 PGNiG S.A., as a company wholly owned by the State Treasury, accrued payments due to profit distribution in line with binding regulations (such payments are recognized as charges to the result) in the amount of 15% of the gross result less CIT. As of 17 September 2005 the Company is not obliged to make payments to the State Treasury due to profit distribution.

11.18. Financial instruments

The Company classifies balance sheet items as various categories of financial instruments taking into account of their characteristics and the purpose of acquisition:

- financial assets held for trading – assets acquired to achieve economic benefits arising from short-term price fluctuations and changes in other market factors, or from the short duration of the purchased instrument, as well as other financial assets irrespective of the intention followed in concluding the contract if they belong to a portfolio of similar assets showing high probability of achieving expected economic benefits in the short term. This category also includes all derivatives in respect to which the Company does not apply hedge accounting criteria. Financial instruments of this category are measured at fair value.
- liabilities held for trading – all derivatives with a negative fair value, in respect to which the Company does not apply hedge accounting criteria. Financial instruments of this category are measured at fair value.

- originated loans and own receivables – financial assets, irrespective of maturity (due date) arising from direct issue to the other party of cash, goods and services, are recognized by companies on condition that they are not intended to be resold in the short term. Originated loans and own receivables also include bonds, notes and other debt instruments acquired in exchange for issuing cash directly to the other party, i.e. purchased on the primary market. Financial instruments of this category are measured at amortized cost using effective interest rate.
- financial assets held to maturity – financial assets not classified as originated loans and own receivables, for which the contracts define the due date of face value repayment and specify the right to obtain economic benefits such as interest, in fixed or determinable amount, at predefined dates, on condition that the company intends and is able to hold those assets to maturity. Financial instruments of this category are measured at amortized cost using effective interest rate.
- assets available for sale – all assets meeting the definition of financial instruments, not classified to any of the above categories. Shares in non-controlled entities in the meaning of the Accounting Act are also classified into this category. Financial instruments from this category are measured at acquisition price less permanent impairment write-downs.
- other financial liabilities – all liabilities meeting the definition of financial instruments, except for liabilities held for trading. In particular, this category includes obtained credits and loans, issuance of debt securities and trade liabilities. Financial instruments of this category are measured at amortized cost using effective interest rate.

11.19. Derivative financial instruments

The Company enters transactions in interest and exchange rate derivatives to hedge the risk of changes in exchange and interest rates affecting certain assets, liabilities and foreign currency transactions.

The company does not apply hedge accounting. Financial instruments are measured at fair value. Changes in fair value of derivatives are charged to the profit and loss account.

The fair value of interest rate swaps and forwards is determined based on discounted cash flows to expiry.

11.20. Impairment of assets

On every balance sheet date, the Company evaluates whether there is any objective evidence indicating permanent impairment of an asset or a group of assets. If such evidence exists, the Company defines estimated recoverable value of the asset and recognizes permanent impairment write-down in the amount equal to the difference between the recoverable value and carrying value. Impairment losses are recorded in the profit and loss account for the current period. For assets previously subject to revaluation,

the impairment loss reduces the revaluation reserve and is then charged to the profit and loss account for the current period.

In respect to capitalized cost of exploration and appraisal projects and assets related to crude oil mining, the profit centre is defined as a group of fixed assets that make up one production area.

The realizable value of production areas, both operational and under construction, is compared with estimated future discounted net revenues possible to be obtained from the remaining estimated resources of the Company. Future net revenues are estimated based on the average crude oil prices over the past five years, costs and exchange rates as at the balance sheet date. Profit center impairment write-downs are created if the economic value of the profit center is lower than its carrying value.

As at each balance sheet date, the Company verifies, whether there are circumstances due to which previously recognized impairment of assets no longer exists or the recognized write-down should be lower. If this is the case, the Company adjusts the write-down as appropriate.

11.21. Revenue recognition

Revenues are recognized in the amount of probable economic benefits obtained by the Company that can be reliably measured.

11.22. Sales of goods and products

Sales value is determined based on the invoiced sales classified to the reporting period less VAT. In case of gas sales, the sales value is determined based on meter readouts invoiced for periods not exceeding one month.

11.23. Services

Revenues from rendered services are recognized proportionally to progress in the service's delivery, under the condition that it can be reliably estimated. If the effects of the service transaction cannot be reliably determined, revenues from provided services are recognized up to the amount of respective expenses.

11.24. Interest

Interest income is recognized when accrued. All interest accrued on overdue receivables is covered by a write-down.

11.25. Dividends

Due dividends are recorded under financial revenues at the date of the resolution on profit distribution passed by the appropriate authority of the Company, unless a different date for dividend entitlement is set in the resolution.

11.26. Special funds

Special funds include the Company Social Benefits Fund (ZFŚS) and the Mine Liquidation Fund. The Company Social Benefits Fund is created from obligatory charges and voluntary write-offs from net profit. Obligatory charges are created by the employer in accordance with the applicable regulations, based on the number of employees and minimum monthly wages. Charges to the Company Social Benefits Fund are recognized under expenses. The Social Benefits Fund can be used only for employee benefits.

The Mine Liquidation Fund is created based on the Act of 27 July 2001 amending the Mining and Geological Law. Write-offs are created in correspondence with other operating expenses.

12. AVERAGE PLN/EUR EXCHANGE RATES IN PERIODS COVERED BY THE FINANCIAL STATEMENTS AND COMPARABLE FINANCIAL INFORMATION AS DETERMINED BY THE NATIONAL BANK OF POLAND

Note "Selected financial data after translation into EUR" at the beginning of these financial statements presents the main items of the balance sheet, profit and loss account and cash flow statement from the financial statements for 2005 and comparable financial information for 2004 after translation into EUR.

Balance sheet items were translated from PLN into EUR using the average PLN/EUR exchange rate defined by the NBP for the last day of each period, i.e. PLN/EUR exchange rate of 3.8598 as at 31 December 2005 and PLN/EUR exchange rate of 4.0790 as at 31 December 2004.

Items in the profit and loss account as well as the cash flow statements were translated using the average EUR exchange rate in each presented period, calculated as the arithmetic average of exchange rates valid on the last day of each month in the given period, i.e. PLN/EUR exchange rate of 4.0241 for the current reporting period and PLN/EUR exchange rate of 4.5182 applied for translating comparable information for the period from 1 January to 31 December 2004.

13. KEY DIFFERENCES BETWEEN POLISH ACCOUNTING STANDARDS (PAS) AND INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

PGNiG S.A. maintains its accounting records in line with the provisions of the Accounting Act of 29 September 1994 (Dz. U. of 2002, No. 76, item 694).

As PGNiG S.A. became a publicly traded company in September 2005, it is obliged to present differences between financial statements prepared in line with Polish Accounting Standards (PAS) and financial statements that would have been prepared in line with International Financial Reporting Standards (IFRS). For the purpose of these financial

statements the Company calculated the adjustments that would be necessary to restate the financial statements prepared in line with PAS into financial statements prepared in line with IFRS. The calculated adjustments together with their influence on equity and the net financial result for the current period as well as for the comparable period are presented below:

	Explanatory notes	31 December 2005	31 December 2004
Equity according to PAS		11 367 043	8 122 230
Revaluation of tangible fixed assets on 1 January 2004	a)	6 242 489	6 750 595
Deferred tax on IFRS adjustments	b)	(1 176 943)	(1 274 266)
Employee profit distribution payments	c)	-	-
Other	d)	(48 051)	(43 929)
Equity according to IFRS		16 384 538	13 554 630

	Explanatory notes	31 December 2005	31 December 2004
Net profit in accordance with PAS		1 132 228	746 713
Revaluation of tangible fixed assets on 1 January 2004	a)	(508 106)	(253 086)
Deferred tax on IFRS adjustments	b)	97 323	47 774
Employee profit distribution payments	c)	(27 255)	(14 000)
Other	d)	(4 122)	1 643
Net profit in accordance with IFRS		690 068	529 044

a) Revaluation of fixed assets as of 1 January 2004

The adjustment covered all changes arising from the 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 mainly covers the asset revaluation applied by the Company based on the balance as at 1 January 2004.

In accordance with IFRS 1, the Company would be a first-time adopter. Due to the above as permitted by IFRS 1 the value of the Company's non-current assets was measured on a one-off basis by an independent expert at fair value as at the IFRS adoption date. The value was recognized as the depreciation base in the following periods.

b) Deferred tax on IFRS adjustments

PAS and IFRS foresee the same method of calculating deferred tax. The need to adjust deferred tax arises from other adjustments that harmonize PAS with IFRS, as a result of which there is a change in temporary differences, which constitute the deferred tax base.

c) Employee profit distribution payments

According to the accounting principles supplied thus far the Company discloses amounts paid in accordance with the profit distribution resolution to the Company Social Benefits Fund and to the bonus fund as a distribution of the net financial result.

In accordance with IAS, the amounts paid to the Company Social Benefits Fund and bonus fund do not constitute a distribution of the net profit, but are considered as expenses. Due to the above, all amounts paid to the Company Social Benefits Fund and the bonus fund are recognized as expenses upon the origination of the liability, i.e. upon the adoption of the resolution distributing the net profit. As a result of the above adjustment, the cost of employee benefits would increase, which, in turn, would lead to a decrease of the given period's financial result.

d) Other

Due to the restructuring of the Company in 2003, the largest component of this item accounts for an adjustment related to actuarial gains and losses that influenced the volume of the provision for jubilee bonuses and retirement severance pay. The Company recognizes the provision for jubilee bonuses and retirement severance pay in its books in the value calculated by an actuary with taking into account any actuarial gains and losses. In accordance with IAS, the entity should recognize all costs arising from such provisions in the profit and loss account. Therefore, actuarial gains would have been recognized in the financial statements as an increase of the period's costs.