PGNiG

Polskie Górnictwo Naftowe i Gazownictwo SA

FINANCIAL STATEMENTS FOR THE PERIOD ENDED ON 31 DECEMBER 2006

WARSAW, 3. April 2007

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SELECTED FINANCIAL DATA TRANSLATED INTO EURO

	in PLN '000		**in EUR '000**	
	2006	2005	2006	2005
I. Net revenues from sales of products, goods and materials	12 121 673	9 867 803	3 108 839	2 452 176
II. Profit (loss) on operating activities	1 408 173	1 591 980	361 153	395 611
III. Gross profit (loss)	1 833 183	1 551 773	470 155	385 620
IV. Net profit (loss)	1 582 268	1 132 228	405 803	281 362
V. Net cash flows from operating activities	678 938	1 529 577	174 127	380 104
VI. Net cash flows from investment activities	(122 346)	51 170	(31 378)	12 716
VII. Net cash flows from financial activities	(310 965)	645 766	(79 753)	160 475
VIII. Total net cash flows	245 627	2 226 513	62 996	553 295
IX. Total assets	19 229 857	19 203 888	5 019 278	4 975 358
X. Liabilities and provisions for liabilities	7 208 401	7 836 845	1 881 500	2 030 376
XI. Long-term liabilities	2 299 108	2 317 096	600 101	600 315
XII. Short-term liabilities	1 843 467	1 852 702	481 172	479 999
XIII. Equity	12 021 456	11 367 043	3 137 778	2 944 482
XIV. Share capital	5 900 000	5 900 000	1 539 987	1 528 577
XV. Number of shares (weighted average in '000)	5 900 000	5 258 904	5 900 000	5 258 904
XVI. Profit (loss) per ordinary share (in PLN/EUR)	0.27	0.22	0.07	0.05
XVII. Diluted profit (loss) per ordinary share (in PLN/EUR)	0.27	0.22	0.07	0.05
XVIII. Book value per share (in PLN/EUR)	2.04	2.16	0.53	0.56
XIX. Diluted book value per share (in PLN/EUR)	2.04	2.16	0.53	0.56
XX. Declared or paid dividend per share (in PLN/EUR)	0.15	0.10	0.04	0.02

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 created from the transformation of the State-owned Enterprise PGNiG into a joint stock company owned by the State Treasury, pursuant to Art. 6 item 1 of the Act on privatization of state enterprises of 13 July 1990 (Journal of Laws of 1990, no 51 item 298 as amended) and the Ordinance of the President of the Council of Ministers on transformation of the state-owned utilities company "Polskie Górnictwo Naftowe i Gazownictwo z siedzibą w Warszawie" into a joint stock company wholly owned by the State Treasury of 30 September 1996 (Journal of Laws No. 116, item 553). The Transformation Act was compiled on 21 October 1996 based on the above ordinance.

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 decision of the District Court for the capital city of Warsaw, XIX Business Division of the National Court Register, PGNiG S.A. was entered in the register of entrepreneurs of the National Court Register under number KRS 0000059492.
The Company was assigned the statistical (REGON) number - 012216736.

Based on the decision of the Warsaw Stock Exchange of 16 September 2005 the A and B series shares as well as the rights to B series shares issued by PGNiG S.A. were admitted to public trading on the primary market. The first quotation of rights to bearer ordinary B series shares took place during the trading session on 23 September 2005. On 18 October 2005 the Warsaw Stock Exchange made the decision to admit A and B series shares issued by PGNiG S.A. to public trading on the primary market. The above shares were quoted for the first time on 20 October 2005.

In accordance with its Articles of Association, the Company realizes the following tasks in order to ensure national energy security:

1) continuous natural gas deliveries to customers and maintenance of necessary reserves,
2) safe operation of gas networks,
3) balancing of gas fuels and controlling the operation and capacity of power units connected to the common gas network,
4) gas production activities.

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

1) production of crude oil,
2) production of natural gas,
3) services related to the exploitation of crude oil and natural gas deposits,
4) mining of sulfur-bearing materials,
5) other mining, not classified elsewhere,
6) production of crude oil and refined products,
7) reprocessing of crude oil and 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 a network system,
14) production of heat (steam and hot water),
15) distribution of heat (steam and hot water),
16) geological and engineering excavations and drilling,
17) general construction work in respect of linear structures: pipelines, power lines, electrical traction and telecommunication– transmission lines,
18) central heating and ventilation installations,
19) gas installations,
20) service and repair of motor vehicles,
21) retail sale of fuels,

22) wholesale of solid, liquid and gas fuels and derivative products,
23) wholesale of semi-finished products,
24) other specialized wholesale trade,
25) hotels and motels with restaurants,
26) hotels and motels without restaurants,
27) freight road transport by specialized vehicles,
28) freight transport by road by general-purpose vehicles,
29) pipeline transport,
30) cargo storage and warehousing in other storage yards,
31) travel agencies,
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 sciences,
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) non-public libraries;,
44) archives,
45) museums,
46) technical tests and analyses,
47) leasing of the Company's assets used for the transmission of energy and gas,
48) other financial agency,
49) activity of holding companies.

2. DURATION OF THE COMPANY

The duration of the Company is unlimited.

3. PERIOD COVERED BY THE FINANCIAL STATEMENTS

The financial statements were drawn up for the period from 1 January 2006 to 31 December 2006.

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

The Management Board of PGNiG S.A.

Pursuant to the Company's Articles of Association, the Management Board of PGNiG S.A. consists of two to seven persons. The number of the Members in the Management Board is defined by the entity that appoints the Management Board. Members of the Management Board are appointed for a joint three year term of office. Members of the Management Board or the entire Management Board are appointed by the Supervisory Board. Each of the Members of the Management Board can be dismissed or suspended by the Supervisory Board or the General Shareholders Meeting. As long as the State Treasury is the Company's shareholder and the Company employs more than 500 persons on average per year, the Supervisory Board appoints one person selected by the employees to the Management Board for one term of office.

As of 1 January 2006 the Management Board of PGNiG S.A. consisted of two persons:

- Jan Anysz – Vice Chairman of the Board,
- Franciszek Krok – Vice Chairman of the Board.

The following changes in the composition of the Management Board of PGNiG S.A. took place in 2006:

On 17 February 2006 the Supervisory Board of PGNiG, by resolutions no. 29/IV/06 and 30/IV/06 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, by resolution no. 33/IV/06, 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 Economic and Financial Affairs.

The Supervisory Board of PGNiG S.A.:

- appointed Mr. Bartłomiej Pawlak, by resolution no. 53/IV/06, as Vice Chairman of the Management Board of PGNiG S.A. in charge of Strategic Projects on 6 April 2006;
- appointed Mr. Zenon Kuchciak, by resolution no. 55/IV/06, as Vice Chairman of the Management Board of PGNiG S.A. in charge of Trade and Marketing on 7 April 2006,
- appointed Mr. Bogusław Marzec, by resolution no. 63/IV/06, as Chairman of the Management Board of PGNiG S.A. on 25 April 2006.

On 21 June 2006 Mr Bogusław Marzec resigned as Chairman of the Management Board of PGNiG S.A., whereas on 23 June 2006 the Management Board of PGNiG S.A. decided to appoint Mr. Bogusław Marzec as the Company's Proxy on 24 June 2006. Mr. Bogusław Marzec was granted a joint power of attorney, i.e. in order for documents to be effective from a legal point of view they must be signed by two proxies or a proxy and a Member of the Management Board of PGNiG S.A.

On 23 June 2006 the Supervisory Board of PGNiG S.A. decided to appoint Prof. Mieczysław Puławski, an independent Member of the Supervisory Board of PGNiG S.A., as the temporary Chairman of the Management Board of PGNiG S.A. from 24 June 2006 to 12 September 2006. Mr. Mieczysław Puławski was obliged to present a report on undertaken activities by 26 September 2006 to the Supervisory Board of PGNiG S.A. In addition, the Supervisory Board decided to instigate qualification proceedings for the position of the Chairman of the Management Board of PGNiG S.A.

Mr. Bartłomiej Pawlak resigned from the position of Vice Chairman of the Management Board of PGNiG S.A. as of 21 July 2006.

By resolution no. 107/IV/06 and 108/IV/06 of 11 September 2006 the Supervisory Board appointed Mr. Krzysztof Głogowski as Chairman of the Management Board of PGNiG S.A. as of 1 October 2006 and Mr. Tadeusz Zwierzyński as Vice Chairman in charge of Strategic Projects.

On 12 September Mr. Mieczysław Puławski, Member of the Supervisory Board, by resolution no. 109/IV/06, was again appointed as the temporary Chairman of the Management Board of PGNiG S.A. from 13 September 2006 to 23 September 2006.

As of 31 December 2006 the composition of the Management Board of PGNiG S.A. was as follows:

- Krzysztof Głogowski - Chairman of the Board
- Jan Anysz – Vice Chairman of the Board,
- Zenon Kuchciak – Vice Chairman of the Board,
- Stanisław Niedbalec – Vice Chairman of the Board,
- Tadeusz Zwierzyński - Vice Chairman of the Board.

In 2007, by preparation of these financial statements no changes in the composition of the Management Board of PGNiG S.A. were made.

The Supervisory Board of PGNiG S.A.

Pursuant to the Company's articles of Association, the Supervisory Board of PGNiG S.A. consists of five to nine members who are appointed by the General Shareholders Meeting for a joint term of office of 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, in acting in cooperation with the minister in charge of economic affairs, is entitled to appoint and dismiss one member of the Supervisory Board.

One member 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 item 3 of the Articles of Association of PGNiG S.A.;
2. cannot be the Company's Related Party or a subsidiary of 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 a person, as a member of the Supervisory Board, to pass unbiased decisions.

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

Pursuant to § 36 item 3 of the Articles of Association of PGNiG S.A., the Supervisory Board Member who is to fulfill the conditions stated above is 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 to shareholders who are present at the General Shareholders Meeting, whose objective is to select 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 the Supervisory Board members is appointed from persons designated by the Company's employees.

As of 31 December 2006, the Supervisory Board consisted of eight members and its composition was as follows:

- Andrzej Rościszewski - Chairman of the Supervisory Board,
- Piotr Szwarc - Vice Chairman of the Supervisory Board
- Kazimierz Chrobak – Secretary of the Supervisory Board,
- Wojciech Arkuszewski – Member of the Supervisory Board,
- Mieczysław Kawecki – Member of the Supervisory Board,
- Marcin Moryń - Member of the Supervisory Board,
- Mieczysław Puławski - Member of the Supervisory Board,
- Mirosław Szkałuba - Member of the Supervisory Board,
- Jarosław Wojtowicz – Member of the Supervisory Board.

The following changes took place in the Supervisory Board of PGNiG S.A. in 2006:

Ms. Magdalena Bąkowska resigned as Member of the Supervisory Board as of 19 June 2006.

On 19 June 2006 the Extraordinary Shareholders Meeting of PGNiG S.A. issued the resolution no. 3 pursuant to which Marcin Moryń was appointed to the Supervisory Board.

On 23 June, Mr. Mieczysław Puławski, Member of the Supervisory Board, by resolution no. 86/IV/06, was appointed as the temporary Chairman of the Management Board of PGNiG S.A. from 24 June 2006 to 12 September 2006.

By the resolution no. 107/IV/06 of 11 September 2006 the Supervisory Board appointed Mr. Krzysztof Głogowski as Chairman of the Management Board of PGNiG S.A. as of 1 October 2006.

On 12 September 2006, Mr. Mieczysław Puławski, Member of the Supervisory Board, by resolution no. 109/IV/06, was again appointed as the temporary Chairman of the Management Board of PGNiG S.A. from 13 September 2006 to 23 September 2006.

On 29 October 2006 the Extraordinary Shareholders Meeting of PGNiG S.A. issued the resolution no. 3 pursuant to which Mr. Jarosław Wojtowicz was appointed to the Supervisory Board.

On 7 December 2006 the Supervisory Board designated the Chairman of the Supervisory Board and the Vice Chairman of the Supervisory Board. By the resolution no. 156/IV/06 the Supervisory Board appointed Mr. Andrzej Rościszewski as the Chairman of the Supervisory Board By the resolution no. 157/IV/06 the Supervisory Board appointed Mr. Piotr Szwarc as the Vice Chairman of the Supervisory Board.

In 2007, by preparation of these financial statements, no changes in the composition of the Management Board of PGNiG S.A. were made.

5. CHANGES IN SHARE CAPITAL

As of 31 December 2006, the Company's share capital was equal to 5,900,000,000 (PLN five billion nine hundred million) and consisted of:

- 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

No changes in the share capital took place in 2006.

6. FINANCIAL STATEMENTS CONTAIN AGGREGATED DATA

PGNiG S.A. draws up aggregated financial statements. As of 31 December 2006 PGNiG S.A. consisted of: the Company's Head Office, 4 domestic branches and a foreign branch in Pakistan. The formal liquidation of six Regional Transmission Branches was conducted during the first half of 2006.

The presented aggregated financial statements of PGNiG S.A. were prepared based on financial data from the joint accounting records of particular domestic branches and based on the financial statements of the foreign branch in Pakistan. As of the balance-sheet date, the data resulting from the balance sheet of the foreign branch were translated into PLN at the average exchange rate, effective as at the balance-sheet date established for a given currency by the National Bank of Poland, whereas the items of the profit and loss account were calculated at the exchange rate which constitutes an arithmetical mean of average exchange rates as of the closing date of each month of the financial year. The exchange differences resulting from the translation were contained in the revaluation capital.

PGNiG S.A., as a holding company, also prepares consolidated financial statements, which contain the data of 20 direct subsidiaries, 1 co-subsidiary, 1 associated entity and 1 indirect subsidiary.

7. GOING CONCERN ASSUMPTION

The Company's financial statements were prepared assuming that the Company would continue its business activity for 12 months after the balance sheet date, i.e. until 31 December 2007.
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 on 31 December 2005 include the data of 11 domestic branches and a foreign branch in Pakistan. Pursuant to Resolution no. 567/2006 passed by the Management Board of PGNiG S.A. on 8 August 2006 the liquidation process of six Regional Transmission Branches (RTBs) was completed and the decision was made to remove them from the National Court Register.
The aggregated financial statements of PGNiG S.A. for the current reporting period were prepared based on financial data from the joint accounting records of particular domestic branches and the financial statements of the 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 2005 were audited by 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 2006 and in the comparable financial data for 2005.

11. ACCOUNTING PRINCIPLES (POLICY) APPLIED, INCLUDING THE METHOD OF ASSETS AND LIABILITIES VALUATION (TOGETHER WITH DEPRECIATION), MEASUREMENT OF THE FINANCIAL RESULT AND PREPARATION METHOD OF 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:

- the Accounting Act of 29 September 1994 (consolidated text - Journal of Laws no. 76 item 694 of 2002)
- Act of 29 July 2005 on Public Offering and Conditions for Introduction of Financial Instruments into an Organized Trading System and on Public Companies (Journal of Laws No. 184, item 1539)
- The Minister of Finance's Ordinance of 18 October 2005 on the scope of information disclosed in financial statements and consolidated financial statements, required in prospectuses for issuers with registered offices in Poland who apply Polish Accounting Standards (Journal of Laws No. 209 item 1743)
- Minister of Finance's Ordinance of 19 October 2005 on current and periodic information provided by issuers (Journal of Laws No. 209, item 1744).

The financial statements were drawn up in accordance with the historical cost principle, with the exception of the measurement of derivative financial instruments, 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 which may be 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 their commissioning.
The following depreciation rates are applied to intangible assets:

Other intangible assets	10.0 – 50.0%

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 valid regulations, tangible fixed assets are subject to revaluation using rates defined by the President of the Central Statistical Office (GUS). The 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 reserve capital.

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 initial value of fixed assets is equal to 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 in the accounting books 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 books under deferred income. For presentation purposes of the financial statements, 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.
Buffer gas and gas used for the first filling of the gas pipelines 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. Buffer gas and gas used for the first filling of the gas pipelines are also classified by the Company as fixed assets under construction.
Fixed assets under construction are not depreciated before completion of construction and commissioning.

11.5. Outlays for exploration and appraisal projects

Costs related to geophysical and geoseismic research are recorded in the profit and loss account in the period, when they are incurred.

The costs of crude oil and gas exploration and appraisal projects in the pre-production phase are activated upon start-up of the work.

If, following further research, the given area proves unsuitable for industrial use, the exploration and appraisal outlays 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

11.6.1. Real property investments

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

11.6.2. Investments in controlled entities

Investments in subsidiaries, in co-subsidiaries and in associated entities are measured at acquisition price less permanent impairment write-downs.

11.6.3. 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 loans granted to related parties, measurement of financial instruments and cash. The recording principles are presented in principles applicable to respective items.

11.8. Leases

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

11.8.1. The Company as a Lessor

Amounts due to financial lease are booked under receivables at the net value of the Company's investment in the lease.
Revenues due to finance lease are recognized in appropriate periods using the fixed rate of return on the net value of the Company's receivables due to leases.
Revenues from operating lease are recognized in the profit and loss account using the straight line method during the period resulting from the leasing agreement.

11.8.2. The Company as a Lessee

Assets used based on finance lease agreements are treated as the Company's assets and are measured at their fair value upon their acquisition, however not higher than the current value of minimal leasing fees. The resulting liabilities toward the Lessor are presented in the balance sheet under finance lease 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 straight line method during the period resulting from the leasing agreement.
Benefits obtained or due as incentives for conclusion of the operating lease agreement are recorded in the profit and loss account using the straight line method during the period resulting from the leasing agreement.

11.9. Inventory

Inventory is measured at acquisition price or manufacturing cost at amounts not exceeding their net sale price. The net sale price is based on the realizable sale price excluding VAT and excise duty, less price reductions, discounts and the cost of making the asset suitable for sale and of transaction execution.
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 weighted average acquisition price of imported gas, actual technical manufacturing cost from domestic sources and denitration costs. Gas is valuated separately for each gas warehouse.
The valuation of imported gas is performed using the exchange rate applied in the Single Administrative Document.
The Company creates revaluation write-downs on obsolete, surplus and slow-moving stock.

11. 9a. Valuation of gas inventory

The gas in storage facilities is valuated at the weighted average unit price of gas from individual sources of origin. The averaged gas prices from individual sources are obtained as follows:

- gas from a given month which originates from individual import contracts is registered as per value and quantity and with a division into particular batches which correspond to individual points of entry to the Polish gas system. The weighted average price of gas from this source is calculated on the basis of the aforementioned data.
- gas produced from domestic mines is registered as per quantity and with a division into batches which correspond to individual mines. The value of this gas originates from the settlement, in a given month, of mining costs in a given mine. The technical cost of gas production which constitutes the price of gas produced in domestic mines is calculated on the basis of the aforementioned information.
- the price of gas originating from the Branch in Odolanów is based on the production cost of this gas, which consists of the technical production cost of nitrated gas used for production of high-methane gas as well as of the denitration costs of this gas in a given month.
- the price of high-methane gas obtained in the process where gas with higher calorific value is mixed with nitrated gases is calculated through division of the sum of mixed gases by the sum of the quantities of these gases.

The gas which is packed into storage facilities in a given month (the registration is performed in separate batches which correspond to individual Underground Gas Storage Facilities (PMG)) is valuated at the weighted average price.
The transfer of gas in a given month from PMG to the gas system is performed at a price which is based on the weighted average acquisition cost of gas in a given month and from a given storage facility.

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 which use significant daily volumes 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, depending on the type of receivables to which the write-down refers.
Write-off or redemption of receivables due to expiry or irrecoverability results in the reduction of write-downs previously created for these receivables.
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 announced on 29 December 2006 in Table No. 252/A/NBP/2006 were applied for the purpose of measurement as of 31 December 2006:

USD 1 = PLN 2.9105
EUR 1 = PLN 3.8312
GBP 1 = PLN 5.7063

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 with maturity of up to 3 months, not classified as investments.

11.13. Accruals

The Company recognizes prepayments, if they are related to future reporting periods.
Accruals are created in the amount of probable liabilities that pertain to the current reporting period.
The Company recognizes deferred income in order to allocate revenues to future reporting periods upon realization of these revenues.
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 to 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 constructive) obligation 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 valuation of forecasted individual entitlements using the actuarial method.
As of January 2006 the balances of provisions for jubilee bonuses and retirement benefits are recognized under current liabilities adjusted by actuarial profits/losses and costs of past employment - benefits to which entitlements were not acquired.
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 allowances. 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 vacations 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 (Journal of Laws 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 Company analyzes balances of all provisions in order to verify their value. Calculated changes in provisions are recognized in correspondence with other operating expenses or other operating revenues.

11.16. Bank credits and 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 loans are then measured at adjusted acquisition price (depreciated 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 measures the 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 be applied 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 to various categories of financial instruments taking into account their nature and the purpose of their 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.
- granted 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. Granted loans and own receivables also include bonds, notes and other debt financial 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 adjusted acquisition price using the 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 adjusted acquisition price using the 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 as understood under 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 adjusted acquisition price using the effective interest rate.

11.19. Derivative financial instruments

The Company enters into transactions related to 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 the 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 impairment of an asset or a group of assets. If such evidence exists, the Company defines the estimated recoverable value of the asset and recognizes an 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 case of the capitalized cost of exploration and appraisal projects and assets related to gas and 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 amount of invoiced sales to customers 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 only 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 Benefit 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 creased based on the Act of 27 July 2001 on the amendment of 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 date 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 2006 and comparable financial information for the first half of 2005 after translation into EUR.

Balance sheet items were translated from PLN into EUR using the average EUR exchange rate determined by the NBP for the last day of each period, i.e. PLN/EUR exchange rate of 3.8312 as of 29 December 2006 and PLN/EUR exchange rate of 3.8598 as of 30 December 2005.

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 3.8991 for the current reporting period and PLN/EUR exchange rate of 4.0241 applied for translating comparable information for the period from 1 January to 31 December 2005.

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 (Journal of Laws No. 76, item 694 of 2002)
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:

Due to the fact that the audit of data for calculation of adjustments necessary to restate the financial statements for 2005 (this data is used to prepare the consolidated financial statements which is audited after only after the audit of the financial statements) was finished already after the preparation of the financial statements, it was necessary to correct the data as of 31 December 2005 in the following table in order to make it comparable with the current period.

	Explanatory notes	31 December 2006	31 December 2005
Equity according to PAS		**12 021 456**	**11 367 043**
Revaluation of fixed assets on 1 January 2004	a)	5 702 751	6 274 795
Deferred tax on IFRS adjustments	b)	(1 106 224)	(1 183 081)
Employee profit distribution payments	c)	-	-
Other	d)	-	(48 051)
Equity according to IFRS		**16 617 983**	**16 410 706**

	Explanatory notes	31 December 2006	31 December 2005
Net profit in accordance with PAS		**1 582 268**	**1 132 228**
Revaluation of fixed assets on 1 January 2004	a)	(572 045)	(475 800)
Deferred tax on IFRS adjustments	b)	76 858	91 185
Employee profit distribution payments	c)	(42 900)	(27 255)
Other	d)	48 051	(4 122)
Net profit in accordance with IFRS		**1 092 232**	**716 236**

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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 prepare its financial statements acc. to IFRS for the first time. 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 subsequent 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 so 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 on net profit distribution. 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

The largest component of this item accounts for an adjustment related to actuarial gains and losses that, pursuant to IAS, should adjust the volume of the provision for jubilee bonuses and retirement severance pay Until the end of 2005, the Company recognized the provision for jubilee bonuses and retirement severance pay in its books in the value calculated by an actuary without taking into account of any actuarial gains and losses.
Due to the fact that in the current reporting period the Company recognized the provisions for jubilee bonuses and retirement severance pay at fair value consistent with IAS, the item shows only the effect of settlement of the restating adjustment (related to the recognition of actuarial gains and losses) from previous periods.