



# Powszechna Kasa Oszczędności Bank Polski SA

**Independent Auditor's Report**

**Financial Year ended**

**31 December 2017**

*This document is a free translation of the Polish original. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to aid understanding. The binding Polish original should be referred to in matters of interpretation.*

## **INDEPENDENT AUDITOR'S REPORT**

*To the General Shareholders' Meeting of  
Powszechna Kasa Oszczędności Bank Polski SA*

### **Report on the Audit of the Annual Separate Financial Statements**

We have audited the accompanying annual separate financial statements of Powszechna Kasa Oszczędności Bank Polski SA, with its registered office in Warsaw, ul. Puławska 15 (the "Bank"), which comprise the statement of financial position as at 31 December 2017, the statement of profit and loss, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended and notes comprising a summary of significant accounting policies and other explanatory information (the "separate financial statements").

#### ***Responsibility of the Management Board and Supervisory Board for the separate financial statements***

The Management Board of the Bank is responsible for the preparation, on the basis of properly maintained accounting records, of separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards, as adopted by the European Union ("IFRS EU") and other applicable laws. The Management Board of the Bank is also responsible for such internal control as the Management Board determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

In accordance with the accounting act dated 29 September 1994 (Official Journal from 2017, item 2342 with amendments) ("the Accounting Act"), the Management Board of the Bank and members of the Supervisory Board are required to ensure that the separate financial statements are in compliance with the requirements set forth in the Accounting Act.

#### ***Auditor's Responsibility for the audit of the separate financial statements***

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with:

- the act on certified auditors, audit firms and public oversight dated 11 May 2017 (Official Journal from 2017, item 1089) (the „Act on certified auditors”);
- International Standards on Auditing as adopted by the resolution dated 10 February 2015 of the National Council of Certified Auditors as National Standards on Assurance;
- Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-listed entities and repealing Commission Decision 2005/909/EC (Official Journal of the European Union L 158 dated 27.05.2014, page 77 and Official Journal of the European Union L 170 dated 11.06.2014, page 66) (the “EU Regulation”); and
- other applicable laws.

Those regulations require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the regulations mentioned above will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve collusion, forgery, deliberate omission, intentional misrepresentations or override of internal controls.

The scope of audit does not include assurance on the future viability of the Bank or on the efficiency or effectiveness with which the Management Board has conducted or will conduct the affairs of the Bank.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation of the separate financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of the Bank, as well as evaluating the overall presentation of the separate financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *The most significant assessed risks of material misstatements*

During our audit we identified the most significant assessed risks of material misstatements (the "key audit matters"), including those due to fraud and we performed appropriate audit procedures to address these matters. Key audit matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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## Impairment of loans and advances to customers

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The carrying value of loans and advances to customers amounted to PLN 186,892 million as at 31 December 2017 and to PLN 189,067 million as at 31 December 2016. Impairment allowances amounted to PLN 7,170 million as at 31 December 2017 and PLN 7,320 million as at 31 December 2016. The net impairment allowance and write-downs amounted to PLN 1,530 million for 2017 and to PLN 1,408 million for 2016.

References to separate financial statements: note 13 “Net impairment allowance and write-downs”, note 24 “Loans and advances to customers”, note 54 “Credit risk – Financial information”.

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### Key audit matter

Loans and advances to customers are measured at amortised cost less impairment allowances. The procedures to estimate impairment allowance comprise two major phases – identification of impairment triggers and calculation of losses.

Impairment triggers are identified based on analysis of payment delinquencies and economic and financial standing of the debtor. Impairment allowances are estimated individually for specific loans and advances to customers and collectively for homogenous loan portfolios using statistical methods including risk parameters. The risk parameters include probability of default (PD), loss given default (LGD) and loss identification period (LIP) and are calculated for homogenous groups of loan based on historical data taking into account the current economic conditions.

Impairment allowances are the best estimate of incurred losses on loans and advances as at the balance sheet date. We have considered this area as a key audit matter because of the size of the loan portfolio and the significant impact that estimation of impairment allowance may have on the Bank’s financial statements. Furthermore, estimating impairment allowances requires from the Bank’s Management to use substantial judgment. In particular:

- In relation to loans and advances assessed collectively there is a risk of improper application of data to estimate statistical parameters, which may not

### Our procedures

Our audit procedures conducted with the support of our internal IT specialists included among others:

- Evaluation of design and implementation of internal controls in the process of impairment triggers identification and impairment allowances calculation (including monitoring of collateral valuation); and testing operating effectiveness of those controls. Our procedures were focused in particular on the controls of timely monitoring of debtors’ standing and calculation of impairment allowances.
- Assessment of methodology used for calculating impairment allowances and write-downs for loan exposures both on individual and collective basis in terms of compliance with relevant financial reporting standards and market practice.
- Analysis of the structure and dynamics of the loan portfolio including quality ratios and provision coverage in order to identify groups of loans with underestimated impairment allowances.

Specific procedures for credit exposures assessed using group and portfolio methods:

- Review of the results of the impairment model validation process conducted by the Bank, including critical assessment of assumptions and input data used to estimate models for particular key parameters of credit risk, including probability of default (PD), loss given

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## Impairment of loans and advances to customers

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reflect the actual level of credit losses existing as at the balance sheet day. Moreover, there is a risk of errors occurring during the impairment allowances calculation process.

- In case of portfolio of non-impaired loans and advances assessed on an individual basis there is a risk that impairment triggers are not identified on a timely basis and as a result the value of loans in the financial statements is incorrect not including the appropriate impairment allowance, especially for impairment triggers occurring prior to payment delinquencies.
- For the portfolio of impaired loans and advances assessed on an individual basis there is a risk that improper assumptions are used in measuring the impairment allowance in relation to applied recovery scenarios, valuation of collaterals or cash flow schedules.

Estimation of impairment allowance on loan exposures for the companies in the renewable energy industry (wind farms) is particularly subject to significant uncertainty due to high volatility of prices of renewable energy certificates which represent significant source of income for such entities.

default (LGD) and loss identification period (LIP).

- Assessment of adequacy of incurred but not reported losses allowance (IBNR) in comparison to actual losses realised on given homogenous loan portfolios in prior periods.
- Verification if the impairment model parameters are correctly applied to particular loans and advances based on their characteristics, such as rating class, delinquency status, LTV ratio.
- Recalculation of impairment allowances calculated using statistical methods.

Specific procedures for credit exposures assessed on an individual basis:

- Selection of a sample of loans to verify the appropriateness of the classification (identification of impairment triggers) and accuracy of the provisioning level. Selection of the exposures was made based on the following criteria:
  - Significance of loan balance
  - Client's industry risk,
  - Bank's internal rating
  - Level of impairment allowance
  - Element of unpredictability.
- For the selected credit review sample – we performed an independent assessment of impairment trigger identification considering the financial standing of the borrower, assessment of the Bank's internal monitoring documentation and analysis of compliance with the loan agreement covenants.
- For selected sample of loans for which an impairment trigger was identified and calculation of impairment allowance was performed – we recalculated the impairment allowances and performed a critical assessment of key assumptions adopted by the Bank. Analysis covered in particular the financial standing of the

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## Impairment of loans and advances to customers

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debtor, strategy adopted by the Bank towards the borrower and other components of impairment allowance calculation, such as collateral valuation or planned cash flows schedule.

- For selected customers from the renewable energy sector we performed critical assessment of the rationale of assumptions adopted by the Bank regarding forecasted prices of renewable energy certificates and consistency of assumptions applied by the Bank in the calculation of impairment allowance with the Bank's strategy towards this industry.

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## Valuation of financial instruments not listed on active market

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The carrying value of financial assets not listed on active market measured at fair value amounted to PLN 16,378 million as at 31 December 2017 and to PLN 21,194 million as at 31 December 2016 and the carrying value of financial liabilities not listed on active market measured at fair value amounted to PLN 2,741 million as at 31 December 2017 and to PLN 4,229 million as at 31 December 2016.

References to separate financial statements: note 21 "Derivative financial instruments". Note 22 "Derivative hedging instruments", note 23 "Financial instruments designated upon initial recognition at fair value through profit and loss", note 25 "Investment securities available for sale", note 46 "Fair value hierarchy".

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### Key audit matter

In accordance with relevant financial reporting standards the Bank measures at fair value the following financial instruments that are not listed on active market: derivatives, corporate bonds, municipal bonds, money market bills and shares.

The fair valuation of not listed financial instrument is performed based on valuation models described in notes 21, 23, 25 and 46 to the financial statements for particular types of instruments.

Valuation of not listed instruments is a complex process and requires the adoption of significant assumptions. Whilst publicly available data is used as a component in the valuation models, subjective assumptions and parameters applied by the Bank relating in particular to counterparty risk component

### Our procedures

Our audit procedures conducted with the support of our internal financial instruments valuation specialists included among others:

- Evaluation of design and implementation of internal controls aimed at verifying the appropriateness of financial instruments valuation measured at fair value; and testing operating effectiveness of those controls.
- Assessment of models used for valuation of not listed instruments in terms of compliance with the relevant financial reporting standards.
- For a selected sample of not listed financial instruments – recalculation of the fair value using own valuation model and

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### Valuation of financial instruments not listed on active market

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have a significant impact on the valuation. Application of incorrect assumptions and parameters in the valuation model may result in material misstatement of the Bank's financial result.

In case of not listed financial instruments that are designated for the purpose of hedge accounting the incorrect valuation may lead to errors in the measurement of the effectiveness of the hedging relationship and hence causing a misstatement of the financial result.

input data derived from independent sources, such as interest rates and discount rates (for derivatives), margins (for debt securities) and discount rates (for equity instruments).

- Evaluation of financial standing of selected counterparties with whom the Bank concluded derivative transactions and issuers of not listed securities in the Bank's portfolio. This included critical assessment of financial standing of the counterparty and checking the payment status in order to assess the adequacy of the credit risk margin used in the valuation of not listed financial instruments.
- Assessment of appropriateness of the classification of not listed financial instruments in the fair value hierarchy in accordance with relevant financial reporting standards.
- For instruments classified to level three of fair value hierarchy we made a critical assessment of valuation sensitivity disclosures, resulting from the changes in unobservable input data applied, in terms their compliance with relevant financial reporting standards.

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### Goodwill – impairment assessment

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The carrying value of goodwill amounted to PLN 871 million as at 31 December 2017 (unchanged compared to 31 December 2016).

References to separate financial statements: note 28 „Intangible assets and tangible fixed assets”.

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#### Key audit matter

The value of goodwill disclosed in the separate financial statements relates to acquisition and merger with the Bank of Nordea Bank Polska SA and Centrum Finansowe Puławska Sp. z o.o. that occurred in previous years.

In accordance with relevant financial reporting standards the Bank performs

#### Our procedures

Our audit procedures included among others:

- Evaluation of design and implementation of internal controls in the process adopted by the Bank for testing impairment of goodwill, including in particular the timely manner of performing the goodwill impairment test and review and approval

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## Goodwill – impairment assessment

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a goodwill impairment test at least once a year. When performing the test goodwill is allocated to specific Cash Generating Units (CGUs) of the acquirer, which in accordance with expectations shall benefit from synergies realised as a result of the merger. The carrying value of these CGUs is then compared with their recoverable amount. The recoverable amount is estimated generally based on the value in use of the CGUs, which represents the present value of estimated future cash flows including the residual value.

Estimation of value in use is a complex process and requires significant judgments and assumptions regarding future cash flows, discount rates, including risk free rate, market risk premium, beta parameter and growth rate in the residual period. Such forecasts are subject to significant risk of volatility due to changing economic conditions.

of the test results by authorized employees.

- Assessment of appropriateness of the Bank's assumptions regarding allocation of goodwill to selected CGUs.
  - With support of our internal valuation specialists we assessed whether the model used by the Bank to estimate value in use of the given CGUs complies with requirements of the relevant financial reporting standards.
  - We performed a critical review of the assumptions and estimates adopted by the Bank for the purpose of calculation of value in use of the given CGUs, to which goodwill was allocated, including:
    - assessment of forecasted financial results by comparing them to historical results and the budget realisation in previous periods;
    - evaluation of models used for calculation of value in use (in terms of mathematical accuracy and logical consistency) and assessment of the rationale of the macroeconomic assumptions adopted by the Bank, including assumptions regarding the discount rate (risk free rate, market risk premium, beta parameter) and growth rate in the residual period.
  - Assessment of the accuracy and completeness of the disclosures included in the separate financial statements in terms of goodwill and goodwill impairment testing as required by the relevant financial reporting standards.
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### *Opinion*

In our opinion, the accompanying separate financial statements of Powszechna Kasa Oszczędności Bank Polski SA:

- give a true and fair view of the unconsolidated financial position of the Bank as at 31 December 2017 and of its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with IFRS EU and the adopted accounting policies;
- have been prepared, in all material respects, on the basis of properly maintained accounting records; and
- comply in all material respects, with regard to form and content, with applicable laws and the provisions of the Bank's articles of association.

### *Report on other legal and regulatory requirements*

#### *Opinion on the report on activities*

Our opinion on the separate financial statements does not cover the Directors' report on the Group's activities prepared together with report on the Bank's activities (the "report on activities").

The Management Board of the Bank is responsible for the preparation of the report on activities in accordance with the requirements of the Accounting Act and other applicable laws. Furthermore, the Management Board of the Bank and members of the Supervisory Board are also required to ensure that the report on activities is in compliance with the requirements set forth in the Accounting Act. Our responsibility was to state, if based on our knowledge about the Bank and its environment obtained in the audit of separate financial statements, we have identified material misstatements in the report on activities and describe the nature of each material misstatement.

In accordance with Act on certified auditors our responsibility was to determine if the report on activities was prepared in accordance with applicable laws and the information given in the report on activities is consistent with the separate financial statements. In addition, in accordance with Article 111a paragraph 3 of the Banking Act dated 29 August 1997 (Official Journal from 2017, item 1876 with amendments) ("Banking Act") our responsibility was to audit financial information described in Article 111a paragraph 2 of the Banking Act presented in the report on activities. We conducted our audit in this respect in accordance with the scope presented in the paragraph "Auditor's Responsibility for the audit of the separate financial statements".

Based on the work undertaken in the course of the audit of the separate financial statements, in our opinion the accompanying report on activities, in all material respects:

- was prepared in accordance with applicable laws, and
- is consistent with the separate financial statements.

Furthermore, based on our knowledge about the Bank and its environment obtained in the audit of the separate financial statements, we have not identified material misstatements in the report on activities.

#### *Opinion on corporate governance statement*

The Management Board of the Bank and members of the Supervisory Board are responsible for preparation of the corporate governance statement in accordance with the applicable laws.

In connection with the audit of the separate financial statements, our responsibility in accordance with the requirements of the Act on certified auditors was to report whether the issuer of securities obliged to file a corporate governance statement, constituting a separate part of the report on activities, included information required by the applicable laws and regulations, and in relation to specific information indicated in these laws or regulations, to determine whether it complies with the applicable laws and whether it is consistent with the separate financial statements.

In our opinion the corporate governance statement, which is a separate part of the report on activities, includes the information required by paragraph 91 subparagraph 5 point 4 letter a, b, g, j, k and letter l of the Decree of the Ministry of Finance dated 19 February 2009 on current and periodic information provided by issuers of securities and the conditions for recognition as equivalent of information required by the laws of a non-member state (Official Journal from 2014, item 133 with amendments) (the “decree”). Furthermore, in our opinion the information identified in paragraph 91 subparagraph 5 point 4 letter c-f, h and letter i of the decree, included in the corporate governance statement, in all material respects:

- has been prepared in accordance with the applicable laws; and
- is consistent with the separate financial statements.

#### *Information about preparation of non-financial statement*

In accordance with the requirements of the Act on certified auditors, we report that the Bank has prepared a statement on non-financial information referred to in art. 49b paragraph 9 of the Accounting act as a separate part of the report on activities.

We have not performed any assurance procedures in relation to the statement on non-financial information of the Bank and, accordingly, we do not express any assurance thereon.

#### *Independence and the appointment of the audit firm*

Our opinion on the audit of separate financial statements is consistent with our report to the Audit Committee.

During our audit the key certified auditor and the audit firm remained independent of the Bank in accordance with requirements of the Act on certified auditors, the EU Regulation and the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants' (IFAC) as adopted by the resolutions of National Council of Certified Auditors.

We declare that, to the best of our knowledge and belief, we did not provide prohibited non-audit services referred to in art. 5 paragraph 1 second subparagraph of the EU Regulation and art. 136 including transitional provisions in art. 285 of the Act on certified auditors.

We have been first appointed to perform the audit of the separate financial statements by the resolution of the Supervisory Board dated 11 March 2015 and reappointed by the resolution dated 26 January 2017.

Our total uninterrupted period of engagement for audit of the separate financial statements of the Bank is 3 years, starting with the period ending 31 December 2015 to the period ending 31 December 2017.

*Information required by the act on certified auditors on compliance with applicable prudential regulations*

The Management Board is responsible for the Bank's compliance with applicable prudential regulations, in particular for the appropriate determination of the capital ratios. The audit objective was not to express an opinion on the Bank's compliance with the applicable prudential regulations, and in particular whether the Bank determined the capital ratios appropriately and therefore we do not express such an opinion.

Our audit of the Bank's separate financial statements included audit procedures designed to identify instances of the Bank's noncompliance with the applicable prudential regulations, defined in separate laws, in particular with respect to the determination of the capital ratios by the Bank disclosed in the note 67 "Capital adequacy", that could have a material impact on the separate financial statements of the Bank.

Based on our audit of the separate financial statements of the Bank we have not identified any instances of noncompliance, in the period from 1 January 2017 to 31 December 2017, of the Bank with the applicable prudential regulations, defined in separate laws, and in particular with respect to the determination of the capital ratios as at 31 December 2017, that could have a material impact on the separate financial statements of the Bank.

On behalf of audit firm  
KPMG Audyt Spółka z ograniczoną odpowiedzialnością sp.k.  
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*Signed on the Polish original*

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Marcin Podsiadły  
Key Certified Auditor  
Registration No. 12774  
Limited Liability Partner  
with power of attorney

*Signed on the Polish original*

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Stacy Ligas  
Member of the Management Board of KPMG  
Audyt Sp. z o.o., entity which is the General  
Partner of KPMG Audyt Spółka z ograniczoną  
odpowiedzialnością sp.k

8 March 2018