

## INTRODUCTION TO THE FINANCIAL STATEMENT

a) Ciech S.A. was established on 1 September 1995, by way of transformation of Centrala Importowo-Eksportowa Sp. z o.o. (*Import Export Head Office*). The Company' has its registered office at ul. Powązkowska 46/50 and is registered in the District Court for the capital city of Warsaw, XII Economic Division of the National Court Register under KRS No. 0000011687.

The Company's main activity, in compliance with the Company's Articles of Association, consists in the business activity including trade, investment, production, service activity, and financial transactions, especially in domestic and foreign trade with chemicals and related activity (PKD 5190 z). The Company is authorised to provide agency services on behalf of domestic and foreign companies.

b) Ciech S.A. was established for an unlimited period.

c) This financial statement includes data for the period between 1 January 2005 and 31 December 2005. Comparable data cover the financial year until 31 December 2004. All financial data are in thousand PLN, unless provided otherwise. The Company keeps its account books according to the act of 29 September 1994 Accounting Act (unified text, Journal of Laws of 2002 No. 76, item 694 as amended).

d) Information on the composition of the Management Board and Supervisory Board is presented in point 9 of additional notes.

e) This financial statement does not refer to aggregate data, since the Company has no internal organisational units presenting their financial statements separately.

f) Ciech S.A. is a dominant company and a significant investor that develops a consolidated financial statement.

g) No mergers were carried out in the periods covered by this financial statement.

h) This financial statement was developed with the assumption of business continuity in the near future. The Management Board knows of no threats to the business continuity of the Company.

i) This financial statement and comparable financial data were developed in line with the unified accounting policy to ensure their comparability. In the period covered by this financial statement, no changes to the accounting policy were presented.

j) Opinions of registered auditors on the Company's financial statements revealed no reservations requiring adjustments of the data presented in the financial statement or comparable financial data.

**k) PRINCIPLES AND METHODS FOR THE VALUATION OF ASSETS AND LIABILITIES AS AT THE BALANCE SHEET DATE, ESTABLISHMENT OF FINANCIAL RESULT AND PRINCIPLES FOR THE DEVELOPMENT OF THE FINANCIAL STATEMENT AND COMPARABLE DATA**

**TANGIBLE AND INTANGIBLE ASSETS**

Tangible and intangible assets in usage for the first time are held at:

- purchase or production cost - acquired, accepted from tangible assets under construction
- market price - received free of charge or as contribution in-kind

The initial value of tangible assets can increase because of improvements or revaluations.

Expenditures for renovations that do not contribute to improvement or expanding useful lives of tangible assets are recognised at the time of their incurring.

Principles for amortisation of tangible and intangible assets:

- tangible and intangible assets over 3.500 PLN are amortised on straight-line basis with amortisation rates reflecting their expected useful lives, beginning as of the month following the month of their release for use
- tangible and intangible assets with the value equal or lower than 3.500 PLN are amortised on a one-off basis in the month following the month of their acceptance for use

Tangible assets were reassessed as at 1 January 1995, in line with the existing regulations. The Company verifies periodically the useful lives of property, plant, and equipment.

**TANGIBLE ASSETS UNDER CONSTRUCTION**

Investments in progress are held at costs incurred for the purchase of tangible and intangible assets that will be the result of completed investments.

**LONG-TERM INVESTMENTS**

Stock and shares are held at purchase cost net of write-offs in respect of impairment.

Write-down of stocks and shares is set individually for each of the companies taking into account equity value and financial results from the last 3 years. For the confirmation of the above method, the Company uses additional DCF verification method for shares and stocks likely to be impaired. The results of value reduction of long-term investment are recognised as financial costs.

Property investments are held at purchase cost net of write-offs in respect of impairment. Property and intangible assets recognised as investments are amortised in line with principles applied in case of tangible and intangible assets.

**FINANCIAL INSTRUMENTS**

Financial instruments are recognised and held in line with the Regulation of the Council of Ministers of 12 December 2001, on detailed principles of recognition, valuation method, range of disclosure and presentation method for financial instruments (Journal of Laws of 2001 No. 149, item 1674). The source of additional explanations and interpretation are IAS No. 32 and IAS No. 39. As regards derivative instruments, such as options, swap, forward, the hedge accounting policy is used only in the case of fulfilment of all conditions provided in the Regulation of the Minister of Finance of 12 December 2001 on detailed principles of recognition, valuation method, and range of disclosure and presentation method for financial instruments. In the event of failure to meet the conditions, a derivative instrument is held in line with valuation principles for assets and liabilities held for trading.

**CURRENT FIXED ASSETS**

Analytic record of current fixed assets is a quantity and value record covering turnover and balance for each component in natural and cash units. Income from current fixed assets is recognised in account books at purchase cost, including:

- the price payable to the seller net of deductible input VAT, or gross of legal taxes such as customs duties and excise duties in the case of imports

- in the case of domestic transactions, purchase price covers also direct costs related to the purchase and preparing goods for sale

The measurement of outflows is executed in line with the FIFO method.

The assessment of reserve impairment at the balance sheet date is performed according to the general principle:

- 30% write-down for reserves lingering for 1-2 years
- 50% write-down for reserves lingering for 2-3 years
- write-down for reserves lingering for more than 3 years

In the case of possibility for sales of the group of goods in the next reporting period, some deviations from the above principle are allowed.

Write-downs decrease the value of reserves in the balance sheet.

### **TRADE RECEIVABLES**

Receivables are valued in the amount payable, in line with the prudence principle, i.e. considering write-downs.

Write-downs for receivables are determined as follows:

- 100% write-down performed individually on registered transaction balance, for claims, receivables from contractors who declared bankruptcy or are in the course of composition proceedings
- 100% write-down net of liabilities, guarantees, discounts, insurance performed on the monthly basis on receivables overdue for more than 6 months
- 100% write-down performed at the end of each month on interest receivables from invoices settled
- 100% write-down performed at the end of the year on interest receivables calculated at the end of the year (balance sheet interest) from invoices unsettled

### **ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES - VALUATION, PRINCIPLES FOR ESTABLISHMENT OF WRITE-DOWNS, INVENTORY**

Open items of receivables and liabilities denominated in foreign currencies are valued at the end of the reporting period according to the average exchange rate set for a currency by the President of the National Bank of Poland. Any exchange differences arising from calculation according to NBP average exchange rates are presented as per account balance in income and financial costs of the reporting period.

Write-downs on receivables are valued according to the same principle as receivables.

Currencies on bank accounts, foreign currency accounts, and bank accounts of foreign operations are valued according to the average exchange rate set for a currency by the President of the National Bank of Poland.

### **SHORT-TERM INVESTMENTS**

Short-term investments are held at market value, and investments without an active market are held at purchase cost adjusted for a write-down determined and based on the financial position of the Company in the reporting period.

### **CASH IN HAND AND AT BANK**

Cash in hand and at bank denominated in the national currency is held at par values. Bank deposits are held at fair value considered as their par value gross of interest due.

## **PREPAYMENTS AND ACCRUALS - VALUATION AND PRESENTATION**

### **i. Prepayments and deferred expenses**

Prepayments and deferred expenses take place at Ciech S.A. if the incurred costs refer to periods following the period when they were incurred.

Prepayments and deferred expenses include:

- deferred acquisition costs - costs incurred, that in following reporting periods will be recognised as operating or financial costs
- other accruals - assets in respect of deferred income tax

Prepayments and deferred expenses at the time of their recognition are held as costs by type. Single expenses for a particular purpose, incurred in a given financial year, that do not exceed 2 500.00 PLN a month are not subject to settlement over time. Such expenses are charged against the profit and loss account for the period at the moment they are incurred.

### **ii. Accrued expenses**

Accrued operating and financial expenses include expenses incurred in the period concerned, commensurate with the income for that period. They are recognised as short-term accrued expenses and presented as "Other accruals." Accrued operating expenses are posted in the relevant "Costs by type of business" accounts at the moment they are incurred, and in "Costs by type" accounts on execution. Potential differences between the value of accrued expenses and the resulting liability are used to adjust the expenses recorded for the period concerned.

### **iii. Prepayments and accrued income**

Prepayments and accrued income in line with a definition of liabilities and income, are divided into:

- deferred income – long and short-term income in its par value that will be executed in the future periods
- accrued income – the equivalent of tangible assets under construction, tangible assets, and intangible assets acquired free of charge (including as gifts), as well as cash acquired to finance the purchase or manufacture of tangible assets including tangible assets under construction and development work.

Accrued income is recognised as increasing other operating income parallel to the amortisation/depreciation charges for tangible assets, tangible assets under construction, intangible assets, or development costs, acquired free of charge or financed from external sources.

## **EQUITY AND SPECIAL FUNDS.**

Regulations of establishing and allocation of share capital, share premium and reserve capital are determined in the Code of Commercial Companies (Journal of Laws of 2000 No. 94, item 1037) and Resolutions of the General Meeting of Shareholders, passed pursuant to the Code. Share capital is recognised at the par value of registered shares, based on the Company's Articles of Association and entry to the National Court Register.

The revaluation reserve is raised at the date of tangible assets revaluation carried out pursuant to relevant separate laws, and is not subject to distribution.

## **PRINCIPLES FOR ESTABLISHING PROVISIONS.**

Provisions are established for:

- some and very likely future liabilities that can be reliably measured
- future liabilities related to restructuring, if upon separate regulations the Company is obligated to restructuring, or if binding agreements have been concluded and the restructuring plans have been announced and allow for reliable measurement of future liabilities

- deferred income tax
- future liabilities for service anniversary awards and retirement gratuities

Provisions for service anniversary awards and retirement gratuities are valued at the end of the financial year with the actuarial method. The provision is charged against other operating costs. It is established in unit 6. and presented in item 'liabilities and reserves for liabilities.' It is posted in group 6 accounts, under "liabilities and provisions."

### **DEFERRED INCOME TAX**

The Company determines assets for the deferred income tax and a provision for the income tax. Assets in respect of deferred income tax are determined in the amount predicted for future deduction from the income tax related to negative transitory differences. In line with the prudence method, the Company does not recognise an asset for the deferred tax related to write-downs of receivables.

The provision for the income tax is established in the amount of income tax payable in the future as a result of positive transitory differences.

The provision and assets in respect of deferred income tax are established taking into account income tax rates applicable in the year when the tax obligation arises.

Deferred income adjustments related to a change in the tax rate are performed at the end of the year.

### **NET SALES OF GOODS AND SERVICES AND TAX DEDUCTIBLE COSTS**

Sales income includes amounts due or received from sales of products, goods, and services. Sales income is recognised as net value, i.e. net of due VAT tax. Income and related costs are recognised in relevant reporting periods, irrespective of the date of receiving or making a payment.

### **OTHER OPERATING INCOME AND COSTS**

Other operating income and costs are related to the Company's activity and they influence the result from operating activities.

Other operating income includes, profit from sales of fixed assets, equivalent of released write-offs for doubtful receivables and business risk, excluding provisions for financial risk, penalties, and damages received.

Other operating costs include, loss from sales of property, plant, and equipment, write-offs for doubtful receivables and business risk (excluding provisions for financial risk), penalties and damages paid, donations and reserve adjustments.

### **FINANCIAL INCOME AND COSTS**

Financial income and costs include interest related to granted and used loans or borrowings, exchange differences, commissions plus income and costs related to adjustments of shares and other short-term investments, adjustments of investment value, interest on bank deposits, overdue payments, profit and loss on short-term securities.

### **EXCHANGE DIFFERENCES**

Exchange differences related to the valuation of assets and liabilities as at the balance sheet date, denominated in foreign currencies and resulting from payment of receivables and liabilities in foreign currencies, and sale of currencies are recognised as financial income or costs respectively. Such differences are presented in the P&L account as per account balance in financial income or costs respectively. They increase the purchase cost or manufacturing cost of fixed assets, fixed assets under construction, or intangible assets.

## EXTRAORDINARY PROFIT AND LOSS

Extraordinary profit and loss result from extraordinary events, outside Company's regular activity.

l) Average PLN exchange rates in the reporting periods and comparable financial data in relation to EUR.

- EUR average exchange rate as at 31 December 2005	3,8598
- EUR average exchange rate as at 31 December 2004	4,0790
- EUR average exchange rate between 1st January and 31 December 2005	4,0233
- EUR average exchange rate between 1st January and 31 December 2004	4,5182
- EUR lowest exchange rate between 1st January and 31 December 2005	3,8223 (as at 13 December 2005)
- EUR highest exchange rate between 1st January and 31 December 2005	4,2756 (as at 29 April 2005)
- EUR lowest exchange rate in 2004	4,0518 (as at 28 December 2004)
- EUR highest exchange rate in 2004	4,9149 (as at 1 March 2004)

Average exchange rate in the reporting period was calculated as the arithmetic average applicable as at the last day of each month in the reporting period.

m) Selected data on basic items of the balance sheet, P&L account and cash flow statement from the financial statement, and comparable financial data, translated into EUR with translation principles were presented in the report sheet 'Selected financial data'.

n) According to art. 18 para. 2 of the Regulation of the Council of Ministers of 11th August 2004 (Journal of Laws No. 186 item 1921) as amended, on detailed conditions of the prospectus and the abridgement of the prospectus, the issuer is obliged to point to and explain the differences in the value of the disclosed data related at least to the equity, net financial result and material differences in the accounting policy applied, between financial statements prepared in line with FAP and IFRS. This requirement will be met in the consolidated financial statement of the Ciech S.A. Capital Group. Only descriptions of adjustments have been presented below.

As at the balance sheet date, Ciech S.A. identified all fields of differences in the accounting policy implemented by the Company and IFSR:

- revaluation of tangible assets - as of 1 January 2004, the Company re-valued tangible assets to the fair value in line with the IFSR requirements.
  1. Revaluation covered all tangible assets with the initial value equal to or higher than 10.000 PLN. According to this condition, 380 facilities were valued, which consists 90% of the initial value of all facilities and 98% of net value of all tangible assets as at 1 January 2004. Because of this operation the value of assets reported in the balance sheet increased by 2.973 000 PLN, whereas value of the Company equity increased.
- investment property - the Company owns investment property, including a complex of offices located at ul. Jasna 12 in Warsaw. As a result of application of the cost method for the investment property, as at 1 January 2004 the Company adjusted amortisation of these facilities for 2002-2003. According to FAP, the investment property was not subject to amortisation in these years. The value of adjustment was 846 000 PLN. This item includes:
  - a complex of offices located at ul. Jasna 12 in Warsaw
  - 4 petrol stations

Since the whole office building and 4 petrol stations are for rent, they were qualified as Investment property. They are subject to amortisation, with amortisation rates used so far.

- deferred tax on tangible fixed assets - The Company established a provision for the deferred tax from transitory differences resulting from revaluation of tangible assets as at 1 January 2004. The adjustment value, provision for the deferred tax, 521 000 PLN, so the financial result for 2005 was recognised as 295 000 PLN
- amortisation - the Company adjusted amortisation for 2005 in connection with revaluation of tangible assets as at 1 January 2004. The adjustment amount was 998 000 PLN for cost deductions (increase of the financial result)
- amortisation - the Company adjusted amortisation of tangible assets held for sale. The adjustment amount was 33 000 PLN for cost deduction (increase of the financial result)

As at 31 December 2005	in thousand PLN
<b>Equity according to FAP</b>	<b>584 079</b>
- revaluation of tangible assets	2 973
- deferred tax on re-valued tangible assets	-521
- amortisation adjustment of tangible assets in respect of revaluation	998
- amortisation adjustment of investment property for 2002-2003	-846
- amortisation adjustment for 2004	2 180
- amortisation adjustment of tangible assets held for sale	33
- adjustment of own cost related to sales of tangible assets subject to revaluation	-2 586
- others	5
<b>Equity according to IFRS</b>	<b>586 315</b>

As at 31 December 2005	in thousand PLN
<b>Net financial result according to FAP</b>	<b>41 900</b>
- amortisation adjustment of tangible assets in respect of revaluation	998
- deferred tax on re-valued tangible assets	295
- amortisation adjustment of tangible assets held for sale	33
- adjustment of own cost related to sales of tangible assets subject to revaluation	-2 586
- others	
<b>Net financial result according to IFRS</b>	<b>40 640</b>