# PKO Bank Hipoteczny 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 PKO Bank Hipoteczny SA

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

We have audited the accompanying annual financial statements of PKO Bank Hipoteczny SA, with its registered office in Gdynia, ul. Jerzego Waszyngtona 17 (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 "financial statements").

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

The Management Board of the Bank is responsible for the preparation, on the basis of properly maintained accounting records, of 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 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 financial statements are in compliance with the requirements set forth in the Accounting Act.

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

Our responsibility is to express an opinion on these 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 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 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 financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the 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 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 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, described below and we performed appropriate audit procedures to address these matters. Key audit matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

#### **Impairment of loans and advances to customers**

The carrying value of loans and advances to customers amounted to PLN 16 042 million as at 31 December 2017 and PLN 8 248 million as at 31 December 2016. The net impairment loss and provisions amounted to PLN 3.3 million for 2017 and PLN 1.6 million for 2016.

Reference to financial statements: note 19 “Loans and advances to customers”, note 10 “Net impairment loss and provisions” and note 38 “Credit risk management”.

| **Key audit matters** | **Our procedures** |
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| Loans and advances to customers are measured at amortised cost less the impairment allowances and write-downs . The | Our audit procedures conducted with the support of our internal IT specialists included among others: |

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| procedures to estimate impairment allowance comprise two major phases – identification of impairment triggers and calculation of the allowance.<br><br>Impairment triggers are identified based mainly on repayment delinquencies, while impairment allowances are estimated using statistical methods including risk parameters (portfolio and group methods; individual method is not used due to the retail profile of credit portfolio). The risk parameters include, probability of default (PD), loss given default (LGD), loss identification period (LIP) and are calculated for homogeneous groups of loans based on empirical data, taking into account current economic conditions.<br><br>The impairment allowances are the best estimate of incurred losses on loans and advances as at the year end. We have considered this as a key audit matter because of the size of credit portfolio and the significant impact that the impairment allowance can have on the Bank's financial statements. Furthermore estimating the impairment allowance requires from the Bank's Management to use substantial judgement. There is a risk that impairment triggers are not identified on a timely basis or the data used to estimate statistical parameters does not reflect the real level of credit losses existing as at the balance sheet day. Moreover, there is a risk of errors occurring during the impairment allowance calculation process. | • Assessment of the Bank's methodology used for calculating of impairment allowances and write-downs for loans and advances to customers for its compliance with relevant financial reporting standards as well as, the market practice;<br><br>• Evaluation of design and implementation of key internal controls, including controls in IT environment, in the impairment identification and calculation process; testing operating effectiveness of these internal controls;<br><br>• 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.<br><br>• 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 default (LGD), loss identification period (LIP).<br><br>• Assessment of adequacy of incurred but not reported provision (IBNR) in comparison with actual losses observed on given homogenous groups of loans in prior years;<br><br>• Verification if the impairment model parameters are correctly matched to particular loans and advances based on the their characteristics, such as rating class, past due status, LTV ratio.<br><br>• Recalculation of impairment allowances by using statistical methods. |

### *Opinion*

In our opinion, the accompanying financial statements of PKO Bank Hipoteczny SA:

- give a true and fair view of the financial position of the Bank as at 31 December 2017 and of its financial performance and its cash flows for the year then ended in accordance with IFRS EU and the adopted accounting principles (policy);
- 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***

### *Report on the  Bank's activities*

Our opinion on the financial statements does not cover the Directors' 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.

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 financial statements. Our responsibility was also to state, if based on our knowledge about the Bank and its environment obtained in the audit, we have identified material misstatements in the report on the activities and describe the nature of each material misstatement.

In addition, in accordance with Article 111a paragraph 3 of the Banking Act dated 29 August 1997 (Official Journal from 2017, item 1876) ("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 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 financial statements.

Furthermore, based on our knowledge about the Bank and its environment obtained in the audit, 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 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 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 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 financial statements.

*Independence and the appointment of the audit firm*

Our opinion on the audit of financial statements is consistent with our report to the Audit and Finance Committee of the Supervisory Board. 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 financial statements by the resolution of the Supervisory Board dated 14 May 2015 and reappointed by the resolution dated 5 March 2017.

Our total uninterrupted period of engagement 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 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 50 "Capital adequacy and the management of capital risk", that could have a material impact on the financial statements of the Bank.

Based on our audit of the 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 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

2 March 2018