

#### **Our vision**

TP Group's goal is to achieve a strong leadership position in all our core markets.

Our success will be founded on a broad portfolio of highly innovative products, a commercially powerful, proactive sales force and outstanding customer care, supported by a robust infrastructure and highly motivated employees.

Co-ordinating our efforts around a lean, agile operating model will ensure that we deliver healthy and sustainable returns to our shareholders.

#### **Contents**

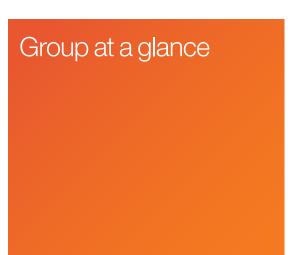
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During a year of steady progress at TP Group, we met our strategic commitments and achieved our financial targets, while also maintaining a very healthy balance sheet.

Once again, we were able to offer attractive returns to shareholders without compromising future growth.



TP Group is the largest telecommunications group in Poland, operating in all segments of the Polish telephony and communications industry. The Group owns the largest technical infrastructure in Poland, with operations in fixed line voice, data and mobile networks.

In 4Q 2011, our share of the Polish telecoms market (by value) was 65.9% of fixed voice, 40.3% of fixed broadband, and 30.2% of mobile through the Orange brand. TP is 49.79% owned by France Telecom (as at the end of 2011).

**Total revenue** PLN

14.9 bn

% change from 2010 -4.1%

**Number of employees** 

23,805

at year end

Retail fixed line customer base

5.6 mn

market share 65.9% (by value)

Mobile customer base

14.7 mn

market share 30.2% (by value)

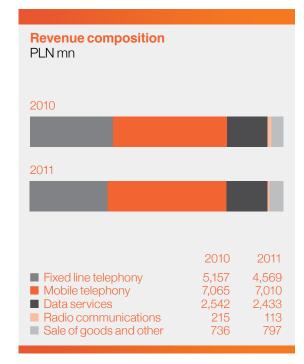
**Retail broadband customer base** 

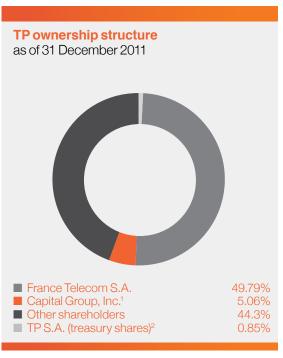
2.3 mn

market share 40.3% (by value)

TV customer base

636,000





<sup>&</sup>lt;sup>1</sup>The number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

<sup>&</sup>lt;sup>2</sup>TP shares purchased in 2011 during the share buy-back program

#### Financial highlights

Total shareholder return

+14.6%

in 2011

Dividend per share

**PLN 1.5** 

Dividend yield<sup>2</sup>

8.7%

at year end

#### **Financial highlights**

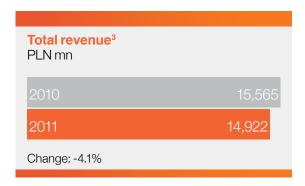
- Total revenue PLN 14.9 billion
- Restated EBITDA<sup>1</sup> PLN 5.4 billion, 36.3% of revenue
- Net free cash flow PLN 2.4 billion
- Market cap<sup>2</sup> PLN 22.8 billion up 4.5% from 2010
- Dividend yield of 8.7%<sup>2</sup>
- PLN 800 million share buyback program started
- Labour expenses down 6.7%
- PLN 182 million cost savings in 2011

#### **Operational highlights**

- 326,000 mobile net adds
- 60,000 new broadband clients
- 47% of new broadband clients on premium speeds
- Enacted network sharing agreement with PTC
- Began offering broadband/TV bundles with TVN
- Reached final settlement in DPTG dispute
- Continued to fulfill our commitments related to MoU with the Regulator
- Reached agreement on future headcount reduction with social partners

<sup>1</sup>2011 results excluding PLN -172 million restructuring provision, PLN -35mn increase in DPTG provision, PLN 1.2 billion gain on Emitel disposal and a PLN -0.46 billion provision for EC fine (both recognised in 2Q). 2010 pro-forma (adj. for de-consolidation of Emitel) and excluding the PLN -1.1 billion revision of provision for the DPTG dispute. Cost base up to EBITDA

<sup>2</sup>based on share price at year end







Market cap<sup>4</sup> PLN

22.8 bn

at year end

- 12011 results excluding PLN -172 million restructuring provision, PLN -35mn increase in DPTG provision, PLN 1.2 billion gain on Emitel disposal and a PLN -0.46 billion provision for EC fine (both recognised in 2Q). 2010 pro-forma (adj. for de-consolidation of Emitel) and excluding the PLN -1.1 billion revision of provision for the DPTG dispute. Cost base up to EBITDA
- <sup>2</sup> segments as defined in TP Group's Consolidated Financial Statement
- <sup>3</sup>adjusted for deconsolidation of Emitel from 2H 2010, all comparisons are based on such pro-forma, unless otherwise stated
- <sup>4</sup>Market Cap = share price x number of outstanding shares (excluding shares purchased in 2011 during the share buy-back program





Cost savings PLN 182 mn

#### CEO's letter

Maciej Witucki President of the Board and Chief Executive Officer



"

In 2011 we continued to implement our medium-term action plan, achieving step-by-step progress across the business and gaining considerable commercial momentum as the year progressed. Our financial results were solid, in terms of both top line and profitability.

"

Dear Shareholders,

2011 was a year of solid performance at TP Group. We were able to steer a steady course despite tough market conditions, and ended the year on target with regard to our commercial and financial objectives.

#### Steady progress in our key markets

We continued to implement our medium-term action plan, and saw step-by-step progress across the business as a result. TP Group gained considerable commercial momentum as the year progressed, maintaining market share in the mobile segment. Revenue from mobile data services showed very healthy growth as we continued to nurture the market for smartphones in Poland. In broadband, growth has been somewhat slower than we would like, and we believe the Polish broadband market is still falling short of its potential. However, the pace of growth in TP Group's broadband segment is accelerating as we continue to implement our product strategy. We claimed a 17% market share of new adds during the year, with almost 50% of our new customers buying speeds of 6Mb/s and faster.

#### Solid financial performance

In terms of financial results, TP Group posted a solid performance both in terms of top line and profitability. Net income was at PLN 1.9 billion, despite pressure from the weakened złoty in the second half of the year. This brought the EPS to PLN 1.44, almost covering the proposed dividend of PLN 1.5 per share. Profitability was in line with our outlook too, with our restated EBITDA margin maintained at a healthy 36.3%. The Group's on-target net free cash flow figure – roughly PLN 2.4 billion for the full year – reflects the strong net income and EBITDA performance. We also finalized the sale of TP Emitel in the second quarter of the year, enabling us to allocate PLN 800 million to a share buy-back, of which PLN 200 million has already been executed in 2011.

Net free cash flow PLN

2.4 bn

on target

Cost base<sup>1</sup>

-3.7%

year-on-year

<sup>1</sup>2011 results excluding PLN -172 million restructuring provision, PLN -35mn increase in DPTG provision, PLN 1.2 billion gain on Emitel disposal and a PLN -0.46 billion provision for EC fine (both recognised in 2Q). 2010 pro-forma (adj, for de-consolidation of Emitel) and excluding the PLN -1.1 billion revision of provision for the DPTG dispute. Cost base up to EBITDA

#### Planning for the future

Cost savings continue to be a priority – as proven by a 3.7% reduction in our cost base, year on year. We also reached an important agreement with our social partners in the third quarter which paves the way for further reductions in headcount over the next two years, amounting to 2,300 fewer full-time employees in total. These measures will significantly contribute to TP Group's future profitability.

Our relationship with the Polish telecoms regulator continued to be stable. Operating within a predictable regulatory framework allows us to plan and execute longer-term strategies. Our ground-breaking network sharing arrangement with T-Mobile is one such project, which will permanently improve the cost structure of our mobile business, while simultaneously increasing network coverage and throughput for our customers.

I want to take this opportunity personally to thank the entire staff of TP Group for the hard work they have put in over the past year. Today we can truly say there is a new culture of cooperation developing within our company, and our strong performance in 2011 is in no small part thanks to the efforts you have made to build and strengthen that culture.

#### The years to come

Looking ahead to 2012, we will continue implementing our action plan in its third and final year. Our key commercial objectives are to maintain leadership in mobile and to boost growth in broadband, as well as using the Orange sponsorship of the EURO 2012 championship to enhance the status of the brand in Poland. Our customer excellence program will continue to focus on making improved customer care a key differentiating factor, with more convergent offers and faster service implementation. Revenue decline is expected to slow down, and we will continue to control costs rigorously. Taken together, all these measures will strengthen our market position and improve operating efficiency, allowing us to keep on achieving our primary goals: sustainable financial results and attractive shareholder remuneration. After a year of strategic successes and steady improvements, with a safe balance sheet and a strong management team in place, I am confident that TP Group will go from strength to strength in 2012 and beyond.

#### Maciej Witucki

President of the Board and CEO

Total shareholder return in 2011

+14.6% TP S.A. vs. -21.9% WIG 20 index



How we are performing against our goals

re-focus re-engage re-balance



2011 was the second year of implementation for our three-year medium term action plan. Across TP Group, we continued to pursue an integrated set of objectives, focused around three main strategic goals: to re-focus on our core business; re-engage with our key markets; and re-balance our operating model. Our achievements in 2011 lay not only in meeting our targets, but also in laying the foundations that will underpin our future achievements.

#### re-focus

#### **Our vision**

- Capitalise on new regulatory environment
- Concentrate on products and customers
- Invest in the future of broadband

#### **Our commitment**

1.2 million new /upgraded broadband lines by the end of 1Q 2013, including 220,000 at 30 Mb/s

#### re-engage

#### **Our vision**

- Increase customer loyalty
- Build critical mass in TV
- Halve time to market for new products
- Move to next generation customer care

#### **Our commitment**

Regain leadership in mobile and broadband

#### re-balance

#### **Our vision**

- Reduce opex
- Rebalance cost structure (from non-commercial to commercial costs)
- Allocate capex to support new operating model

#### **Our commitment**

Robust cost transformation plan to offset impact of regulation and preserve margins







#### **Progress**

- MTR cuts implemented at agreed levels
- Emitel disposal completed
- Broadband investment programme in line with schedule
- Improved sales processes and customer relations visible in commercial performance

#### **Key performance indicators**

 Almost 860,000 new/upgraded lines by end 2011 (72% of total 3 year plan) High speed share in Neostrada sales

2010

18%

2011

47%

#### **Progress**

- Began selling enhanced TV offer with TVN
- Continued "customer excellence" programme
- Steady growth in mobile and broadband

#### **Key performance indicators**

- Mobile market no. 1 by value
- 944,000 mobile customers since start of medium term action plan (introduced in 2010)
- Added 60,000 broadband customers in 2011
- Over 300, 000 mobile net adds in 2011
- 17% increase in TV clients
- 47% of Neostrada sales at 6Mb/s or above

Net adds in mobile exceeded

600,000 in 2010 300,000 in 2011

#### **Progress**

Cost transformation programme including

- Sale of obsolete cabling
- Better customer retention, reducing commercial costs
- Process simplification
- Intra-sector co-operation to reduce costs

#### **Key performance indicators**

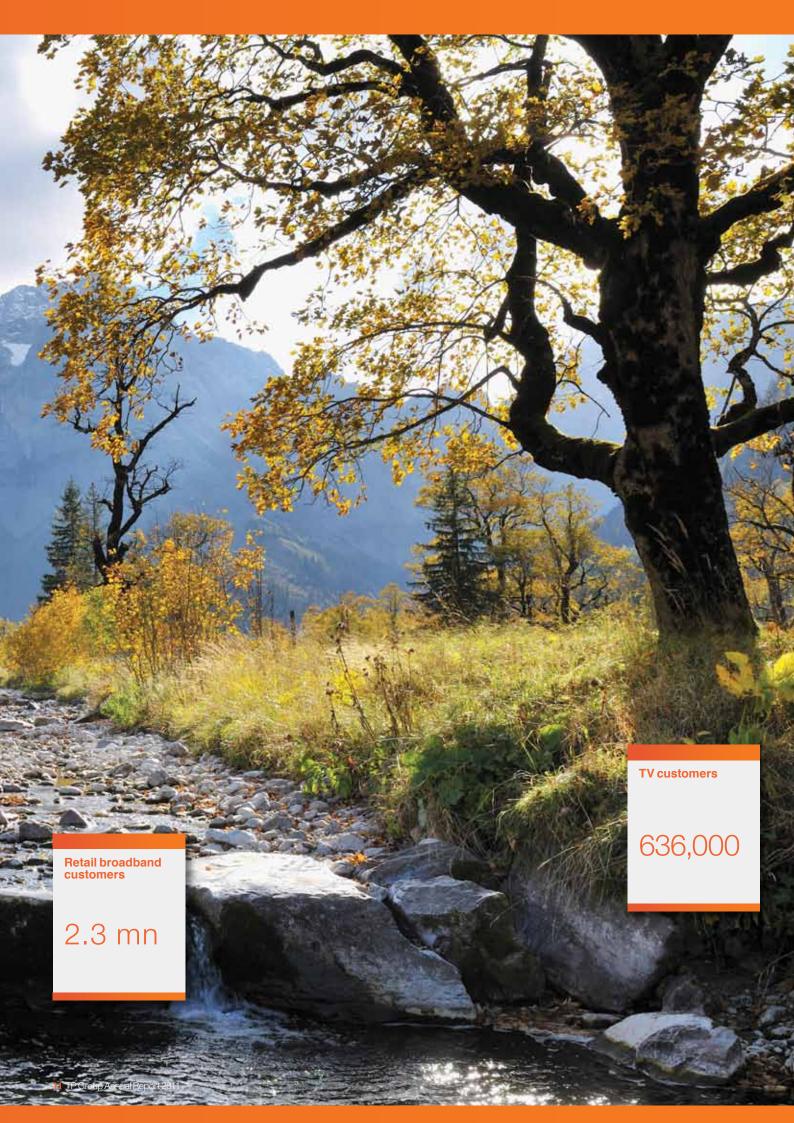
- Almost PLN 182 million cost savings in 2011
- Cost base<sup>1</sup> -3.7% year-on-year
- 2,300 headcount reduction agreed with labour unions
- Deals signed with TVN Group and PTC

<sup>2</sup> 2011 results excluding PLN -172 million restructuring provision, PLN -35mn increase in DPTG provision, PLN 1.2 billion gain on Emittel disposal and a PLN -0.46 billion provision for EC fine (both recognised in 20). 2010 pro-forma (adj. for de-consolidation of Emittel) and excluding the PLN -1.1 billion revision of provision for the DPTG dispute. Cost base up to EBITDA

Cost savings PLN

182 mn



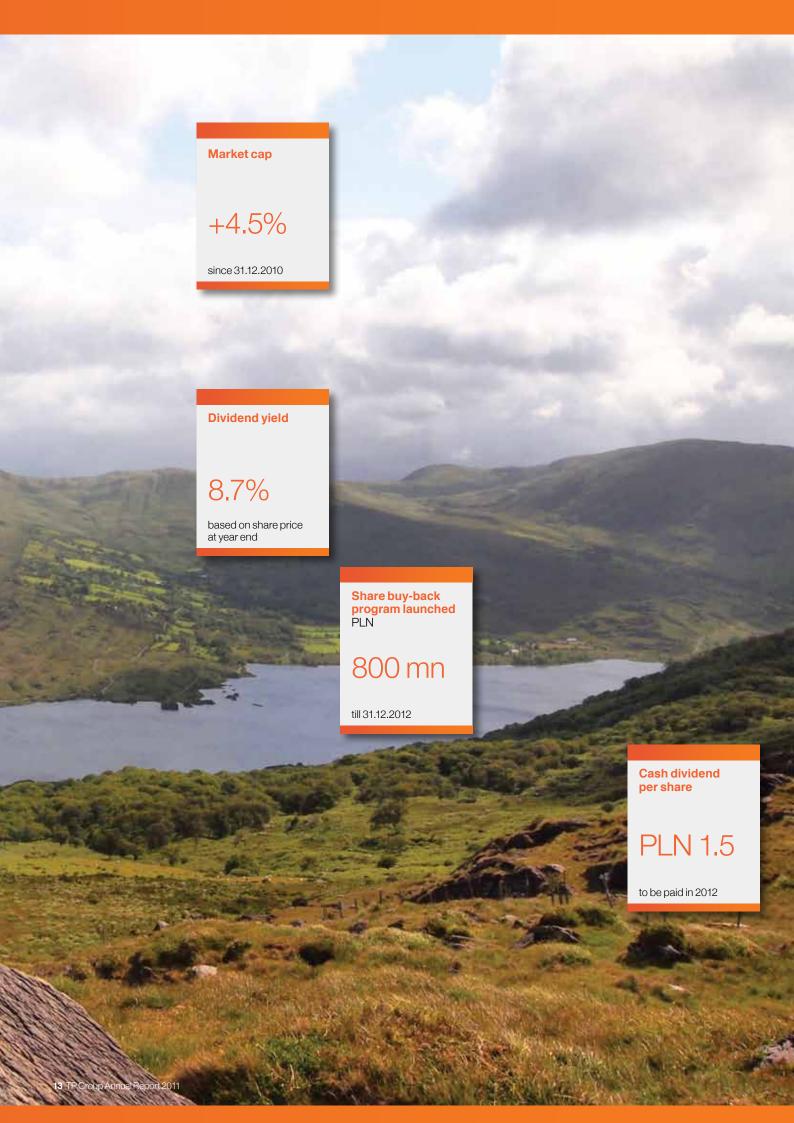


## Reaching our targets and aiming higher

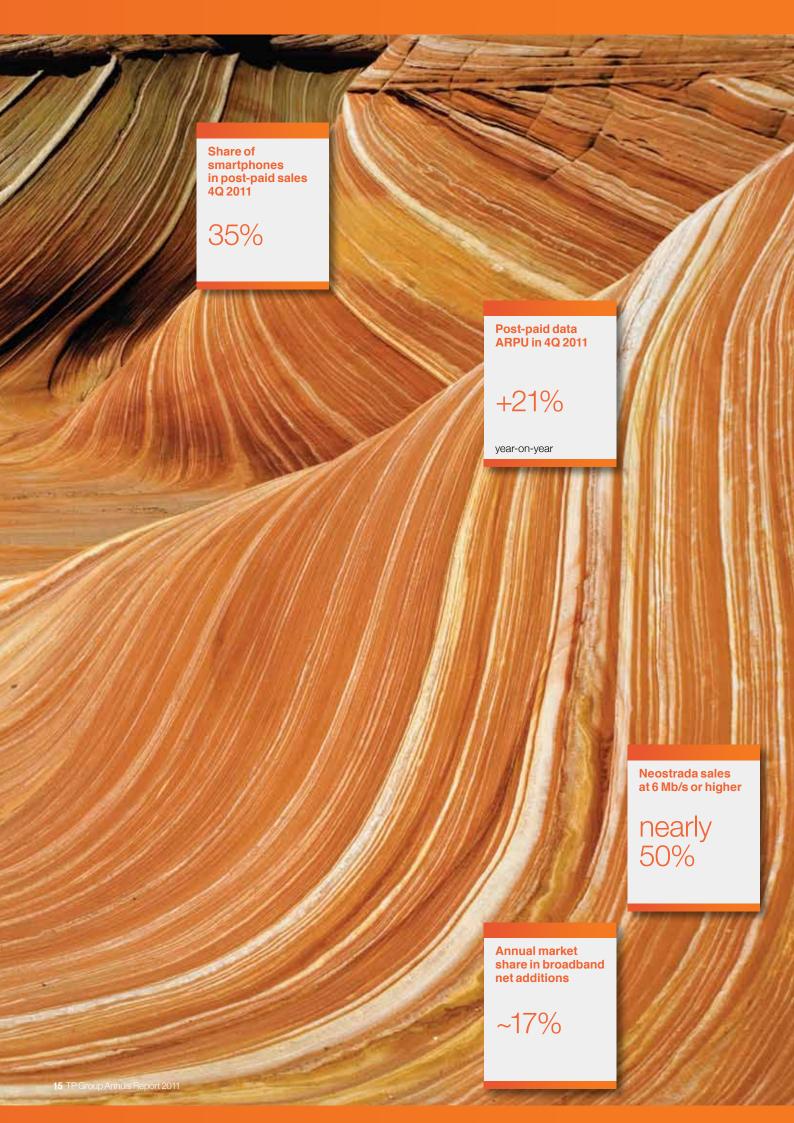
# Consistent returns

We maintained an exceptionally safe balance sheet last year, which enabled us to pay dividends to our shareholders at the same level as the previous year. Furthermore, this was coupled with the start of a PLN 800 million share buy-back program. TP's share price was also consistently strong, ending the year 5.4% up on a year earlier, and outperforming the Polish WIG 20 index, which fell by 21.9%. This compares very favorably with the majority of our peers – as the European telecom index Beteles fell by 9.1%. The market's confidence in TP reflects the fact that the company has the right management team and the right strategy to steer safely through turbulent





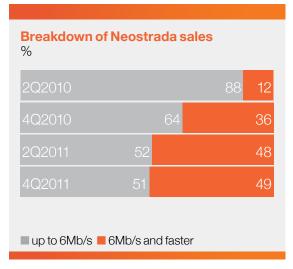


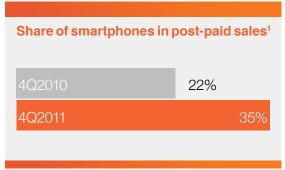


Despite tough economic conditions for the Polish telecoms market, TP Group held its own in 2011, defending market share in mobile and broadband. We kept operational expenses firmly under control, and invested in the infrastructure, technologies and capabilities that will enable our company to aim even higher in the future.

### 2011 Operating review Market climate







 $<sup>^{\</sup>rm 1} total\, smartphones\, in\, acquisition\, and\, retention\, in\, the\, period$ 

Poland's economy continued to be one of the strongest in Europe, with GDP growth for 2011 estimated at 4.3%. Unemployment remained relatively high, little changed from 2010 levels at around 12.5%. Market consensus on the economy's prospects for 2012 suggests that growth will continue, but at a slower rate – closer to 2.5%.

The Polish telecoms market did not fare so well in 2011: according to our estimates it contracted by 0.4%. The factors behind this decline include the erosion of fixed line voice revenues and the impact of Mobile Termination Rate (MTR) cuts.

#### Data is the big news in mobile

Although the mobile voice market is at saturation phase, with a SIM card penetration rate of 133%, the mobile data market still provides operators with revenue growth opportunities thanks to the growing popularity and availability of smartphones, as well as tablets and other mobile Internet devices.

#### Strong demand for faster broadband

The broadband market is gradually slowing down. However, changes to the BSA pricing model in 2010 have allowed TP Group to adjust its prices to better compete in this crowded market. An increased demand from consumers for higher broadband speeds emerged as a clear trend in 2011. As a result, we are beginning to realise the potential of the broadband investments we are making as part of the Memorandum of Understanding with the Regulator.

#### New alliances reshape the market

Overall, the telecoms market in Poland has entered a consolidation phase, with mergers and acquisitions occurring on a regular basis. For example, in 2011 UPC acquired Aster, Zygmunt Solorz-Żak acquired Polkomtel and Netia acquired Dialog and Crowley. Meanwhile, increased cooperation between former rivals is becoming more common, as companies seek more efficient ways to expand their offer into new markets, or look to cut costs by sharing infrastructure. The most significant examples of this are TP Group's deal with TVN Group to offer bundled TV with broadband, and the network-sharing joint venture between PTK Centertel (our mobile operating company) and PTC.

# 2011 Operating review Regulatory update

Since signing the Memorandum of Understanding (MoU) with UKE in October 2009, our dialogue with the Regulator has been constructive and the regulatory landscape has stabilised. In 2011 we continued to deliver on our commitments, both in terms of non-discriminatory treatment of alternative operators, and in terms of our investment obligations.

#### **Broadband network upgrades**

By the end of 2011, we had invested in almost 860,000 new or upgraded broadband lines, amounting to almost 72% of the 3 year MoU commitment. We have also agreed that 220,000 of the remaining 341,000 lines will be at speeds of 30 Mb/s or above. This means employing VDSL technology, which will be our main weapon for competing against cable operators in major cities. But importantly, this will not involve extra capex in relation to the MoU commitments, and we are still confident in meeting our commitment to lower capex to its former levels after 2012.

The dialogue with the regulator has brought several benefits in 2011. For one thing, the new cost-plus formula for Bitstream has been instrumental in the recovery of our broadband trends. We have also been able to agree an acceptable glide path for MTR cuts in 2011 and 2012, for both SMS and voice.

#### **Future priorities**

Looking ahead to 2012, we will continue to seek dialogue with the new regulator on two main topics. Firstly, regarding the auction for the 1800MHz spectrum, which has been put up for public consultation. In its current shape it strongly favours the fourth player and so we hope that positive dialogue may result in more neutral and price-driven tender rules. We will also watch with great interest the process leading towards frequency auctions for 800 MHz and 2600 MHz, which are key to the timely roll-out of LTE technologies for mobile broadband. Secondly, we will engage in the debate about fibre regulation, where we strongly believe that fair and stable rules could stimulate investments into this vital technology.



Positive dialogue continues

### 2011 Operating review Products and services

Vincent Lobry
Vice President of
the Board and
Chief Marketing Officer



"

In 2011, we continued to execute our medium term action plan with discipline and purpose. While our focus on cost optimisation remained strong, we also worked hard to capitalise on the commercial momentum of 2010. Having regained leadership positions in mobile and broadband in 2010, we continued to make steady progress, underlining our commitment to re-engage with our key markets and turn customer excellence into a real differentiator for TP Group.

"

#### Mobile

#### Satisfying the demand for data

Our mobile customer base increased by over 300,000, or 2.3% - a satisfactory result in a very competitive market, where the fourth operator, Play, still benefits from MTR asymmetry. Our most important achievement in 2011 was to systematically increase smartphone penetration. Mobile data devices now make up more than 35% of our sales, and this share is growing. On the strength of this development, we saw post-paid data ARPU rise in 4Q 2011 by 21% compared to 2010. Data ARPU is now a key factor in the resilience of our overall retail ARPU to price pressure.

#### Meeting the changing needs of customers

We made vital modifications to our network and service offering in order to support the new demands of Polish consumers. We implemented HSPA DC to guarantee our customers the Internet speeds that they need for their smartphones and tablets. And we launched a convergent offer called 'combo', that includes both fixed and mobile services. We believe that convergence and customer care will be the main levers of competitive advantage in the future. Therefore our focus in 2012 will be on the launch of better bundles and more convergent services.

4Q 2011 post-paid data ARPU

+21%

year-on-year





**VDSL** speeds

40-80 Mb/s

launched in 2011

#### **Broadband and TV**

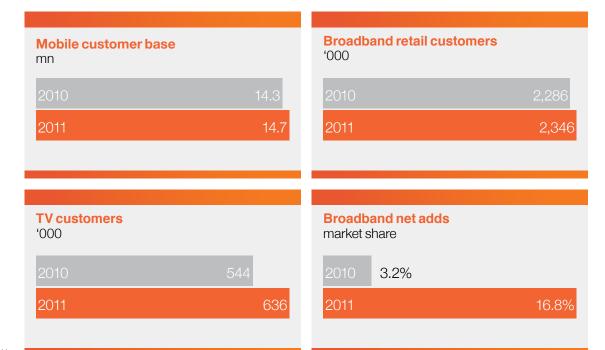
#### Investing for the future

Throughout the year, we worked to capitalise on the October 2010 revamp of our broadband offering. A key part of our strategy was the commercial launch of the TV/broadband bundle with enhanced content from TVN. Although we saw no immediate breakthrough, this was not a surprise in what was a very challenging year for the industry. We remain confident that cooperating with TVN on this offer will secure our position in the media-and-telco market for the future. Both companies will benefit from this attractive multi-play offering, which is on sale through TP Group's distribution network as well as TVN's. As well as the up-selling potential that comes from access to each other's customer bases, there are significant cost synergies from our joint technical, marketing and sales activities.

We also successfully launched new speeds based on VDSL, enabling 40 and 80 Mb/s options. VDSL-based high speed broadband will significantly boost our competitive position in the big cities, where we compete against cable operators. We also worked to improve geo-marketing and door-to-door sales activities in these territories.

#### Slow but steady recovery

Our actions resulted in a progressive upturn in broadband trends. Although the total growth in customer base was below our targets, we did see progressive growth every quarter, showing that the positive trend is sustainable. What is more, almost 50% of the year's new sales were at speeds of 6Mb/s or higher, compared to just 18% a year earlier, helping to stabilise ARPU despite a major reduction in our retail prices in 2010. This gives us a good platform for revenue growth in broadband in 2012.



After completing a major integration of our customer care operations in 2010, 2011 was another year in which we prioritised efficiency, but efficiency at the service of our customers. Our "customer excellence" initiative really began to take root throughout the Group, ensuring that as we continue to streamline our systems and processes, we are always focused on making our services simpler and more accessible for the people who use them.

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**e-invoices** monthly

1.7 mn

up from 1.2 mn in 2010

# 2011 Operating review Customers and distribution

### Mariusz Gaca Chief Commercial Officer,

Chief Executive Officer of PTK Centertel (TP's Mobile arm)





#### Orange Customer Service: more than ordinary aftersales

2011 was the first full year of activity for Orange Customer Service, which we established in October 2010. By overhauling the whole range of aftersales and bill payment processes, and adopting a Service-to-Sales approach, we have built a modern, user-friendly organisation, oriented around the customer experience. We also continued our efforts to optimise our aftersales operations and cost base, looking at areas like e-invoicing and inbound traffic management, with a strong focus on customer segmentation and competence-based routing. Moreover, we developed new e-care channels adapted to the changing needs and lifestyles of our customers, like "virtual advisor" on the Orange Poland Facebook page.

#### Modernising sales and distribution to reflect our evolving product portfolio

2011 brought significant changes in terms of our sales to TP Group key accounts, with the establishment of Integrated Solutions – a new TP Group company serving the information and communications technology (ICT) market. In the mass market segment, as well as continuing to increase the use of remote sales channels, we focused on modernising our sales and delivery processes to handle demanding new services (e.g. high-speed broadband 40Mb/s+). Facing new challenges in a mature market, we worked hard to develop a regional strategy, concentrating our efforts on areas where new investments are being made, as well as on the biggest cities where we compete with cable TV operators. We also revamped our commission systems to make them more effective and value-driven. Through our Service-to-Sales approach, we ensured that we realised maximum commercial benefits from inbound calls from existing customers. We also made use of our distribution network to profit from temporary sales of specific non-telco items, such as UEFA EURO 2012™ products.

#### Focus on value-driven customer management

Because we are now operating in a mature telco market considered to be one of the most competitive in Europe, our priority is to build long-term customer value. While we believe that our customer excellence program is building customer loyalty, a simple volume-driven approach is not enough. That's why we have developed new value-based market segmentation strategies, and adjusted our aftersales and retention activities towards different customer segments. We have also implemented a sophisticated anti-churn approach in mobile, paying special attention to those customers who appear most likely to leave us.

Making our services simpler to understand



**Cost optimisation** PLN

0.2 bn

savings in 2011

Customer service excellence



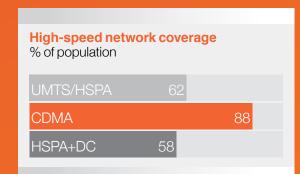
# 2011 Operating review Technology Piotr Muszyński Vice President of the Board and Chief Operating Officer

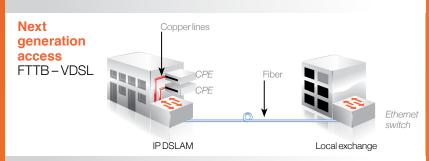


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We continued the transformation of our network in 2011, introducing unprecedented data speeds for our mobile and broadband customers. We extended high-speed coverage to more of the population than ever before, expanding the infrastructure that will enable Poland's social and economic progress in the long term, as well as ensuring a strong and sustainable commercial future for TP Group.

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#### Data network: revolutionary speeds

Enhancements to our data networks infrastructure included major increases to our IP core network capacity, which we have boosted by more than 20% since 2010. In our ongoing push for higher connection speeds we installed new VDSL access switches which, combined with optical fibre technology (FTTB), pave the way for speeds of up to 80 Mb/s. We continued with the investment program mandated by our Memorandum of Understanding with UKE, which includes improvements to backbone, aggregate and access networks.

We also expanded our infrastructure for providing Videostrada tp, Video on Demand and Digital-to-Home satellite television. Our IPTV services were available to over 70% of our xDSL broadband customer base by the end of 2011.

#### Mobile network: meeting data demand

The growing popularity of smartphones and other mobile data devices means that our mobile network needs to stay ahead of customer demand. In 2011, our next-generation, 100% IP-based core network reached the final stage of implementation. By the end of the year, we were handling over 90% of GSM and UMTS/HSPA network users' calls on the new network.

We also expanded coverage for our UMTS/HSPA services to 62% of the population, and increased the capacity of the GSM network, as well as continuing to expand the CDMA network to cover 88% of Polish territory by the end of 2011. We also extended the reach of our new mobile data technology, HSPA+DC, covering 58% of the population at the year's end.



Investing in mobile data technology



Training and retaining the best people

## 2011 Operating review People

Jacek Kowalski Board Member in charge of Human Resources



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In 2011 we focused on embedding the customer excellence standards throughout the organisation. We decided it was a key element in our activity and a potential source of our competitive advantage. We invested a lot in development of our managers, establishing, together with our France Telecom Group partners, the Orange Campus, an innovative system for managerial training. We also continued a dialogue with our social partners, concluding a new social agreement, which provides for further voluntary departures in 2012 and 2013. This programme is dedicated to people employed in the areas where workforce optimisation is necessary to increase efficiency; it will generate considerable savings, particularly in terms of labour costs.

"

#### **Employer of choice**

For several years we have been steadily investing in building the image of TP Group as one of the market's best employers. A broad job portfolio of almost 300 professions, professional development opportunities, stable remuneration and friendly environment are the elements which attract people to us. We have won a number of prestigious HR awards, such as the HR Management Leader or TOP Employer. For over three years we have been actively promoting TP Group at Poland's key universities and institutes of technology. This has attracted a growing number of graduates, which is an element of our longterm HR strategy. In addition, we have been implementing a corporate culture based on 360-degree feedback. In 2011, all managers were covered by the 360-degree feedback programme.

The company focuses on talent development and invests in people with the highest competencies. For over three years we have been successfully building a team of top grade professionals. We have also acquired competencies from the market by opening several hundred recruitments. Almost 50 talents from our Talent Pool were promoted to managerial positions. In 2010, we introduced a modified management-by-objectives system. Its newest version will be implemented in 2012, effectively concentrating our managers around the key strategic goals and indices.

#### **Professional schools**

Training related to deepening of specialist knowledge has been encapsulated in an integrated system of professional schools. They create a training culture based on sharing experience and knowledge and cover a full cycle of employee development and promotion. Teachers are our employees who are experts in their respective areas. In 2011, there were 16 professional schools with over 4,000 'students'.

#### **Orange Campus**

In June 2011, we launched the Orange Campus programme. It is a development centre for all FT Group's managers. Training sessions are held in Serock (Poland), Paris and Madrid. They involve sharing experience and ideas concerning achievement of business objectives as well as our style of doing it. In 2011, 16 international sessions were held in Serock and a total of 183 of our managers attended development programmes in all Orange Campus centres.

#### A more efficient organisation

Growing competitive pressure in the market, automation of processes and changing needs for skills and competencies have forced further optimisation of our workforce. We slimmed down Group's total workforce by 7%, trimming labour costs by 6.7% in 2011. We also commenced negotiations on the continuation of a voluntary departure programme, agreeing a further 2300 redundancies over the next two years.

Labour cost reduction

6.7%

year-on-year

# Financial performance Jacques de Galzain Chief Finance Officer



"

Once again, TP Group has delivered a solid set of financial results, in line with the outlook and guidance we gave at the beginning of 2011. Continuing the successful execution of our medium term strategy, we have met our targets and maintained a very healthy balance sheet, even taking into account the EUR 550 million final settlement of the dispute with DPTG. The successful disposal of TP Emitel has not only allowed us to launch a PLN 800 million share buy back, but also contributed to a net result of PLN 1.9 billion, which nearly fully covers our dividend for 2011. We believe that together with the share buyback program, our proposal of PLN 1.5 dividend per share further underscores our commitment to offer shareholders an appropriate remuneration for their ongoing support.

"

#### Revenue trends: no surprises

TP's top-line fell by 4.1% in 2011, an improvement on the 5.1% decline of 2010¹, but nonetheless a reflection of the adverse impact of MTR voice and SMS cuts in January and July. Excluding these regulatory impacts, the Group's revenue fell by 2.6%. The improvement in revenue dynamics is down to two main factors. Firstly, we saw solid growth of 2.3% in our mobile customer base, which offset market price pressures to ensure that mobile revenues remained flat year-on-year – and would have shown a 3% rise without the impact of MTR cuts. Secondly, we were able to slow down declining revenues in the fixed segment (-6.6% year-on-year compared to -8.5% for the previous period). Our fixed broadband customer base grew 2.6% year-on-year, with positive net adds reported each quarter and 47% of customers taking high-speed packages (6Mb/s and above) compared to 18% in 2010.

Net free cash flow PLN

2.4 bn

 $<sup>^{1}</sup> unless\ stated\ otherwise,\ all\ 2010\ figures\ are\ pro-forma-adjusted\ for\ deconsolidation\ of\ Emitel\ from\ 2H2010$ 

1 on comparable basis

<sup>2</sup>2010 pro-forma and excluding impact of DPTG provision revision (PLN -1,061 million)

<sup>3</sup>excluding gain on Emitel disposal (PLN + 1,183 million), provision for Effine (PLN -458 million), restructuring costs (PLN -172 million) and increase in DPTG provision (PLN -35 million)





#### Defending margins, maintaining profitability

Our restated EBITDA margin for the full year was 36.3%, just 0.3 percentage points down on the previous year. Without the impact of PLN 90million foreign exchange losses due to the weakening of the Polish złoty, EBITDA margin would have stood at 36.9% – close to the top of our 36-37% outlook for the year. EBITDA was boosted by PLN 182 million savings from our rigorous cost optimisation program, which has brought our cost base down for a third consecutive year: it has fallen by 3.7% since 2010. Tight control of commercial costs related to subscriber acquisition and retention also helped us to defend our margins.

TP's net income for 2011 stood at PLN 1.9 billion, resulting in earnings per share of PLN 1.44.

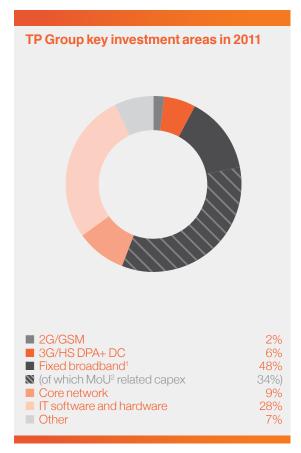
#### Capex objectives achieved

Total capital expenditure for the year was just over PLN 2.6 billion, or 17.5% of revenue. This is broadly similar to the previous year, being PLN 37 million lower than 2010. In our medium-term action plan, we promised that we would prioritise capex towards projects that support our goal of a leaner operating model and our priorities for commercial growth. We continued to fulfil this promise in 2011.

This year, we invested 48% of capex – PLN 1.3 billion – in broadband, completing network upgrade projects that fulfill almost three quarters of our obligations under the Memorandum of Understanding with the Regulator. We upgraded our mobile network to HSPA DC technology. Other key investment areas include improvements to the IT systems that help us manage our network and support our service delivery, sales and customer care.

<sup>42011</sup> excluding: PLN -172 million restructuring costs, PLN -35 million increase in DPTG provision, PLN +1.2 billion gain on Emitel disposal and PLN 0.46 billion increase in provision for EC fine; 2010 pro-forma (adj. for deconsolidation of Emitel) and excluding PLN -1.1 billion revision of provision for the DPTG dispute. Cost base up to EBITDA. Deferred tax has not been adjusted in the net result

# Financial performance continued



<sup>&</sup>lt;sup>1</sup>including capex for customer premises equipment

#### Cash generation: in line with guidance

TP Group's cash generation remained strong this year, with net free cash flow of PLN 2,403 million, in line with our guidance and little changed from PLN 2,440 million in 2010.

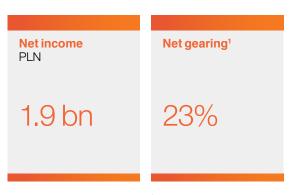
In early 2012, we reached a final settlement in our long-running dispute with DPTG, which we believe to be in the best interests of our company and our shareholders. We have therefore included the €550 million payment in the 2011 net debt numbers, with the result that pro-forma net debt is up PLN 300 million on 2010, at PLN 4.1 billion. Despite this, our balance sheet remains very safe, with pro-forma net gearing at 23% and the net debt to EBITDA ratio at 0.8. This strong balance sheet, coupled with high available liquidity and robust cash generation, underpins our solid A3/BBB+ credit ratings and provides the security and flexibility we need to maintain our dividends to shareholders.

#### **Proposed shareholder remuneration**

In considering the proposed level of shareholder remuneration for 2011, TP Group has followed its existing policy, taking the following parameters into account in order to offer its shareholders an attractive remuneration:

- the level of competition in TP Group's markets
- the flexibility required to make the capital expenditures necessary to sustain profitable growth
- the financial discipline needed to support the current rating at A3 / BBB+.

<sup>&</sup>lt;sup>2</sup>MoU = Memorandum of Understanding signed with UKE



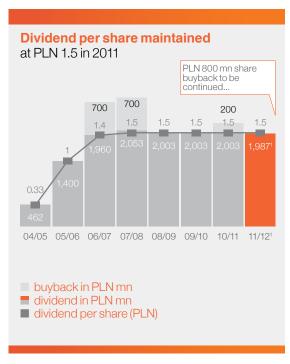
<sup>1</sup> pro-forma, including DPTG settlement

Based on the 2011 results and taking into account the current economic climate, the Management Board will submit to shareholders' approval an ordinary cash dividend of PLN 1.50 per share, amounting to around PLN 2 billion.

We also began a PLN 800 million share buy-back program in 2011. A quarter of the transaction has already been executed, with the rest to follow in 2012.

#### Looking ahead

In 2012, we will continue with our disciplined approach. We plan to maintain the momentum in mobile and continue our efforts to push broadband onto a higher growth path. The final year of our current medium-term action plan will see concrete benefits from our customer excellence program, and from our Orange brand promotion activities around the EURO 2012 championships. All of these activities will help to improve our market position and our revenue trend, but they will also put additional strain on profitability. Therefore we will continue with rigorous cost control measures, striving for a stabile EBITDA margin and sustainable cash generation.



<sup>1</sup> subject to Shareholders' approval, total dividend based on number of shares in circulation as of Dec 31, 2011

# Corporate Social Responsibility

As the largest telecommunication group in Central Eastern Europe, TP Group recognizes and welcomes its responsibilities to the wider community, both now and in future generations. For us, "corporate social responsibility" is a long-term management strategy that recognizes these responsibilities and puts us in the best position to meet the challenges the future will bring. Our CSR strategy also has the potential to bring important commercial benefits by improving our competitive advantage in the marketplace.



State-of-the-art infrastructure will reach even the remotest parts of Poland

#### TP included in RESPECT Index at Warsaw Stock Exchange for the third year in a row

The Warsaw Stock Exchange has launched the third edition of RESPECT Index, which encompasses companies being managed according to the top corporate social responsibility standards, including corporate governance and investor relations.

The index portfolio was adjusted on the 14th of July 2011 and comprises 22 Polish companies, including Telekomunikacja Polska, present in RESPECT Index since 2009.

#### TP Group strives to be:

- an active player in building the information society
- a provider of safe products, services and technologies
- an innovator providing tools to build the "low carbon society"
- a reliable partner in an ethical supply chain
- a good employer
- a provider of high quality services and standards of customer service
- active in the field of social commitment and corporate volunteering.

#### **Building the infomation society**

As the largest telecom group, not only in Poland but also in Central and Eastern Europe, we have an important social role to play in building an information society accessible to all. Our network investments will combat digital exclusion by ensuring that state-of-the-art telecommunication infrastructure reaches even the remotest parts of Poland. In 2011, we devoted 34% of capex to extending broadband Internet access (in line with the plan agreed with the Regulator), bringing the number of new or enhanced lines installed since 2009 to 860,000.

Providing broader access to digital communication tools means not only investing in infrastructure but also breaking down social barriers to the use of new technologies. One barrier is caused by our worries about the youngest users of modern media. TP Group's response to that is the "Education with Internet TP" program in which we offer Internet at preferential terms to schools and we support children, parent and teacher education on web safety.

We also fight exclusion due to social circumstances. In 2011 we introduced NN Assistant – a speech synthesiser application which allows sight-impaired people to use mobile phones. We provide generous discounts on telecoms services for people registered disabled or dependent on permanent state benefits, and we are active members of a Polish coalition for digital inclusion of people over 50.

#### Innovation and the environment

The telecommunications industry has a huge positive contribution to make to the cause of environmental sustainability by enabling new, more energy-efficient ways of working: for example, tele- and video-conferencing in place of business travel; more flexible home-working to reduce commuting; on-line information sharing that cuts down on printing. On the other hand, our industry is in rapid development, resulting in shorter lifespans for our products, and creating issues around resource use in manufacturing as well as recycling. TP Group aims to be an innovator, limiting our impact on the planet and providing new, eco-efficient telecoms solutions.

Our Orange Labs are part of a global Orange network of research and development centres, tasked with setting trends in the fast-moving world of communication technologies. Live projects in 2011 included: research into VDSL2 for faster broadband; development of speech recognition technologies; and co-operation with Polish universities to involve students and academic staff in research and development.

#### CO, emissions

		2010¹	2011
Amount of emitted CO <sub>2</sub> from energy consumption and stationary sources	tonnes	423,807	365,255
Total amount of CO <sub>2</sub> emissions during transport	tonnes	18,338	16,223
Total amount of CO <sub>2</sub> emissions	tonnes	442,145	381,478

#### **Fuel consumption**

		2010 <sup>1</sup>	2011
Direct energy consumption, primary sources			
Fuel (all buildings, all uses)	tonnes	3,448	2,851
Gas	$M^3$	3,443,462	4,085,454
Coal	tonnes	119	24
Energy, excluding transport	GWh	697	611
Indirect energy consumption, primary sources			
Electricity	GWh	619	535

#### GreenBox

A great example of using technology to make our operations more sustainable is the GreenBox application, which we integrated into our network systems in 2010 after a successful pilot scheme in 2009. GreenBox automatically turns off unused ports on DSLAMs (network devices involved in data transfer from our network to our customers), reducing energy consumption and heat emission. This translates directly into a reduction not just in network maintenance costs but in greenhouse gas emissions too.

Results till the end of 2011	
------------------------------	--

Energy saved	590,000 kWh
CO <sub>2</sub> reduction	560,000 kg
Cost savings	€59,000
Which is equivalent to: Trees planted	8,400
Km driven by car	3,200,000

<sup>1</sup>data reported for TP Group

In 2011, we completed the implementation of our In-house Refurbishment project: a central facility that will allow us to refurbish and reuse multimedia products such as decoders and modems returned by our customers. We also launched the Orange Recycling program, encouraging customers to re-sell their unwanted mobile handsets for their own profit or for charity. We organise the collection and recycling of unwanted mobile phones and accessories.

We are working to create a more energy-efficient organisation, from top to bottom. We have reduced paper consumption throughout the supply chain, including the option of electronic invoices for our customers. We have also reduced consumption of electricity in recent years by introducing power conservation policies in offices and educating staff about what they can do to save energy. A major overhaul of our IT systems in favour of "Green IT" has led to more efficient power consumption in both offices and technical infrastructure. In order to ensure that we are keeping our environmental promises within the company, we monitor and report on 122 indicators (waste, electricity use, water, paper, fuels, cooling systems etc.) every six months.

Since we launched the project in 2009, the environmental benefits have included:

- reduction of annual CO<sub>2</sub> emissions by more than 6 thousand tonnes
- reduction of annual water consumption at the TP Group Data Processing Centre by approximately 1.5 million litres
- reduction of number of printed pages by 7.3 %
- replacement of over 70 million pages of paper documents in electronic form
- scrapping worn out infrastructure using certified companies and purchasing new infrastructure with recycled elements where possible.

#### The customer relationship

TP Group is committed to open, transparent communication with its customers and aims to make their contact with the company as easy as possible. Since 2005, our Simplicity+ program has allowed us to monitor and simplify the majority of our customer interactions, from supplying clearer information on tariffs to better procedures for installation and de-installation of services. We continually test the customer experience through both lab tests and consumer research, looking for areas where we can improve our processes or help our employees to provide a better service.

We operate a "Code of Responsible Communication", introduced in 2010, which ensures that all our marketing communications take into account our social and environmental obligations. We also promote Internet safety; in 2009, the actions of TP Group reduced the amount of spam email generated in Poland by more than 90% – a decisive measure that ended Poland's previously poor reputation for spam traffic.

# Corporate Social Responsibility

continued

Staff training hours in 2011

637,111

ICT facilities installed in over

3,000

of Poland's 8,500 libraries

#### Responsibility in the workplace

With more than 23,000 employees in over 630 locations, TP Group is one of Poland's largest employers. For us, corporate social responsibility begins "at home", in our own company. Our priorities include: making sure the voices of employees are heard in matters critical to the company's future; protecting the right to associate; implementing our ethics code; ensuring safe working conditions; and ensuring equal treatment for all, regardless of gender, religion or views.

TP Group's corporate values are formalised in a **Code of Ethics**, adherence to which is scrutinised by the Ethics Committee. The Code covers the whole spectrum of corporate good behaviour, including non-discriminatory employment practices, sound relationships with suppliers, whistleblowing and respect and tolerance between members of staff.

We are transparent about our recruitment and remuneration policies, ensuring that appointments and promotions are non-discriminatory and that salaries and bonuses are based on performance. These measures are ultimately monitored by the Remuneration Committee of the Supervisory Board.

Talent development and retention are key priorities for TP Group. We devoted 637,111 hours to staff training in 2011 – an average of 27.6 hours per employee. Our elite Talent Group is a program to spot and promote people with managerial potential within the Group. At present, women are under-represented in the ranks of TP management, but we have stepped up talent-spotting and training measures towards our goal of increasing the percentage of women in management.

#### Commitments to the community

Social commitment is an integral part of our CSR activities. On the "think global, act local" principle, we look at major issues affecting society today, and offer solutions – based on our skills and experience as a telecoms company – that really work at the level of an individual school, hospital or community organisation.

Today, the majority of TP Group's philanthropic activities take place under the banner of the Orange Foundation, which is focused on helping children and young people. As well as its own programs, the Orange Foundation gives direct grant support to other NGOs working with similar aims in the areas of education, health care and culture. The Foundation also promotes volunteering, particularly among the employees of TP Group – more than 7.6% of whom gave their time to charitable projects during 2011.

#### **Diversity at TP Group**

	2010	2011
Number of men employed in managerial positions	2,782	2,639
Number of women employed in managerial positions	950	966
Number of employees employed in managerial positions	3,732	3,605
% of women employed in managerial positions	25.5	26.8

Key initiatives of the Orange Foundation include:

Education with TP Internet: supports Internet access provision on preferential terms and Internet safety education (so far 14,500 schools throughout Poland, serving over 4 million students, registered for the program).

Orange Academy: issues grants for innovative educational projects centred around new technology, including the installation of ICT facilities in over 3,000 of Poland's 8,500 libraries.

Phone to Mum: supports sick children and their families by maintaining over 1,000 colourful free phones in children's wards and giving out free phonecards – over 1.5 million so far.

School Without Violence: anti-bullying campaign, under the honorary patronage of the Polish President. Almost 5,000 schools have taken part so far, with 15,000 students, parents and teachers participating in dedicated workshops around the country.

Sounds of Dreams: provides hearing aids and rehabilitation services that have helped over 1,000 hearing-impaired children since 2006.

You can learn more about these and other projects by visiting the Orange Foundation website at www.fundacja.orange.pl.

#### Measuring and reporting on progress

Since 2006, TP Group has been a signatory to the UN Global Compact, a set of ten core principles in the areas of human rights, labour, the environment and anti-corruption. Each year, we publish an account of the progress we have made in supporting and enacting these values. We also published an extensive report on our corporate social responsibility efforts and achievements from 2007-2010. You can find the report in the CSR section of our website, www.tp-ir.pl

In 2011 we began a new dialogue with our stakeholders, aimed at achieving a higher level of verification and accountability, based on the AA1000 standards<sup>1</sup>. This is an ongoing process, and the results will be published in our next CSR report.

1 the series of CSR principles-based standards

**Corporate** volunteers

4.8%

among TP Group employees

Spending on charitable activities PLN



Helping children with impaired hearing through 'Sounds of Dreams'



Internet safety education: participating in dedicated workshops around Poland



Helping to provide digital inclusion of people over 50

#### Management team



**Piotr Muszyński** Vice President in charge of Operations



**Jacques de Galzain**Board Member, Chief Financial Officer



Maciej Witucki
President of the Management Board,
Chief Executive Officer



**Jacek Kowalski**Board Member in charge of Human Resources



**Vincent Lobry**Vice President in charge of Marketing and Strategy



Mariusz Gaca
Chief Commercial Officer,
Chief Executive office of PTK Centertel (Orange)

# Management Board

The scope of the Board's remit includes the management of all aspects of the Company's affairs, with the exception of those matters which are stipulated by the Polish Commercial Code and the Company's Articles of Association as being within the competence of the General Meeting of Shareholders or the Supervisory Board. The responsibilities and obligations of the Board, together with its rules of procedure, are defined in a formal statement of the Board's role. Particular members of the Management Board manage the areas of the Company's operations dedicated to each of them.

#### **Maciej Witucki**

#### President of the Board, Chief Executive Officer

Maciej Witucki graduated from the Electrical Department of the Poznan Technical University in 1991. Between 1992 and 1997 he undertook post graduate research in industrial system management at Ecole Centrale, Paris. In September 1997 he began working for Cetelem Bank: first in France, where he took part in the development of the business plan for Cetelem's Polish subsidiary; then in Poland, as a Member of the Management Board of Cetelem Polska Expansion S.A. In October 2001 he joined the Credit Agricole Group and in 2002 he became a Member of the Management Board of Polish retail bank LUKAS S.A., rising to the position of President and CEO in March 2005. He joined TP Group as President of the Board and Chief Executive Officer on 6th November 2006.

#### Vincent Lobry

#### Vice President of the Board, Chief Marketing Officer

Vincent Lobry joined France Telecom in 1979 as a systems and network management engineer. After postings in Indonesia, the US, Spain and Italy, he moved into marketing, and was appointed B2C Marketing Director at FT France in 2006. He is a Knight of the Order of Merit and a graduate of École Polytechnique et École Nationale Supérieure des Télécommunication (Telecom ParisTech). Vincent Lobry joined TP Group's Management Board in September 2009.

#### Piotr Muszyński

Vice President of the Board, Chief Operating Officer Piotr Muszyński graduated from the Faculty of Law and Administration at the University of Wrocław, completed Postgraduate Study in Management at the Polish International Business School and the Advanced Management Program organised by IESE Business School, University of Navarra. He started his career in 1990 in Eastern Europe Investment Ltd (EEI) as a Partner and Project Manager. From 1993 he was employed in REMA 1000 Poland Ltd as Managing Director and Member of the Management Board and from 1999 as President of the Management Board. In parallel in 1996-1998 he was a Member of the Management Board of Intersport Poland. He joined TP S.A. in 2001 as the Director of Customer Care Branch, then served as the Director of Sales and Services Division from 2005 onwards. Piotr Muszyński joined TP Group's Management Board in September 2008.

#### Jacques de Galzain

#### **Chief Financial Officer**

Jacques de Galzain graduated from Bordeaux University in 1981 and qualified as a Certified Accountant in 1989.

After 9 years spent in audit firms, from 1991 to 2000 he worked for USINOR, where he held several accounting positions. In 2000 he moved to ALSTOM, initially as Deputy Chief Accounting Officer. Between 2001 and 2006 he undertook board-level financial roles at ALSTOM and AREVA. He joined France Telecom – Orange in March 2006 as Group Chief Accounting Officer, head of the financial information system. In December 2009 he joined Telekomunikacja Polska S.A. as Group Director in charge of Accounting and PTK Centertel Management Board Member in charge of Finance, and he was appointed Chief Financial Officer in January 2011.

#### Jacek Kowalski

#### **Board Member in charge of Human Resources**

Mr Kowalski graduated from the history faculty of Warsaw University before moving on to postgraduate studies in local government and non-governmental organizations management, which he completed in 1996. He worked for Infor Training and served as Director of the National In-Service Teacher Training Centre before joining TP Group in 2001, as Human Resources Manager for sales and marketing in PTK Centertel. From 2005 he was the Director of Employee Competence and Management Development for TP Group, and he joined the management board as member in charge of Human Resources in January 2011. Jacek Kowalski is a member of the Program Board of the Polish Human Resources Management Association.

On January 14, 2011, Mr. Roland Dubois resigned from the position of TP S.A. Management Board Member.

On January 27, 2011, Messrs. Jacques de Galzain and Jacek Kowalski were appointed by the Supervisory Board as Members of the Management Board.

On 12 July 2011, the Supervisory Board of TP S.A. appointed Mr. Maciej Witucki for his third consecutive term as the President of the Management Board of TP S.A. This third term will start on the day of the next General Meeting of the Shareholders in April 2012 and will last three years.

#### Corporate governance

As a company listed on both the Warsaw and London Stock Exchanges, we are committed to maintaining standards of corporate governance which are in accordance with international best practice. We are sensitive to the expectations of the international investment community and our domestic investor base in Poland.

Both the supervisory and management boards of TP Group see governance as a continuing set of processes linked to our annual business cycle. We are committed to transparency in our corporate governance.

The following information is also available on our website at www.tp-ir.pl:

- Ownership structure and ownership history
- Articles of Association
- Annual shareholders' meeting procedures
- Operating rules for the management board and the supervisory board
- Corporate governance disclosure to the Warsaw Stock Exchange
- Dividend payment



# Corporate governance Role of shareholders

TP encourages shareholders to play an active role in the Company's corporate governance. Indeed, shareholder consent is required for key decisions, including: the review and approval of the financial statements and Management Board Report on Activities; the review and approval of the Management Board's recommendations on dividend payments; the review and approval of the Supervisory Board Assessment of the Group's situation; the election of the members of the Supervisory Board (and, if necessary, their dismissal); amendments to the Company's Articles of Association; increase and reduction of the share capital; and the buy-back of shares.

At the Company's General Meetings, each share in TP entitles its owner to one vote. Holders of the Company's GDRs are also encouraged to submit their voting instructions to the Company's Depository Bank. In addition to their participation in General Meetings, members of the Company's Management Board and senior executives engage in active dialogue with the Company's shareholders. To ensure that investors receive a balanced view of the Company's performance, Management Board members – led by the President of the Management Board and the Chief Financial Officer – also make regular presentations to institutional investors and representatives of the domestic and international financial community.

France Telecom S.A.	49.79%
Capital Group, Inc. <sup>1</sup>	5.06%
Other shareholders, including GDR holders	44.30%
TP S.A. (treasury shares) <sup>2</sup>	0.58%
Total	100.00%

<sup>&</sup>lt;sup>1</sup>the number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

<sup>&</sup>lt;sup>2</sup>TP shares purchased in 2011 during the share buy back program

# Corporate governance Supervisory Board

The term of office of each member of the Supervisory Board is three years, and their remuneration is determined by the General Meeting of Shareholders. The Supervisory Board meets at least once a quarter and among others is responsible for the appointment and remuneration of the members of the Management Board, the appointment of the Company's independent auditors, and the supervision of the Company's business.

As part of this process, it examines the Company's strategic plan and annual budget and monitors the Company's operating and financial performance. In considering these matters, the Board takes into account the social, environmental and ethical considerations that relate to TP Group's businesses.

The work of the Supervisory Board is coordinated by the Board Chairman, with the assistance of the Board Secretary; and the responsibilities and obligations of the Board, together with its rules of procedure, are defined in a formal statement of the Board's role. Although the Board performs its tasks collectively, it delegates some of the work. The committees to which these tasks are delegated are described in further paragraphs.

# Composition of TP Supervisory Board (as of 31 March 2012)

- 1 Prof. Andrzej K. Koźmiński Chairman and Independent Board Member
- 2 Benoît Scheen Deputy Chairman and Chairman of the Strategy Committee
- 3 Nathalie Clere Board Member and Secretary
- 4 Timothy Boatman Independent Board Member and Chairman of the Audit Committee
- 5 Thierry Bonhomme Board Member
- 6 Jacques Champeaux Board Member
- 7 Dr. Mirosław Gronicki Independent Board Member
- 8 Marie-Christine Lambert Board Member
- 9 Pierre Louette Board Member
- 10 Prof. Jerzy Rajski Independent Board Member
- 11 Gérard Ries Board Member
- 12 Dr. Wiesław Rozłucki Independent Board Member

Composition of Committees of the Supervisory Board (as of 31 March 2012):

#### **The Audit Committee**

- 1 Timothy Boatman Chairman
- 2 Nathalie Clere
- 3 Marie-Christine Lambert

The Audit Committee is chaired by Mr. Timothy Boatman, an independent member of the Supervisory Board. He has relevant experience and qualifications in finance, accounting and audit.

# **The Remuneration Committee**

- 1 Benoît Scheen
- Nathalie Clere
- 3 Dr. Wiesław Rozłucki

# **The Strategy Committee**

- 1 Benoît Scheen Chairman
- 2 Jacques Champeaux
- 3 Dr. Mirosław Gronicki
- 4 Prof. Jerzy Rajski
- 5 Gérard Ries

Prof. Andrzej K. Koźmiński and Mr. Timothy Boatman an Independent Board Member and Chairman of the Audit Committee are permanent guests.

# Corporate governance Report on Supervisory Board activities

# I. TP S.A. Supervisory Board composition

# Supervisory Board composition as of January 1, 2011

- 1 Prof. Andrzej K. Koźmiński Chairman
- 2 Olivier Barberot Deputy Chairman and Chairman of the Strategy Committee
- 3 Olivier Faure Secretary
- 4 Timothy Boatman Board Member and Chairman of the Audit Committee
- 5 Thierry Bonhomme Board Member
- 6 Jacques Champeaux Board Member
- 7 Ronald Freeman Board Member and Chairman of the Remuneration Committee
- 8 Dr. Mirosław Gronicki Board Member
- 9 Marie-Christine Lambert Board Member
- 10 Prof. Jerzy Rajski Board Member
- 11 Raoul Roverato Board Member
- 12 Dr. Wiesław Rozłucki Board Member
- 13 Olaf Swantee Board Member

# In 2011 the following changes occurred in the composition of the Supervisory Board

Mr. Raoul Roverato resigned from his function on the Supervisory Board as from January 26, 2011. On January 27, 2011, Mr. Gérard Ries was appointed by the Supervisory Board as a Member of the Supervisory Board.

Mr. Olivier Barberot resigned from his function on the Supervisory Board as from March 24, 2011. On the same day, Mr. Pierre Louette was appointed by the Supervisory Board as a Member of the Supervisory Board.

On April 14, 2011, the mandates of Mr. Timothy Boatman and Mr. Gérard Ries expired. On the same day, Mr. Timothy Boatman and Mr. Gérard Ries were appointed by the Annual General Assembly as Members of the Supervisory Board.

Mr. Olivier Faure resigned from his function on the Supervisory Board as from July 11, 2011. On July 12, 2011, Ms. Nathalie Clere was appointed by the Supervisory Board as a Member of the Supervisory Board.

Mr. Olaf Swantee resigned from his function on the Supervisory Board as from October 12, 2011. On October 13, 2011, the mandates of Ms. Nathalie Clere and Mr. Pierre Louette expired. On the same day, Ms. Nathalie Clere, Mr. Pierre Louette and Mr. Benoit Scheen were appointed by the Extraordinary General Assembly as Members of the Supervisory Board.

Mr. Ronald Freeman resigned from his function on the Supervisory Board as from December 23, 2011.

# Supervisory Board composition as of December 31, 2011

- 1 Prof. Andrzej K. Koźmiński Chairman
- 2 Benoit Scheen Deputy Chairman and Chairman of the Strategy Committee
- 3 Nathalie Clere Secretary
- 4 Timothy Boatman Board Member and Chairman of the Audit Committee
- 5 Thierry Bonhomme Board Member
- 6 Jacques Champeaux Board Member
- 7 Dr. Mirosław Gronicki Board Member
- 8 Marie-Christine Lambert Board Member
- 9 Pierre Louette Board Member
- 10 Prof. Jerzy Rajski Board Member
- 11 Gérard Ries Board Member
- 12 Dr. Wiesław Rozłucki Board Member

On January 5, 2012, Mr. Henri de Joux was appointed by the Supervisory Board as a Member of the Supervisory Board.

At present, TP has five independent members on the Supervisory Board, namely Messrs. Prof. Andrzej K. Koźmiński, Timothy Boatman, Dr. Mirosław Gronicki, Prof. Jerzy Rajski, and Dr. Wiesław Rozłucki.

Three permanent committees operate within the Supervisory Board. Their composition was the following (as of December 31, 2011):

# **Audit Committee**

Timothy Boatman – Chairman, Nathalie Clere and Marie-Christine Lambert – members;

#### **Remuneration Committee**

Benoit Scheen, Nathalie Clere and Wiesław Rozłucki - members;

#### **Strategy Committee**

Benoit Scheen – Chairman, Jacques Champeaux, Mirosław Gronicki, Jerzy Rajski and Gérard Ries – members. Corporate governance
Report on Supervisory Board activities

continued

# II. Operation

The Supervisory Board, acting in compliance with the provisions of the Commercial Companies Code and the Company's Articles of Association, exercised permanent supervision over the Company's operations in all fields of its activities.

In 2011 the Supervisory Board fulfilled its duties resulting from the provisions of the Commercial Companies Code:

- Evaluation of the Management Board's report on TP SA operations and the financial statements for the financial year 2010 and the Management Board's motion for distribution of the Company's profit;
- 2 Evaluation of the Management Board's report on TP Group's operations and the consolidated financial statements for the financial year 2010;
- 3 Filing with the General Assembly of the Shareholders reports presenting the results of the above mentioned evaluation.

The Supervisory Board took due care to ensure that the Management Board's reports and the financial statements were in compliance with the law.

The Supervisory Board also executed its rights and obligations arising from the Company's Articles of Association and the Best Practices for Companies listed on the Warsaw Stock Exchange, of which the following should be mentioned:

- expressing opinions on motions addressed to the General Meeting,
- 2 selecting an independent auditor to audit the Company's financial statements.
- 3 preparing opinions on TP and TP Group budgets,
- 4 supervising the execution of TP Group's operating and financial objectives,
- 5 expressing opinions on financial commitments of a value exceeding the equivalent of EUR 100 million,
- 6 concise assessing of the TP Group's standing in 2010, including an assessment of the internal control system and the significant risks management system,
- 7 expressing opinion on the TP S.A. programme of own shares buy-back for the purpose of their redemption,
- 8 expressing opinion on the Long Term Incentive Program 2011-2013 for the TP Group Senior Executives.
- 9 executing changes in the Management Board of the Company.

Throughout 2011 the Supervisory Board and its permanent committees put a particular emphasis on the following issues:

- Group's financial results and performance in comparison to the budget,
- b continued implementation of the Group's medium term action plan,
- c resolving the dispute with DPTG,
- d execution of the Memorandum of Understanding with UKE (the Office of Electronic Communication – the Polish Regulator),
- e customer satisfaction the customer excellence programme,
- f disposal of TP Emitel and subsequent allocation of part of proceeds to a share buy back program,
- g execution of agreements between PTK Centertel (PTK) and Polska Telefonia Cyfrowa (PTC) regarding the operations of NetWorkS!, a jointly controlled company conducting management, planning, operations, development and maintenance of the radio access networks of PTK and PTC,
- h related parties transactions, including the proposed rebranding of the fixed-line business and TP Group's participation in Buyln SA a purchasing joint-venture between France Telecom and Deutsche Telecom,
- establishing a new company Integrated Solutions sp. z o.o. as a response to growing demand for services related to comprehensive management of the ICT infrastructure,
- j giving opinion regarding development of convergent services in fixed and mobile,

The Supervisory Board met 7 times in 2011. The Board adopted 49 resolutions, of which 4 in writing (by correspondence).

The Supervisory Board used in its operations opinions of its Committees (the Audit Committee, the Remuneration Committee and the Strategy Committee), wherever applicable.

The reports of the three permanent committees of the Supervisory Board on their activities in 2011 are attached hereto.

The Supervisory Board formulated a number of recommendations, remarks and motions to the Management Board, referring to different aspects of the company's operations.

The Supervisory Board was regularly monitoring the execution of its resolutions and recommendations, analysing the information presented by the Management Board.

# Corporate governance

# Reports on activities of the Supervisory Board's committees

# **Activity of TP Group Audit Committee in 2011**

The Audit Committee was established by virtue of the Resolution of the TP Supervisory Board no. 324/V/2002 dated June 14, 2002 regarding the establishment of the Audit Committee as a consultative body acting under the Supervisory Board.

The task of the Committee is to advise the Supervisory Board on the proper implementation of budgetary and financial reporting and internal control (including risk management) principles in the TP Group and to liaise with the auditors of TP Group.

#### Composition

In 2011, the Audit Committee was composed of the following persons:

## Chairman

Mr. Timothy Boatman ("Independent Director")

#### Members

Ms. Marie Christine Lambert
Ms. Nathalie Clere
nominated on July 12, 2011
Mr. Ronald Freeman
("Independent Director")
until December 23, 2011 when he resigned
Mr. Olivier Faure
until July 11, 2011 when he resigned.

The Secretary of the Committee was Mr. Jerzy Klonecki. Mr. Jacek Chaber, Director of TP Group Internal Audit, attended all the meetings of the Audit Committee.

#### **Functions of the Committee**

The key functions of the Audit Committee include:

- 1 Monitoring the integrity of the financial information provided by the Company in particular by reviewing:
  - a The relevance and consistency of the accounting methods used by the Company and the TP Capital Group, including the criteria for the consolidation of the financial results;
  - Any changes to accounting standards, policies and practices;
  - c Major areas of financial reporting subject to judgment;
  - d Significant adjustments arising from the audit;
  - e Statements on going concern;
  - f Compliance with the accounting regulations;
- 2 Reviewing at least annually the Group's system of internal control and risk management systems with a view to ensuring that the main risks (including those related to compliance with existing legislation and regulations) are properly identified, managed and disclosed;
- 3 Reviewing annually the Internal Audit program, including the review of independence of the Internal Audit function, and coordinating between the internal and external auditors;
- 4 Analysing reports of the Company's Internal Audit and major findings of any other internal investigations and responses of the Management Board to them;
- 5 Making recommendations in relation to the selection and remuneration of the Director of the Internal Audit and on such function's budget;
- 6 Reviewing and providing an opinion to the TP Management and/or the TP Supervisory Board (where applicable) on significant transactions with related parties as defined by the corporate rules;
- 7 Monitoring the independence and objectivity of the Company's external auditors and presentation of recommendations to the Supervisory Board with regard to selection and remuneration of the Company's auditors, with particular attention being paid to remuneration for additional services;
- 8 Reviewing the issues giving rise to the resignation of the external auditor;
- 9 Discussing with the Company's external auditors before the start of each annual audit on the nature and scope of the audit and monitoring the auditors' work;
- 10 Discussing (in or without the presence of the Company Management Board) of any problems or reservations, resulting from the financial statements audit;
- 11 Reviewing the effectiveness of the external audit process, and the responsiveness of the Management Board to recommendations made by the external auditor;
- 12 Considering any other matter noted by the Audit Committee or the Supervisory Board;
- 13 Regularly informing the Supervisory Board about all important issues within the Committee's scope of activity;
- 14 Providing the Supervisory Board with its annual report on the Audit Committee's activity and results.

#### Corporate governance

Reports on activities of the Supervisory Board's committees

continued

# **Activity in 2011**

In 2011, the TP Group Audit Committee held 10 meetings, out of which 9 were regular meetings and 1 dedicated ad-hoc meeting, and in particular performed the following:

- 1 Reviewed the Company's and Group's published financial statements, notably the relevance and consistency of the accounting methods used by the Company and the TP Capital Group, particular attention was paid to those aspects where judgment is required, e.g. impairment of assets including goodwill, major outstanding litigations, revenue recognition and deferred tax:
- 2 Reviewed the Group's system of internal control (including risk management) as reported by the Management Board and, in particular, the way risks were identified, managed and disclosed by the Management. The Audit Committee received reports from Management on action plans in response to comments on internal controls from the internal and external auditors;
- 3 Reviewed the annual plan of the Internal Audit, its budget and progress reports, as well as monitored the responsiveness of management to Internal Audit findings and recommendations. The Audit Committee was provided with a report regarding the renewal in 2011 of the certification of Internal Audit activities by Institut Français de l'Audit et du Contrôle Internes (IFACI). The Audit Committee reviewed also the independence of the Internal Audit;
- 4 Made recommendation to the Supervisory Board on the external auditor, its remuneration and terms of engagement. In accordance with the Code of the Best Practices for companies listed on the Warsaw Stock Exchange, the Audit Committee recommended to the Supervisory Board the appointment of Deloitte Audit Sp. z o.o. to the audit of TP S.A. and Telekomunikacja Polska Group for the financial year 2011 and to review half-yearly financial statements for the period of six months ended June 30, 2011;

- 5 Kept under review the scope and the results of the external audit, independence and objectivity of the auditors and reported its conclusions to the Supervisory Board; monitored the Company's responsiveness to the recommendations from the external auditor made in its management letter. In addition, the Committee met privately with the lead partner of the statutory audit firm;
- 6 Reviewed the development and operation of the Group's Ethics Committee activity, anti-fraud and whistle-blowing programs managed by the Management Board; monitored results of investigations initiated by whistle-blowing;
- 7 Reviewed the Group's 2011 budget and addressed recommendations on it to the Supervisory Board;
- 8 Reviewed the Share Buy Back program and 2011 dividend distribution policy proposed by the Management;
- 9 Issued opinions on other matters referred to the Committee by the Supervisory Board and/or the Management Board including M&A transactions, the medium and long term financing of the Company and its subsidiaries.

During the course of the year, the Audit Committee reviewed the *Recommendations on the work of the Audit Committee* issued in November 2010 by the Office of the Financial Supervision Authority in Poland and satisfied itself that it complies in all material respect with these recommendations.

In the year under review, the Audit Committee, especially its two independent members, reviewed and gave opinions to the Management Board of TP on significant transactions with related parties as defined by the corporate rules and received reports on them from the Company's Internal Audit.

# Timothy Boatman

Chairman of the Audit Committee of the Supervisory Board

March 29, 2012

# Report on the activity of the Remuneration Committee of the Supervisory Board of Telekomunikacja Polska S.A. in 2011

The Remuneration Committee was established by virtue of the Resolution of the TP Supervisory Board no. 385/04 dated June 16, 2004 regarding TP S.A. Supervisory Board's Remuneration Committee establishment as consultative body acting under the Supervisory Board.

The task of the Committee is to advise the Supervisory and Management Board on general remuneration policy of TP Group and to make recommendations on appointment, performance objectives, remuneration procedures and amounts to the Supervisory and Management Board.

# Composition

In 2011, the Remuneration Committee was composed of the following persons:

#### Chairman

Ronald Freeman ("Independent Director") until December 23, 2011

#### Members

Olivier Barberot
until March 24, 2011
Wiesław Rozłucki
("Independent Director")
Olaf Swantee
until October 12, 2011
Olivier Faure
from March 24, 2011 until July 11, 2011
Nathalie Clere
from July 12, 2011
Benoit Scheen
from October 13, 2011

The Secretary of the Committee was Jacek Kowalski, TP Management Board Member in charge of Human Resources.

#### **Activity in 2011**

In 2011, the Remuneration Committee held five meetings and in particular developed recommendations for Supervisory Board consideration focused on the following remuneration-related issues:

- Benefits under the employment contract for the Management Board Members;
- 2 Discussion and approval of CEO proposal on new solution of Management Board Members motivational system;
- 3 Assessment of performance relative to objectives and decision on the bonus percentage for Management Board Members for H2 2010 and H1 2011;
- 4 Validation of objectives for Management Board Members for H2 2011 and H1 2012;
- 5 Discussion on overall level of remuneration of the Management Board members and direct reports of the CEO.

Jacek Kowalski Secretary of the Remuneration Committee

March 29, 2012

# Report from the activities of the Strategy Committee of the Supervisory Board of Telekomunikacja Polska S.A. in 2011

The Strategy Committee was established by virtue of the Resolution of the TP Supervisory Board no. 417/05 dated June 15, 2005.

The major goal for the Strategy Committee is to give necessary support and advice for the Management Board in the area of TP Group strategic plans and initiatives of strategic importance.

#### Strategy Committee members in 2011

#### Chairman of the Strategy Committee

Olivier Barberot until March 24, 2011 Olaf Swantee from March 24, 2011 until October 12, 2011 Benoit Scheen from October 13, 2011

# Members of the Strategy Committee

Jacques Champeaux Olivier Faure until March 24, 2011 Mirosław Gronicki Jerzy Rajski Gérard Ries from March 24, 2011

Vincent Lobry was Secretary of the Strategy Committee in 2011.

#### Activities in 2011

In 2011, the activities of the Strategy Committee of TP Group Supervisory Board concentrated on the key strategic directions for the TPG development included in the Group's medium term action plan and investment strategies for fixed and mobile networks.

Strategy Committee also widely discussed TPG activities in new growth areas like ICT and TVE and the role of R&D in TP Group and France Telecom Group structures.

In all these areas the members of TP Group Management Board actively participated.

There were four Strategy Committee meetings in 2011 during which other Supervisory Board Members also participated: Chairman of the Supervisory Board, prof. Andrzej K. Koźmiński, Chairman of the Audit Committee, Timothy Boatman and Chairman of the Remuneration Committee, Ronald Freeman.

Benoit Scheen Chairman of the Strategy Committee

March 29, 2012

# Corporate governance Internal control including risk management

The system of internal control and risk management has been designed and implemented by the Management Board to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

A TP Group Code of Ethics was adopted within the Company in 2008 which encompasses TP's relationship with customers, shareholders, employees, suppliers, competition and also with respect to the environment in which the TP Group operates. A warning system related to ethics and reporting of potential and actual fraud has been enhanced by the Group which is coordinated by the TP Group Ethics Committee. Training on ethics is provided to employees, which is confirmed by a personal certification. Formal channels for whistle blowing have been established, including reporting to the Chairman of the TP Audit Committee of the Supervisory Board, the Chairman of the TP Group Ethics Committee and the TP Group Internal Audit Director.

The key elements of TP Group's internal control and risk management system include the following procedures:

- 1 An internal audit function, which reports directly to the President of the Management Board. The internal audit program is annually reviewed by the Audit Committee which also analyses the Group's Internal Audit reports. In order to promote an appropriate independent outlook for the Internal Audit Department, Management Board decisions regarding the appointment and remuneration of the TP Group Internal Audit Director require, since 2005, an opinion of the Audit and Remuneration Committees. Group Internal Audit director attends all Audit Committee meetings.
- 2 The Group conducts ongoing assessments of the quality of the risk management system and controls. As part of this process, a Risk Map which enables identification and classification of the Group's financial and non-financial risks is maintained.
- 3 Procedures were implemented in order to identify, report and monitor significant risks (i.e. legal, regulatory, environmental, financial reporting and operational) effectively on an ongoing basis. It provides a framework for the TP Group Internal Audit Department's ongoing risk-controlling activities.

In 2011, the Management Board again completed a comprehensive assessment of the Group's internal controls over financial reporting. Main deficiencies were identified and corrected or appropriate action points have been launched. As a result of the assessment, the Management concluded that there were no weaknesses that would materially impact the internal control over the financial reporting at 31 December 2011.



# Corporate governance Disclosure

TP Group is diligent in its approach to reporting financial results and its ongoing communication with the Polish and international investment community, as well as fulfilling its disclosure obligations. Key managers responsible for the financial, legal, regulatory and internal control functions review financial statements and make comments thereto at the TP Group Disclosure Committee. The purpose of the Committee's meetings is to ensure that financial disclosures are timely, exact, transparent, complete, and presented in accordance with all relevant laws, applicable regulations and recognised practices, as well as being properly representative of the financial and operational condition of the Group. In 2011, the Disclosure Committee had five meetings.



# Corporate governance

Concise assessment of the Group's standing in 2011 prepared by TP S.A. Supervisory Board

This document is the Supervisory Board assessment of TP Group performance in 2011 in accordance with recommendation no. III.1.1 of the Code of Best Practices for WSE Listed Companies, introduced by the Warsaw Stock Exchange. The assessment is based on the 2011 Financial Results of the Group (the Company and its subsidiaries), as well as, on information obtained by the Supervisory Board during conducting its statutory tasks.

Throughout 2011, the Supervisory Board focused on the following issues:

- Group's financial results and performance in comparison to the budget,
- b Continued implementation of the Group's medium term action plan,
- c Resolving the dispute with DPTG,
- d Execution of the Memorandum of Understanding with UKE (the Office of Electronic Communication the Polish Regulator),
- e Customer satisfaction the customer excellence programme,
- f Disposal of TP Emitel and subsequent allocation of part of proceeds to a share buy back program,
- g Execution of agreements between PTK Centertel (PTK) and Polska Telefonia Cyfrowa (PTC) regarding the operations of NetWorkS!, a jointly controlled company conducting management, planning, operations, development and maintenance of the radio access networks of PTK and PTC,
- h Related parties transactions, including the proposed rebranding of the fixed-line business and TP Group's participation in BuyIn SA a purchasing joint-venture between France Telecom and Deutsche Telecom,
- Establishing a new company Integrated Solutions sp. z o.o. as a response to growing demand for services related to comprehensive management of the ICT infrastructure,
- j Giving opinion regarding development of convergent services in fixed and mobile.

The Supervisory Board, through the work of its committees and all its members (including six independent members until December 23, 2011'), was actively engaged in the process of evaluation of the most important initiatives, having in mind the interest of all the Group's shareholders. In addition, it maintained oversight of the Group's operational and financial goals through management reporting at its quarterly meetings and was able, through the Audit Committee, to review and challenge the control, risk management and budgeting function performed by the Management.

# TP Group operational review

Throughout 2011, the Group focused most of its efforts on execution of the medium term action plan, developed in 2009. In particular, this included capitalising on the meaningful changes to the mobile commercial offers made in April 2010 and regaining growth momentum in the number of Group's broadband customers. The mobile marketing approach has proved to be a success, enabling the Group to grow its mobile customer base by 326,000 (or 2.3%) in 2011, which has allowed Orange to maintain its market share leadership. Mobile broadband was also very popular in 2011, with number of dedicated mobile broadband subscribers growing by 35%. In order to facilitate this trend further, TP made the necessary investments and rolled-out the HSPA DC network, with speeds up to 42Mb/s. Further mobile network development could significantly benefit from a network sharing agreement, signed in 2011 with Polska Telefonia Cyfrowa (PTC); TP Group and PTC have signed a letter of intent providing for future reciprocal use of each others' radio access networks and associated frequencies. In turn, upon implementation, this could increase TP Group's mobile coverage potential, whilst limiting investments needed to cope with increasing traffic.

In 2011, the Group also paid close attention to execution of the Arrangement with the President of UKE (signed in October 2009). Amongst other items, TP has gone to great efforts to ensure equal treatment of alternative operators and equivalence of access. The Group has also respected its investment commitments, as specified in the Arrangement, by investing into 406,000 broadband lines in 2011. On the other hand, TP benefitted from the Arrangement, as the 'cost plus' methodology, implemented in the 4th quarter of 2010, allowed TP Group to re-price its retail broadband offering, bringing its prices back to competitive levels, while increased broadband investments made it possible for TP S.A. to promote speed options exceeding 6Mb/s. This brought positive results, as the adverse trend in Group's retail broadband base was reversed and TP group achieved four consecutive quarters of customer base growth in 2011, resulting in 60,000 (2.6%) growth of the number of broadband customers in 2011. Simultaneously TP was able to increase the share of higher speed options in its sales numbers, with the proportion of speed options at or exceeding 6Mb/s rising to 49% in 4Q 2011.

TP Group's TV offering continued to be popular amongst consumers, which was reflected in a 17% growth of the number of its subscribers, which in 2011 reached 636,000. In 2011, TP Group implemented the agreement, signed in 2010 with TVN Group, relating to its TV activity, which, amongst others providing for reciprocal sales of both sides' services, co-operation in the field of content acquisition.

 $<sup>^{\</sup>rm 1}$  Mr. Ronald Freeman resigned from his function on the Supervisory Board as from December 23, 2011

# **TP Group financial overview**

Operating in more stable regulatory conditions and yet, in a very competitive market, the Group's key strategic goals in 2011 were to:

- maintain positive momentum on the mobile market;
- revamp the broadband offering, by returning to growth of the number of broadband customers,
- strengthen promotion of integrated services to increase ARPU and improve customer retention and customer satisfaction;
- further integrate fixed and mobile units and gain efficiency from integrated business processes;
- further rationalise Group's operations and processes in order to optimize operating expenses
- meet the investment targets in broadband, as committed in the Arrangement with UKE;
- continue to optimise Capex spending based on sound investment criteria and without hampering growth;
- generate Net Free Cash Flow of at least PLN 2.4 billion;
- continue Group's balance sheet optimisation to improve return on assets base, including optimisation of the real estate portfolio;
- improve quality of service and shorten time to market for new products by continuing IT systems transformation and integration with CRM systems;
- deliver an attractive return to shareholders keeping in mind conditions set up in the shareholder remuneration policy;
- promote predictable regulations according to the European Regulatory Framework and consistent with comparable benchmarks;
- further enhance internal control and risk management measures.

In 2011, due to consistency in the deployment of the medium term action plan and to a stable regulatory environment, TP Group reported meaningful progress, both in the commercial field and the cost optimisation program. In turn, this allowed the Management to meet its outlook for revenue decline, restated EBITDA margin and Capex as percentage of revenue. TP Group has also delivered on the Management's Cash Flow guidance, by reporting Net Free Cash Flow for 2011 of PLN 2.4bn.

In June 2011 TP S.A. finalised the disposal of its subsidiary – TP Emitel. It was acquired by EM Bidco sp. z o.o., controlled by funds managed by Montagu Private Equity, for a total of PLN 1.7bn, providing TP Group with capital gains of PLN 1.2bn. In turn, this has allowed TP Group's Management to allocate up to PLN 800mn to a share buy back, which gained shareholders' approval during an Extraordinary General Meeting held in October 2011.

In January 2012, acting in the best interest of the Company and its shareholders, TP S.A.'s Management Board signed a final settlement in the TPSA vs. DPTG dispute, for the total of €550mn. The Supervisory Board supported the Management in its actions taken with regards to the dispute.

TP Group has followed on the Supervisory Board recommendations and continued its progress in terms of its financing activity. Throughout 2011, the Company has reduced its net debt, and despite the € 550mn payment made to DPTG, its pro-forma net gearing was kept at ~23%. It continued to pay focus to its gross debt structure, keeping a high share of bonds (at ~66%). Coupled with a strong liquidity position and an effective hedging policy, this enabled TP to maintain its credit rating of A3/BBB+ with a stable outlook.

TP Management Board has proposed an ordinary dividend of PLN 2,003 million, an equivalent of PLN 1.5 per share, payable in cash in 2012. That proposal obtained a positive opinion of the Supervisory Board and is subject to approval by the General Assembly of TP S.A.'s shareholders.

#### Conclusions and 2012 recommendations

Despite intensive competition across all segments as well as regulatory pressure, TP Group has delivered satisfactory results in 2011. The Supervisory Board believes TP's Management Board has made the appropriate efforts to reach the 2011 objectives. Moreover, the Group, with its integrated offers and the commercial and investment program for broadband, is in a strong position to continue creating and exploiting new opportunities on the Polish telecommunication market.

The Supervisory Board's opinion is that in 2012 the Group should focus its activities to continue to implement the medium term action plan, to prepare the next action plan for the future, and also to:

- Monitor business performance closely so as to be able to react quickly to unfavourable trading conditions caused by the continued volatility of the financial markets;
- Strive for leadership in value on fixed voice, mobile and broadband markets;
- Increase customer satisfaction and loyalty, also by implementing the newly launched customer excellence program;
- Monitor TP Group EBITDA margin, with particular reference to the mobile segment;
- Monitor capital expenditure, with a specific focus on the spend and efficiency of the broadband investment program, which is executed in connection with the Arrangement with the Regulator
- Mitigate foreign exchange effect on commercial expenses, financial costs and capital expenditure;
- Further optimise operating cost base;
- Maintain financial stability;
- Generate Net Free Cash Flow of at least PLN 2 billion;
- Successfully implement the Arrangement with the Regulator;
- Deliver an attractive return to shareholders keeping in mind conditions set up in the shareholder remuneration policy;
- Further enhance internal control and risk management measures;
- Continue with the Radio Access Network sharing cooperation with PTC (T-Mobile brand) through the NetWorkS! joint venture.

# Assessment of the Group's internal control including risk management

The Supervisory Board is responsible for reviewing the effectiveness of the Group's system of internal control and risk management established by the Management Board. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The key elements of this system of internal control, including risk management were presented in the Management Board's Report on the Activity of Telekomunikacja Polska Group for 2011, published on February 14, 2012.

In 2011, the Group again completed a comprehensive assessment of its processes of internal control over financial reporting within the framework of Sarbanes-Oxley Program of France Telecom Group. Main deficiencies both in design and in effectiveness of the internal control have been either identified and corrected, or appropriate action points have been launched. As a result of the assessment, the Management concluded that there were no weaknesses that would materially impact the internal control over the financial reporting at December 31, 2011. Continued efforts by Management in this regard are also needed in 2012.

Both the internal and external auditors report to the Management Board and also to the Audit Committee on control deficiencies which they identified during their audit. Their recommendations are being implemented.

# **Consolidated Income Statement**

		12 mont	ns ended
	Note	31 December 2011	31 December 2010
(in PLN millions, except for earnings per share)		(audited)	(audited)
Revenue	5	14,922	15,715
External purchases	6	(7,012)	(7,174)
Labour expenses	6	(2,031)	(2,218)
Other operating expense	6	(1,366)	(769)
Other operating income	6	407	193
Restructuring costs	27	(172)	(34)
Gains on disposal of assets	7	32	59
Gain on disposal of TP Emitel	7	1,183	_
Dispute with DPTG	31.e	(35)	(1,061)
Depreciation and amortisation	13,14	(3,703)	(3,792)
Impairment of non-current assets	8	(9)	(11)
Share of profit of investments accounted for using the equity method	15	1	_
Operating income		2,217	908
Interest income	9	111	85
Interest expense and other financial charges	9	(450)	(484)
Foreign exchange gains	9	7	23
Discounting expense	9	(100)	(83)
Finance costs, net		(432)	(459)
Incometax	10	133	(341)
Consolidated net income		1,918	108
Net income attributable to owners of TP S.A.		1,917	107
Net income attributable to non-controlling interests		1	1
Earnings per share (in PLN) (basic and diluted)	3.4	1.44	0.08
Weighted average number of shares (in millions) (basic and diluted)	3.4	1,334	1,336

# Consolidated Statement of Comprehensive Income

		12 months ended		
(in PLN millions)	Note	31 December 2011 (audited)	31 December 2010 (audited)	
Consolidated net income		1,918	108	
Gains/(losses) on cash flow hedges	11	8	(18)	
Actuarial losses on post-employment benefits	11	(11)	(16)	
Income tax relating to components of other comprehensive income	11	-	7	
Translation adjustment		1	_	
Other comprehensive loss, net of tax		(2)	(27)	
Total comprehensive income		1,916	81	
Total comprehensive income attributable to owners of TP S.A.		1,915	80	
Total comprehensive income attributable to non-controlling interests		1	1	

# **Consolidated Balance Sheet**

(in PLN millions)	Note	At 31 December 2011 (audited)	At 31 December 2010 (audited)
Assets			
Goodwill	12	4,016	4,016
Other intangible assets	13	2,955	2,861
Property, plant and equipment	14	14,912	16,500
Investments accounted for using the equity method	15	16	3
Financial assets available for sale	16	4	4
Loans and receivables excluding trade receivables	16	12	22
Financial assets at fair value through profit or loss	16	132	52
Hedging derivatives	21	145	50
Deferred tax assets	10	899	603
Total non-current assets		23,091	24,111
Inventories		214	272
Trade receivables	17	1,506	1,637
Loans and receivables excluding trade receivables	16	8	10
Financial assets at fair value through profit or loss	16	234	28
Hedging derivatives	21	_	1
Income tax assets		1	7
Other assets	17	227	266
Prepaid expenses	17	78	94
Cash and cash equivalents	18	2,860	2,447
Total current assets		5,128	4,762
Total assets		28,219	28,873
Equity and liabilities			
Share capital	29	4,007	4,007
Share premium		832	832
Treasury shares	29	(200)	_
Other reserves	11,26	24	27
Translation adjustment		(5)	(6)
Retained earnings		9,673	9,760
Equity attributable to owners of TP S.A.		14,331	14,620
Non-controlling interests		3	14
Total equity		14,334	14,634

continued

# Consolidated Balance Sheet (continued)

(in PLN millions)	Note	At 31 December 2011 (audited)	At 31 December 2010 (audited)
Financial liabilities at amortised cost excluding trade payables	19,20	4,170	4,456
Financial liabilities at fair value through profit or loss	21	53	90
Hedging derivatives	21	65	191
Trade payables	28	825	751
Employee benefits	25	285	342
Provisions	27	304	189
Deferred tax liabilities	10	_	9
Other liabilities	28	15	_
Deferred income	28	48	66
Total non-current liabilities		5,765	6,094
Financial liabilities at amortised cost excluding trade payables	19,20	767	1,547
Financial liabilities at fair value through profit or loss	21	_	55
Hedging derivatives	21	_	54
Trade payables	28	3,199	3,156
Employee benefits	25	240	266
Provisions	27	3,130	2,242
Income tax payable		37	72
Other liabilities	28	202	220
Deferred income	28	545	533
Total current liabilities		8,120	8,145
Total equity and liabilities		28,219	28,873

# Consolidated Statement of Changes in Equity

	Number of					Otherre	eserves					Non-	
	shares in issue (not in millions)	Share capital	Share premium	Treasury shares				i	Translation adjustments		Total	cont- rolling interest	Total equity
(In PLN millions)				ins	Hedging er struments	Actuarial losses on post- mployment benefits		Share- based ayments					
Balance at 1 January 2010 (audited)	1 335 649 021	4,007	832	_	- 20	(50	)) 5	7:	5 (6)	11,656	16,539	14	16,553
Total comprehensive income for the 12 months ended 31 December 2010		_	_	_	- (18)	(16	6) 7		<u> </u>	107	80	1	81
Share-based payments		_	_	_		_		4	4 –	_	4	_	4
Dividends		_	_	_		-		-		(2,003)	(2,003)	(1)	(2,004)
Balance at 31 December 2010 (audited)	1 335 649 021	4,007	832	_	- 2	(66	6) 12	79	9 (6)	9,760	14,620	14	14,634
Balance at 1 January 2011 (audited)	1 335 649 021	4,007	832	_	- 2	(66	6) 12	7:	9 (6)	9,760	14,620	14	14,634
Total comprehensive income for the 12 months ended 31 December 2011		_	_	_	- 8	(11	I) –		- 1	1,917	1,915	1	1,916
Purchase of treasury shares	(11 313 409)	-	_	(200	)) –		<u> </u>			_	(200)	-	(200)
Acquisition of non- controlling interests		_	_	_		-				(1)	) (1)	(11)	(12)
Dividends		-	_	-		-		-		(2,003)	(2,003)	(1)	(2,004)
Balance at 31 December 201 (audited)	1 1 324 335 612	4,007	832	(200	)) 10	(77	') 12	79	9 (5)	9,673	14,331	3	14,334

# **Consolidated Statement of Cash Flows**

		12 mont	hs ended
(in PLN millions)	Note	31 December 2011	31 December 2010
(III FENTILIII OTS)		(audited)	(audited)
Operating activities			
Consolidated net income		1,918	108
Adjustments to reconcile net income to funds generated from operations			
Depreciation and amortisation	13,14	3,703	3,792
Impairment of non-current assets	8	9	11
Gains on disposal of assets	7	(1,215)	(59)
Change in provisions		517	1,088
Share of profit of investments accounted for using the equity method		(1)	-
Income tax	10	(133)	341
Finance costs, net, excluding realised exchange rate effect on cash and cash equivalents		427	489
Operational foreign exchange and derivatives losses, net		71	8
Share-based payments	6,26	-	4
Change in working capital (trade)			
Decrease/(increase) in inventories		58	(43)
Decrease/(increase) in trade receivables		143	(214)
Increase/(decrease) in trade payables		142	1
Change in working capital (non-trade)			
Decrease/(increase) in prepaid expenses and other receivables		33	(116)
Increase/(decrease) in accrued expenses, other payables and deferred income		(23)	(12)
Interest received		115	85
Interest and interest rate effect on derivatives paid, net		(479)	(566)
Exchange rate effect on derivatives, net		72	(50)
Income tax paid		(188)	(337)
Net cash provided by operating activities		5,169	4,530
Investing activities		<u>,                                      </u>	<u> </u>
Purchases of property, plant and equipment and intangible assets	13,14	(2,606)	(2,713)
Increase/(decrease) in amounts due to fixed assets suppliers		(175)	637
Decrease in receivables related to leased fixed assets		7	5
Exchange rate effect on derivatives economically hedging capital expenditures, net		8	(19)
Proceeds from sale of property, plant and equipment and intangible assets		55	85
Proceeds from sale of subsidiaries, net of cash and transaction costs	4	1,633	_
Proceeds from sale of investments accounted for using the equity method	·	3	_
Cash paid for investments accounted for using the equity method	4	(15)	_
Decrease/(increase) in marketable securities and other financial assets	16	1	(9)
Exchange rate effect on other derivatives, net	.0	(1)	(1)
Net cash used in investing activities		(1,090)	(2,015)
			., -,

#### Consolidated Statement of Cash Flows (continued)

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Cash and cash equivalents at the end of the period		2,860	2,447
Cash and cash equivalents at the beginning of the period		2,447	2,218
Effect of changes in exchange rates and other impacts on cash and cash equivalents		(3)	_
Net change in cash and cash equivalents		416	229
Net cash used in financing activities		(3,663)	(2,286)
Exchange rate effect on derivatives, net		(17)	(50)
Acquisition of non-controlling interests		(12)	-
Dividends paid	29	(2,004)	(2,004)
Purchase of treasury shares	29	(200)	-
Decrease in bank overdrafts and other short-term borrowings	19,20	(7)	(2)
Repayment of long-term debt	19,20	(234)	(230)
Redemption of bonds	19,20	(1,189)	-
Financing activities			

#### Segment information

For management purposes, the Telekomunikacja Polska Group ("the Group") is organised into business units based on their products, and has two reportable operating segments as follows:

- Fixed line segment which includes entities offering predominantly telecom services based on fixed line technology and other companies offering services
  predominantly for those entities, and
- Mobile segment which includes entities offering predominantly telecom services based on mobile technology and other companies offering services predominantly for those entities.

Margin earned by Orange Customer Service Sp. z o.o. on intragroup transactions is eliminated from fixed and mobile segment data.

Segment performance is evaluated based on revenue, EBITDA, EBIT and capital expenditures. EBITDA corresponds to operating income before depreciation and amortisation expense, impairment of non-current assets and share of profit of investments accounted for using the equity method. EBIT corresponds to operating income.

Telekomunikacja Polska S.A. operates in the fixed line telecommunications sector where it provides local, long distance domestic and international public telephony services. In addition, Telekomunikacja Polska S.A. provides leased lines and other telecommunications value added services.

Mobile telecommunications services are provided by Polska Telefonia Komórkowa – Centertel Sp. z o.o., a provider of DCS 1800, GSM 900 and UMTS mobile telecommunications and services based on the CDMA technology.

The Group's operational activities are conducted in one geographical area, the territory of the Republic of Poland.

The accounting policies are uniform for all segments. Transactions between segments are eliminated on consolidation.

Both segments have dispersed customer base – no single customer generates more than 10% of segment revenue.

Financing and income tax are managed on a group basis and are not allocated to operating segments.

# Segment information (continued)

Basic financial data of the business segments is presented below:

(in PLN millions)	Fixed line telecommunications	Mobile telecommunications	Eliminations and unallocated items	Consolidated
		12 months ended 31 December 2011		
Revenue	8,282	7,706	(1,066)	14,922
External	7,481	7,441	_	14,922
Inter-segment	801	265	(1,066)	-
External purchases	(3,449)	(4,955)	1,392	(7,012)
Labour expenses	(1,819)	(212)	-	(2,031)
Other operating expense	(940)	(468)	42	(1,366)
Other operating income	550	225	(368)	407
Restructuring costs	(172)	_	_	(172)
Gains on disposal of assets	29	3	_	32
Gain on disposal of TP Emitel	1,183	-	_	1,183
Dispute with DPTG	(35)	_	_	(35)
EBITDA	3,629	2,299	_	5,928
Depreciation and amortisation	(2,365)	(1,338)	_	(3,703)
Impairment of non-current assets	(9)	_	_	(9)
Share of profit of investments accounted for using the equity method	_	1	_	1
EBIT	1,255	962	_	2,217
Capital expenditures	1,991	615	_	2,606
		At 31 Dec		
Segment assets	14,729	9,383	(204)	23,908
Investments accounted for using the equity method	_	16	_	16
Unallocated assets	-	_	4,295	4,295
Total assets				28,219
Segment liabilities	6,293	2,704	(204)	8,793
Unallocated liabilities	_	_	5,092	5,092
Total liabilities				13,885
Equity	_	_	14,334	14,334
Total equity and liabilities				28,219

(in PLN millions)	Fixed line telecommunications	Mobile telecommunications	Eliminations and unallocated items	Consolidated
		12 months ended 31 December 2010		
Revenue	9,028	7,711	(1,024)	15,715
External	8,283	7,432	_	15,715
Inter-segment	745	279	(1,024)	_
External purchases	(3,418)	(4,981)	1,225	(7,174)
Labour expenses	(1,927)	(291)	_	(2,218)
Other operating expense	(491)	(280)	2	(769)
Other operating income	295	101	(203)	193
Restructuring costs	(34)	_	_	(34)
Gains on disposal of assets	59	_	_	59
Dispute with DPTG	(1,061)	_	_	(1,061)
EBITDA	2,451	2,260	_	4,711
Depreciation and amortisation	(2,476)	(1,316)	_	(3,792)
Impairment of non-current assets	(11)	_	_	(11)
EBIT	(36)	944	_	908
Capital expenditures	2,007	709	_	2,716
		At 31 Dec	cember 2010	
Segment assets	15,766	10,202	(322)	25,646
Investments accounted for using the equity method	3	_	_	3
Unallocated assets	_	_	3,224	3,224
Total assets				28,873
Segment liabilities	5,348	2,739	(322)	7,765
Unallocated liabilities	-	_	6,474	6,474
Total liabilities				14,239
Equity	-	_	14,634	14,634
Total equity and liabilities				28,873

continued

#### 1. Corporate information

#### 1.1. The Telekomunikacja Polska Group

Telekomunikacja Polska S.A. ("Telekomunikacja Polska" or "the Company" or "TP S.A."), a joint stock company, was incorporated and commenced its operations on 4 December 1991. The Telekomunikacja Polska Group ("the Group") comprises Telekomunikacja Polska and its subsidiaries.

The Group is the principal supplier of telecommunications services in Poland. Telekomunikacja Polska provides fixed-line telephony services (local, domestic and international calls), Integrated Services Digital Network ("ISDN"), fixed access to the Internet, TV and Voice over Internet Protocol ("VoIP"). Telekomunikacja Polska provides telecommunications services on the basis of entry number 1 in the register of telecommunications companies maintained by the President of Office of Electronic Communication ("UKE"). Through its subsidiary, Polska Telefonia Komórkowa-Centertel Sp. z o.o. ("PTK-Centertel"), the Group is one of Poland's major DCS 1800 and GSM 900 mobile telecommunications providers. PTK-Centertel also provides third generation UMTS services and services based on the CDMA technology. In addition, the Group provides leased lines and other telecommunications value added services, sells telecommunications equipment, provides data transmission, multimedia services and various Internet services.

Telekomunikacja Polska's registered office is located in Warsaw at 18 Twarda St.

The Group's operations are subject to regulatory controls of UKE, the government telecommunications market regulator. Under the Telecommunication Act, UKE can impose certain obligations on telecommunications companies that have a significant market power ("SMP"). Telekomunikacja Polska S.A. and PTK-Centertel Sp. z o.o. are deemed to be SMPs on certain markets.

#### 1.2. Entities of the Group

The Group comprises Telekomunikacja Polska and the following subsidiaries:

Share capital owned by the Group 31 December 2011 31 December 2010 Entity Location Scope of activities PTK-Centertel Sp. z o.o. Warsaw, Poland PolandMobile telephony services, construction and operation of mobile telecommunications networks 100.00% 100.00% TP EmiTel Sp. z o.o.(1) Kraków. TV and radio signals broadcasting, construction, ("TP Emitel") Wirtualna Polska S.A. lease and maintenance of technical infrastructure. 100.00% Gdańsk, Poland Internet portal and related services including internet advertising. 100.00% 100.00% OPCO Sp. z o.o. Warsaw, Poland Facilities management and maintenance. 100.00% 100.00% Otwarty Rynek Warsaw, Poland Elektroniczny S.A. Provision of complex procurement solutions, including advisory, implementation and operation of e-commerce platform and IT systems, hosting. 100.00% 100.00% TP Edukacja i Wypoczynek Sp. z o.o. Warsaw, Poland Hotel services, training and conference facilities. 100.00% 100.00% TP Invest Sp. z o.o. Warsaw, Poland Services for Group entities, holding management. 100.00% 100.00% - Orange Customer Service Sp. z o.o. Warsaw, Poland Post-sale services for TPS.A. and PTK-Centertel customers. 100.00% 100.00% - Contact Center Sp. z o.o. Warsaw. Poland Call-centre services and telemarketing. 100.00% 100.00% -Telefon 2000 Sp. z o.o. Warsaw, Poland 100.00% 100.00% No operational activity. -TP TelTech Sp. z o.o. Łódź. Poland Monitoring of alarm signals, servicing telecommunications 100.00% 100.00% networks, design and development of telecommunications systems. - Telefony Podlaskie S.A.(2) Sokołów Podlaski, Local provider of fixed-line, internet and cable TV services. 89.27% 55.11% Poland -TPSA Finance B.V. Amsterdam, The Netherlands Financial and investment operations. 100.00% 100.00% -TPSA Eurofinance B.V. Amsterdam, The Netherlands Financial and investment operations. 100.00% 100.00% TPSA Eurofinance France 99.99% 99.99% S.A. Paris, France Financial and investment operations. Pracownicze Towarzystwo Emerytalne Telekomunikacji 100.00% Warsaw, Poland Management of employee pension fund. 100.00% Polskiej S.A. Fundacja Orange Warsaw, Poland 100.00% 100.00% PayTel S.A.(3) Warsaw, Poland E-commerce and electronic services, including GSM prepaid services, bill charging and processing of electronic financial transactions. 100.00% 100.00% Distributor of PTK-Centertel and TPS.A. products on mass Ramsat S.A. Modlnica, 100.00% 100.00% Poland and business market. Integrated Solutions Sp. z o.o.(4) Warsaw, Poland Provision of integrated IT and network services. 100.00% Bilbo Sp. z o.o.(4) 100.00% Warsaw, Poland Investment operations.

In the 12 months ended 31 December 2011 and 2010, the voting power held by the Group was equal to the Group's interest in the share capital of its subsidiaries. Main acquisitions, disposals and changes in scope of consolidation are described in Note 4.

The Group has the following interests in joint ventures and investments in associates:

As at 31 December 2011, PTK-Centertel held a 50% interest in NetWorkS! Sp. z o.o. (see Note 4).

As at 31 December 2011 and 2010, PTK-Centertel held a 25% interest in 4MNO Sp. z o.o.

As at 31 December 2010, Wirtualna Polska S.A. held the 25% voting power in Polskie Badania Internetu Sp. z o.o. which conducts studies on Internet use in Poland. The voting power decreased to 15.79% in 2011.

As at 31 December 2010, TP Invest Sp. z o.o. held a 25% interest in Telefony Opalenickie S.A., a local fixed line telecommunications operator. TP Invest Sp. z o.o. disposed of its shareholding in 2011.

<sup>(1)</sup> The Company was disposed of in 2011 (see Note 7.1).

<sup>&</sup>lt;sup>(2)</sup> The Group purchased additional shares of the Company in 2011 (see Note 4).

<sup>(3)</sup> The Company was disposed of in 2012 (see Note 33).

<sup>(4)</sup> Companies incorporated in 2011 (see Note 4).

#### continued

#### 1. Corporate information (continued)

#### 1.3. The Management Board and the Supervisory Board of the Company

The Management Board of the Company at the date of the authorisation of these Consolidated Financial Statements was as follows:

Maciej Witucki - President of the Management Board, Chief Executive Officer,

Vincent Lobry - Vice President in charge of Marketing and Strategy,

Piotr Muszyński - Vice President in charge of Operations,

Jacques de Galzain - Board Member, Chief Financial Officer,

Jacek Kowalski - Board Member in charge of Human Resources.

The Supervisory Board of the Company at the date of the authorisation of these Consolidated Financial Statements was as follows:

Prof. Andrzej K. Koźmiński - Chairman of the Supervisory Board, Independent Member of the Supervisory Board,

Benoit Scheen - Deputy Chairman of the Supervisory Board,

Nathalie Clere - Secretary of the Supervisory Board,

Timothy Boatman - Independent Member of the Supervisory Board,

Thierry Bonhomme - Member of the Supervisory Board,

Jacques Champeaux - Member of the Supervisory Board,

Dr. Mirosław Gronicki - Independent Member of the Supervisory Board,

Henri de Joux - Member of the Supervisory Board,

Marie-Christine Lambert - Member of the Supervisory Board,

Pierre Louette - Member of the Supervisory Board,

Prof. Jerzy Rajski - Independent Member of the Supervisory Board,

Gerard Ries - Member of the Supervisory Board,

Dr. Wiesław Rozłucki - Independent Member of the Supervisory Board.

The following changes occurred in the Management Board of the Company in the year ended 31 December 2011 and in the year 2012 until the date of the authorisation of these Consolidated Financial Statements:

On 14 January 2011, Mr Roland Dubois resigned from the position of Management Board Member of TP S.A. in charge of Finance – Chief Financial Officer. As of 17 January 2011, his duties were passed on to Mr Jacques de Galzain.

On 27 January 2011, the Supervisory Board of the Company appointed Mr Jacques de Galzain and Mr Jacek Kowalski as Members of the Management Board of TP S.A. The Supervisory Board also appointed Mr Piotr Muszyński for the subsequent term of office.

On 12 July 2011, the Supervisory Board of the Company appointed Mr Maciej Witucki for his third consecutive term as the President of the Management Board of TP S.A. This third term will start on the day of the next General Shareholders' Meeting of TP S.A. for a period of three years.

The following changes occurred in the Supervisory Board of the Company in the year ended 31 December 2011 and in the year 2012 until the date of the authorisation of these Consolidated Financial Statements:

Mr Raoul Roverato resigned from the Supervisory Board of TP S.A. with the effect from 26 January 2011. On 27 January 2011, the Supervisory Board appointed Mr Gerard Ries as a Member of the Supervisory Board of TP S.A.

On 24 March 2011, Mr Olivier Barberot resigned from the Supervisory Board of TP S.A. On the same day, the Supervisory Board appointed Mr Pierre Louette as a Member of the Supervisory Board of TP S.A.

On 14 April 2011, the General Shareholders' Meeting of TP S.A. renewed mandates of the following Members of the Supervisory Board of TP S.A., whose term of office expired as of the day of this General Meeting: Mr Timothy Boatman and Mr Gerard Ries.

On 11 July 2011, Mr Olivier Faure resigned from the Supervisory Board of TP S.A. On 12 July 2011, the Supervisory Board appointed Ms Nathalie Clere as a Member of the Supervisory Board of TP S.A.

On 7 October 2011, Mr Olaf Swantee resigned from the Supervisory Board of TP S.A. as of 12 October 2011. On 13 October 2011, the Extraordinary General Shareholders' Meeting of TP S.A. appointed Mr Benoit Scheen as a Member of the Supervisory Board of TP S.A. and renewed mandates of the following Members of the Supervisory Board of TP S.A., whose term of office expired as of the day of this Extraordinary General Meeting: Ms Nathalie Clere and Mr Pierre Louette.

On 23 December 2011, Mr Ronald Freeman resigned from the Supervisory Board of TP S.A. On 5 January 2012, the Supervisory Board appointed Mr Henri de Joux as a Member of the Supervisory Board of TP S.A.

## 2. Statement of compliance and basis for preparation

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") adopted for use by the European Union. IFRSs comprise standards and interpretations approved by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC").

Comparative amounts for the year ended 31 December 2010 have been compiled using the same basis of preparation.

The Consolidated Financial Statements have been prepared under the historical cost convention, except for the fair value applied to derivative financial instruments, financial assets available for sale, assets held for sale and debt that is hedged against exposure to changes in fair value.

The Consolidated Financial Statements have been prepared on the going concern basis.

The financial data of all entities constituting the Group included in these Consolidated Financial Statements were prepared using uniform group accounting policies.

These Consolidated Financial Statements are prepared in millions of Polish zloty ("PLN") and were authorised for issuance by the Management Board on 13 February 2012.

The principles applied to prepare financial data relating to the year ended 31 December 2011 are described in Note 3 and are based on:

- all standards and interpretations endorsed by the European Union and applicable to the reporting period beginning 1 January 2011,
- IFRSs and related interpretations adopted for use by the European Union whose application will be compulsory for periods beginning after 1 January 2011 but for which the Group has opted for earlier application,
- accounting positions adopted by the Group in accordance with paragraphs 10 to 12 of IAS 8 (Use of judgements).

#### Use of estimates

In preparing the Group's accounts, the Company's management is required to make estimates, insofar as many elements included in the financial statements cannot be measured with precision. Management reviews these estimates if the circumstances on which they were based evolve, or in the light of new information or experience. Consequently, estimates made as at 31 December 2011 may be subsequently changed. The main estimates made are described in the following notes:

	Note	Type of information disclosed
3.5.7, 3.5.11, 8 discount rates, growth rates.	Impairment of cash generating units and individual tangible and intangible assets	Key assumptions used to determine recoverable amounts: impairment indicators, models,
3.5.12, 16.2	Impairment of loans and receivables	Methodology used to determine recoverable amounts.
3.5.14, 10	Income tax	Assumptions used for recognition of deferred tax assets.
3.5.16, 25	Employee benefits	Discount rates, salary increases, expected average remaining working lives.
3.5.12, 21, 24	Fair value of derivatives and other financial instruments	Model and assumptions underlying the measurement of fair values.
3.5.15, 27, 31	Provisions	Provisions for termination benefits and restructurings: discount rates and other. The assumptions underlying the measurement assumptions of provisions for claims and litigation.
3.5.8, 3.5.9	Useful lives of tangible and intangible assets	The useful lives and the amortisation method.
27	Dismantling costs	The assumptions underlying the measurement of provision for the estimated costs for dismantling and removing the asset and restoring the site on which it is located.
3.5.3, 5	Revenue	Allocation of revenue between each separable component of a packaged offer based on its relative fair value. Straight-line recognition of revenue relating to service access fees. Reporting revenue on a net versus gross basis (analysis of Group's involvement acting as principal versus agent).
3.5.13	Allowance for slow moving and obsolete inventories	Methodology used to determine net realisable value of inventories.

continued

#### 2. Statement of compliance and basis for preparation (continued)

#### Use of judgments

Where a specific transaction is not dealt with in any standard or interpretation, management uses its judgment in developing and applying an accounting policy that results in information that is relevant and reliable, in that the financial statements:

- represent faithfully the Group's financial position, financial performance and cash flows,
- reflect the economic substance of transactions,
- are neutral.
- are prudent and
- are complete in all material respects.

#### 3. Significant accounting policies

This note describes the accounting principles applied to prepare the Consolidated Financial Statements for the year ended 31 December 2011.

#### 3.1. Application of new standards, amendments and interpretations

#### Adoption of standards, amendments to standards and interpretations which are compulsory as at 1 January 2011

The following standards or amendments to standards and interpretations (already endorsed or in the process of being endorsed by the European Union) have become effective and are compulsory as at 1 January 2011:

- Amendments to IAS 32 "Financial Instruments: Presentation",
- Amendments to IAS 24 "Related Party Disclosures",
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments",
- Amendments to IFRIC 14 "Prepayments of a Minimum Funding Requirement",
- Improvements to International Financial Reporting Standards a collection of amendments to IFRSs, the amendments are effective, in most cases, for annual periods beginning on or after 1 January 2011.

The adoption of the standards and interpretations presented above did not result in any significant changes to the Company's accounting policies and to the presentation of the financial statements.

#### Standards and interpretations issued but not yet adopted

Management has not opted for early and full application of the following standards and interpretations (already endorsed or in the process of being endorsed by the European Union):

- IFRS 9 "Financial Instruments" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed by the European Union.
- Amendments to IFRS 7 "Financial Instruments: Disclosures" applicable for financial years beginning on or after 1 July 2011. These amendments have not been endorsed by the European Union,
- IFRS 10 "Consolidated Financial Statements" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed
  by the European Union,
- Amendments to IAS 27 "Separate financial statements" applicable for financial years beginning on or after 1 January 2013. These amendments have not been endorsed by the European Union,
- Amendments to IAS 28 "Investments in associates and joint ventures" applicable for financial years beginning on or after 1 January 2013.
   These amendments have not been endorsed by the European Union,
- IFRS 11 "Joint Arrangements" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed by the European Union.
- IFRS 12 "Disclosure of Interests in Other Entities" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed by the European Union,
- IFRS 13 "Fair Value Measurement" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed by the European Union,
- Amendments to IAS 1 "Presentation of Financial Statements" applicable for financial years beginning on or after 1 July 2012. These amendments have not been endorsed by the European Union,
- Amendments to IAS 19 "Employee Benefits" applicable for financial years beginning on or after 1 January 2013. These amendments have not been
  endorsed by the European Union.

Management is currently analysing the practical consequences of these new standards and interpretations and the impact of their application on the financial statements.

# 3.2. Accounting positions adopted by the Group in accordance with paragraphs 10 to 12 of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors"

The accounting position described below is not specifically (or is only partially) dealt with by any IFRS standards or interpretations endorsed by the European Union. The Group has adopted accounting policies which it believes best reflect the substance of the transactions concerned.

#### Multiple-elements arrangements

When accounting for multiple-elements arrangements (bundled offers) the Group has adopted the provisions of Generally Accepted Accounting Principles in the United States, Accounting Standards Codification 605-25 "Revenue Recognition – Multiple Element Agreements" (see Note 3.5.3 Separable components of packaged and bundled offers).

# 3.3. Options available under IFRSs and used by the Group

Certain IFRSs offer alternative methods of measuring and recognising assets and liabilities. In this respect, the Group has chosen:

Standards and amendments		Option used	
IAS 2	Inventories	Recognition of inventories at their original cost determined by the weighted average unit cost method.	
IAS 16	Property, plant and equipment	Property, plant and equipment are measured at cost less any accumulated depreciation and any accumulated impairment losses.	
IAS 19	Employee benefits	Actuarial gains and losses on post-employment benefits are recognised immediately in their total amount in the other comprehensive income, with no recycling to the income statement.	
IAS 20	Government grants and disclosure of government assistance	Non-repayable government grants related to assets decrease the carrying amount of the assets. Government grants related to income are deducted from the related expenses.	
IAS38	Intangible assets	Intangible assets are measured at cost less any accumulated depreciation and any accumulated impairment losses.	
IAS 31	Interests in joint ventures	Interests in jointly controlled entities are accounted for using the equity method.	

# 3.4. Presentation of the financial statements

# Presentation of the balance sheet

In accordance with IAS 1 "Presentation of financial statements", assets and liabilities are presented in the balance sheet as current and non-current.

## Presentation of the income statement

As allowed by IAS 1 "Presentation of financial statements", expenses are presented by nature in the consolidated income statement.

#### Earnings per share

The net income per share for each period is calculated by dividing the net income for the period attributable to the equity holders of the Company by the weighted average number of shares outstanding during that period. The weighted average number of shares outstanding is after taking account of treasury shares and, if applicable, the dilutive effect of the pre-emption rights attached to the bonds issued under TP S.A. incentive programme (see Note 26).

continued

# 3. Significant accounting policies (continued)

#### 3.5. Significant accounting policies

#### 3.5.1. Consolidation rules

Subsidiaries that are controlled by Telekomunikacja Polska, directly or indirectly, are fully consolidated. Control is deemed to exist when the Group owns more than 50% of the voting rights of an entity, unless it can be clearly demonstrated that such ownership does not constitute control, or when one of the following four criteria is met:

- power over more than one half of the voting rights of the other entity by virtue of an agreement,
- power to govern the financial and operating policies of the other entity under a statute or agreement,
- power to appoint or remove the majority of the members of the management board or equivalent governing body of the other entity,
- power to cast the majority of votes at meetings of the management board or equivalent governing body of the other entity.

Subsidiaries are consolidated from the date on which control is obtained by the Company and cease to be consolidated from the date on which the Company loses control over the subsidiary.

Intercompany transactions and balances are eliminated on consolidation.

Investments in associates and interests in joint ventures (in respect to jointly controlled entities) are accounted for using the equity method.

#### 3.5.2. Effect of changes in foreign exchange rates

Translation of financial statements of foreign subsidiaries

The financial statements of foreign subsidiaries whose functional currency is not the Polish zloty are translated into the Group presentation currency as follows:

- assets and liabilities are translated at the National Bank of Poland ("NBP") period-end exchange rate,
- items in the income statement are translated at the NBP average rate for the reporting period,
- the translation adjustment resulting from the use of these different rates is included as a separate component of shareholders' equity.

Transactions in foreign currencies

The principles covering the measurement and recognition of transactions in foreign currencies are set out in IAS 21 "The Effects of Changes in Foreign Exchange Rates". Transactions in foreign currencies are converted by the entities constituting the Group into their functional currency at the spot exchange rate prevailing as at the transaction date. Monetary assets and liabilities which are denominated in foreign currencies are re-measured at each balance sheet date at the period-end exchange rate quoted by NBP and the resulting translation differences are recorded in the income statement:

- in other operating income and expense for commercial transactions,
- in financial income or finance costs for financial transactions.

Derivative instruments are measured and recognised in accordance with the general principles described in Note 3.5.12.

Currency hedges that qualify for hedge accounting are recognised in the balance sheet at fair value at each period-end. Gains and losses arising from re-measurement to fair value are recognised:

- in other operating income and expense for fair value hedges of commercial transactions;
- in financial income or finance costs for hedges of financial assets and liabilities;
- in other comprehensive income for the effective portion of the net gain or loss on cash flow hedges.

Gains and losses arising from re-measurement to fair value of currency derivative instruments that economically hedge commercial or financial transactions and do not qualify for hedge accounting are recognised as other operating income/cost or financial income/expense depending on the nature of the underlying transaction. Gains and losses arising from re-measurement to fair value of other currency derivative instruments are recognised as financial income or finance cost.

#### 3.5.3. Revenue

Revenue from the Group's activities is recognised and presented in accordance with IAS 18 "Revenue". Revenue comprises the fair value of the consideration received or receivable for the sale of services and goods in the ordinary course of the Group's activities. Revenue is recorded net of value-added tax and discounts.

#### Separable components of packaged and bundled offers

Sales of packaged mobile and Internet offers are considered as comprising identifiable and separate components to which general revenue recognition criteria can be applied separately. Numerous service offers on the Group's main markets are made up of two components, a product (e.g. mobile handset / internet modem) and a service. Once the separate components have been identified, the amount received or receivable from the customer is allocated based on each component's fair value. The sum allocated to delivered items is limited to the amount that is not dependent on the delivery of other items. For example, the sum allocated to delivered equipment generally corresponds to the price paid by the end-customer for that equipment and the balance of the amount received or receivable is contingent upon the future delivery of the service.

Offers that cannot be analysed between separately identifiable components, because the commercial effect cannot be assessed without reference to the series of transactions as a whole, are treated as bundled offers. Revenue from bundled offers is recognised in full over the life of the contract. The main example is connection fee: this does not represent a separately identifiable transaction from the subscription and communications, and connection fees are therefore recognised over the average expected life of the contractual relationship.

#### Equipment sales

Revenue from equipment sales is recognised when the significant risks and rewards of ownership are transferred to the buyer (see also paragraph "Separable components of packaged and bundled offers").

For mobile and broadband services, when equipment is sold through a distributor considered as an agent, handsets or modems/laptops and telecommunications services are a single bundled offering with multiple deliverables, and the handset or modem/laptop revenue from the sale is recognised when a subscriber is connected to the network.

#### **Equipment leases**

Equipment lease revenue is recognised on a straight-line basis over the life of the lease agreement, except in the case of finance leases which are accounted for as sales on credit.

# Revenues from the sale or supply of content

The accounting for revenue from the sale or supply of content (audio, video, games, etc.) depends on the analysis of the facts and circumstances surrounding these transactions. To determine if the revenue must be recognised on a gross or a net basis, an analysis is performed using the following criteria:

- the Group has the primary responsibility for providing services desired by the customer;
- the Group has inventory risk (the Group purchases content in advance);
- the Group has discretion in establishing prices directly or indirectly, such as by providing additional services;
- the Group has credit risk.

Revenues from the sale or supply of content via the Group's various communications systems (mobile, TV, fixed line, etc.) are recognised:

- gross when the Group is deemed to be the primary obligor in the transaction with respect to the end-customer (i.e. when the customer has no specific
  recourse against the content provider), when the Group bears the inventory risk, when the Group has a reasonable latitude in setting prices charged
  to the end-customer, when the Group has credit risk and
- net of amounts due to the content provider when the latter is responsible for supplying the content to the end-customer, for setting the price to subscribers, when the content provider bears the inventory risk, when it has credit risk.

#### Service revenue

Telephone service and Internet access subscription fees are recognised in revenue on a straight-line basis over the service period.

Charges for incoming and outgoing telephone calls are recognised in revenue when the service is rendered.

Revenue from the sale of phone cards in fixed and mobile telephony systems is recognised when they are used or expire.

Revenue from Internet advertising is recognised over the period during which the advertisement appears.

# Promotional offers

For certain commercial offers where customers do not pay for service over a certain period in exchange for signing up for a fixed period (time-based incentives), the total revenue generated under the contract is spread over the fixed, non-cancellable period.

continued

#### 3. Significant accounting policies (continued)

#### 3.5.3. Revenue (continued)

#### Loyalty programs

Loyalty programs consist of granting future benefits to customers (such as call credit and product discounts) in exchange for present and past use of the service or purchase of goods.

Points awarded to customers are treated as a separable component to be delivered out of the transaction that triggered the acquisition of the points. Part of the invoiced revenue is allocated to these points based on their fair value taking into account an estimated utilisation rate, and deferred. If the Group supplies the awards itself, revenue allocated to the points is recognised in the income statement when points are redeemed and the Group fulfils its obligations to supply awards. The amount of revenue recognised is based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed. When a third party supplies the awards and the Group is collecting the consideration on behalf of a third party, revenue is measured as a net amount retained on the Group's own account and is recognised when the third party becomes obliged to supply the awards and is entitled to receive consideration for doing so.

Loyalty programs that exist in the Group are without a contract renewal obligation.

#### Discounts for poor quality of services or for breaks in service rendering

The Group's commercial contracts may contain service level commitments (delivery time, service reinstatement time). If the Group fails to comply with these commitments, it is obliged to grant a discount to the end-customer. Such discounts reduce revenue. Discounts are recorded when it becomes probable that they will be due based on the non-achievement of contractual terms.

#### **Barter transactions**

When goods or services are exchanged for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods are sold or services are rendered in exchange for dissimilar goods or services, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred. The revenue from barter transactions involving advertising is measured in accordance with Interpretation 31 of the Standing Interpretations Committee "Revenue – Barter Transactions Involving Advertising Services".

# 3.5.4. Subscriber acquisition costs, advertising and related costs

Subscriber acquisition and retention costs, other than loyalty program costs (see Note 3.5.3), are recognised as an expense for the period in which they are incurred. Advertising, promotion, sponsoring, communication and brand marketing costs are also expensed as incurred.

## 3.5.5. Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset. Qualifying assets are assets that necessarily take a substantial period of time to get ready for their intended use or sale.

## 3.5.6. Share issuance costs and treasury shares

External costs directly related to share issuance are deducted from the related share premium. Other costs are expensed as incurred.

If TP S.A. or its subsidiaries purchase equity instruments of the Company, the consideration paid, including directly attributable incremental costs, is deducted from equity attributable to the Company equity holders and presented in the balance sheet separately under "Treasury shares" until the shares are cancelled or reissued.

Treasury shares are recognised using settlement date accounting.

# 3.5.7. Goodwill

Goodwill is the excess of (a) over (b) below:

- (a) the aggregate of:
  - (i) the consideration transferred measured generally at acquisition-date fair value;
  - (ii) the amount of any non-controlling interest in the acquiree measured either at its fair value or at its proportionate interest in the net identifiable assets;
  - (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured at fair value, apart from limited exceptions provided in IFRS 3.

Goodwill represents a payment made in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised.

#### Impairment tests and Cash Generating Units

In accordance with IFRS 3 "Business Combinations", goodwill is not amortised but is tested for impairment at least once a year or more frequently when there is an indication that it may be impaired. IAS 36 "Impairment of Assets" requires these tests to be performed at the level of each Cash Generating Unit (CGU) to which the goodwill has been allocated (a Cash Generating Unit is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets). The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the synergies of business combination.

#### Recoverable amount

To determine whether an impairment loss should be recognised, the carrying value of the assets and liabilities of the CGU (or group of CGUs), including allocated goodwill, is compared to its recoverable amount. The recoverable amount of a CGU is the higher of its fair value less costs to sell and its value in use.

Fair value less costs to sell is the best estimate of the amount realisable from the sale of a CGU in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. This estimate is determined on the basis of available market information taking into account specific circumstances.

Value in use is the present value of the future cash flows expected to be derived from the CGU or group of CGUs, including goodwill. Cash flow projections are based on economic and regulatory assumptions, license renewal assumptions and forecast trading conditions drawn up by the Group management, as follows:

- cash flow projections are based on the business plan and its extrapolation to perpetuity by applying a declining or flat growth rate reflecting the expected long-term trend in the market,
- the cash flows obtained are discounted using appropriate rates for the type of business concerned.

If the recoverable amount of CGUs to which the goodwill is allocated is less than its carrying amount, an impairment loss is recognised in the amount of the difference. The impairment loss is firstly allocated to reduce the carrying amount of goodwill and then to the other assets of CGUs on a pro rata basis.

Goodwill impairment losses are recorded in the income statement as a deduction from operating income and are not reversed.

# 3.5.8. Intangible assets (excluding goodwill)

Intangible assets, consisting mainly of licenses, software and development costs, are initially stated at acquisition or production cost comprising its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any directly attributable costs of preparing the assets for their intended use, and, if applicable, attributable borrowing costs.

Payments deferred beyond normal credit terms are discounted and the cost of an intangible asset at the initial recognition amounts to the present value of all payments. The difference between the cost and actual payments is recognised as a discounting expense over the period of credit.

When intangible assets are acquired in a business combination, they are initially stated at their fair values. They are generally determined in connection with the purchase price allocation based on their respective market values. When their market value is not readily determinable, cost is determined using generally accepted valuation methods based on revenue, costs or other appropriate criteria. The intangible assets are recognised at the acquisition date separately from goodwill if the asset's fair value can be measured reliably, is identifiable, (i.e. is separable) or arises from contractual or the legal rights irrespective of whether the assets had been recognised by the acquiree before the business combination.

Internally developed trademarks and subscriber bases are not recognised as intangible assets.

#### Telecommunication licenses

Expenditures to acquire telecommunication licenses are amortised on a straight-line basis over the license period from the date when the network is technically ready and the service can be marketed. For the details of concessions values see Note 13.

#### Research and development costs

Under IAS 38 "Intangible Assets", development costs are recognised as an intangible asset if and only if the following can be demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use,
- the intention to complete the intangible asset and use or sell it and the availability of adequate technical, financial and other resources for this purpose,
- the ability to use or sell the intangible asset,
- how the intangible asset will generate probable future economic benefits for the Group,
- the Group's ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development costs not fulfilling the above criteria and research costs are expensed as incurred. The Group's research and development projects mainly concern:

- upgrading the network architecture or functionality;
- developing service platforms aimed at offering new services to the Group's customers.

Development costs recognised as an intangible asset are amortised on a straight-line basis over their estimated useful life, generally not exceeding four years.

continued

#### 3. Significant accounting policies (continued)

#### 3.5.8. Intangible assets (excluding goodwill) (continued)

#### Software

Software is amortised on a straight-line basis over the expected life, not exceeding five years.

Useful lives of intangible assets are reviewed annually and are adjusted if current estimated useful lives are different from previous estimates. These changes in accounting estimates are recognised prospectively.

#### 3.5.9. Property, plant and equipment

The cost of tangible assets corresponds to their purchase or production cost or price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, as well as including costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, and, if applicable, attributable borrowing costs.

Payments deferred beyond normal credit terms are discounted and the cost of a tangible asset at the initial recognition amounts to the present value of all payments. The difference between the cost and actual payments is recognised as a discounting expense over the period of credit.

It also includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, representing the obligation incurred by the Group.

The cost of networks includes design and construction costs, as well as capacity improvement costs. The total cost of an asset is allocated among its different components and each component is accounted for separately when the components have different useful lives or when the pattern in which their future economic benefits are expected to be consumed by the entity varies. Depreciation is established for each component accordingly.

Maintenance and repair costs (day to day costs of servicing) are expensed as incurred.

#### **Government grants**

The Group may receive non-repayable government grants in the form of direct or indirect funding of capital projects. These grants are deducted from the cost of the related assets and recognised in the income statement, as a reduction of depreciation, based on the pattern in which the related asset's expected future economic benefits are consumed.

#### Finance leases

Assets acquired under leases that transfer substantially all risks and rewards of ownership to the Group are recorded as assets and an obligation in the same amount is recorded in liabilities. Normally, the risks and rewards of ownership are considered as having been transferred to the Group when at least one condition is met:

- the lease transfers ownership of the asset to the lessee by the end of the lease term,
- the Group has the option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable
  for it to be reasonably certain, at the inception of the lease, that the option will be exercised,
- the lease term is for the major part of the estimated economic life of the leased asset,
- at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset,
- the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

Assets leased by the Group as lessor under leases that transfer substantially risks and rewards of ownership to the lessee are treated as having been sold.

#### Derecognition

An item of property, plant and equipment is derecognised on its disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is recognised in operating income and equals the difference between the net disposal proceeds, if any, and the carrying amount of the item.

#### Depreciation

Items of property, plant and equipment are depreciated to write off their cost, less any estimated residual value on a basis that reflects the pattern in which their future economic benefits are expected to be consumed. Therefore, the straight-line basis is usually applied over the following estimated useful lives:

Buildings 10 to 30 years
Networks, terminals and towers 2 to 33 years
IT equipment 3 to 5 years
Other 2 to 10 years

Land is not depreciated. Perpetual usufruct rights are amortised over the period for which the right was granted, not exceeding 99 years.

These useful lives are reviewed annually and are adjusted if current estimated useful lives are different from previous estimates. These changes in accounting estimates are recognised prospectively.

#### 3.5.10. Non-current assets held for sale

Non-current assets held for sale are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than continuing use. Those assets are available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets and the sale is highly probable.

Non-current assets held for sale are measured at the lower of carrying amount and estimated fair value less costs to sell and are presented in a separate line in the balance sheet if IFRS 5 requirements are met.

Those assets are no longer depreciated. If fair value less costs to sell is less than its carrying amount, an impairment loss is recognised in the amount of the difference. In subsequent periods, if fair value less costs to sell increases the impairment loss is reversed up to the amount of losses previously recognised.

#### 3.5.11 Impairment of non-current assets other than goodwill

International Accounting Standard 36 "Impairment of assets" requires that the recoverable amount of an asset should be estimated whenever there is an indication that the asset may be impaired and an impairment loss should be recognised whenever the carrying amount of an asset exceeds its recoverable amount. Where possible, the recoverable amount is estimated for individual assets. The recoverable amount of such assets is determined at their fair value less cost to sell or their value in use. If it is not possible to estimate the recoverable amount of the individual asset, the Group identified the cash-generating unit ("CGU") to which the asset belongs.

In the case of decline in the recoverable amount of an item of property, plant and equipment or an intangible asset to below its net book value, due to events or circumstances occurring during the period (such as obsolescence, physical damage, significant changes in the manner in which the asset is used, worse than expected economic performance, a drop in revenue, regulatory changes or other external indicators), an impairment loss is recognised.

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. The recoverable amount of an asset is generally determined by reference to its value in use, corresponding to the future economic benefits expected to be derived from the use of the asset and its subsequent disposal. It is assessed by the discounted cash flow method, based on management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset and the asset's expected conditions of use.

The impairment loss recognised equals the difference between net book value and recoverable amount.

Impairment tests are carried out on individual assets, except where they do not generate independent cash flows. In such cases the recoverable amount is then determined at the level of the cash-generating unit (CGU) to which the asset belongs, except where:

- the fair value less costs to sell of the individual asset is higher than its book value; or
- the value in use of the asset can be estimated as being close to its fair value less costs to sell, where fair value can be reliably determined.

Given the nature of its assets and operations, most of the Group's individual assets do not generate cash flow independently from other assets.

#### 3.5.12. Financial assets and liabilities

Financial assets include assets available-for-sale, assets at fair value through profit or loss, hedging derivative instruments and loans and receivables.

Financial liabilities include financial liabilities at amortised cost (borrowings, trade accounts payable and fixed assets payable, including the UMTS license liability), liabilities at fair value through profit or loss and hedging derivative instruments.

Financial assets and liabilities are recognised and measured in accordance with IAS 39 "Financial Instruments: Recognition and Measurement".

A regular way purchase or sale of financial assets is recognised using settlement date accounting.

Management determines the classification of financial assets and liabilities at initial recognition.

#### Recognition and measurement of financial assets

When financial assets are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

#### Assets available-for-sale

Available-for-sale assets consist mainly of shares in companies and marketable securities that are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss. They are measured at fair value and gains and losses arising from re-measurement at fair value are recognised in other comprehensive income. Fair value corresponds to market price for listed securities and estimated fair value for unlisted securities, determined according to the most appropriate financial criteria in each case. Investments in unquoted equity instruments whose fair value cannot be reliably measured are measured at cost, less any impairment losses.

When there is objective evidence that available-for-sale assets are impaired, the cumulative loss included in other comprehensive income is taken to the income statement. A significant or prolonged decline in the fair value of equity instruments below cost is considered as an indicator that the securities are impaired. Impairment losses on equity instruments are not reversed through the income statement.

continued

#### 3. Significant accounting policies (continued)

#### 3.5.12. Financial assets and liabilities (continued)

#### Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include trade receivables, cash and cash equivalents, cash deposits paid to banks as collateral for derivatives and other loans and receivables. They are recognised initially at fair value plus directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method. Short-term receivables with no stated interest rate are measured at the original invoice amount if the effect of discounting is immaterial. Cash flows on loans and receivables at variable rates of interest are re-measured periodically, to take into account changes in market interest rates.

Cash and cash equivalents consist of cash in bank and on hand and highly-liquid instruments that are readily convertible into known amounts of cash and are subject to insignificant changes in value.

Loans and receivables are carried in the balance sheet under:, "Loans and receivables excluding trade receivables", "Trade receivables" and "Cash and cash equivalents".

At each balance sheet date, the Group assesses whether there is any objective evidence that loans or receivables are impaired. If any such evidence exists, the asset's recoverable amount is calculated. If the recoverable amount is less than the asset's book value, an impairment loss is recognised in the income statement.

Trade receivables that are homogenous and share similar credit risk characteristics are tested for impairment collectively. When estimating the expected credit risk the Group uses historical data as a measure for a decrease in the estimated future cash flows from the group of assets since the initial recognition.

In calculating the recoverable amount of receivables that are individually material and not homogenous, significant financial difficulties of the debtor or probability that the debtor will enter bankruptcy or financial reorganisation are taken into account.

The carrying amount of loans and receivables is reduced through an allowance account. Uncollectable receivables are written off against that account.

# Assets at fair value through profit or loss

Financial assets at fair value through profit or loss are the following financial assets held for trading:

- $\ \ financial \ assets \ acquired \ by \ the \ Group \ principally \ for \ the \ purpose \ of \ selling \ them \ in \ the \ near \ term;$
- financial assets that form a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking;
- derivative assets not qualifying for hedge accounting as set out in IAS 39.

#### Recognition and measurement of financial liabilities

#### Financial liabilities at amortised cost

Borrowings and other financial liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method. Financial liabilities measured at amortised cost are carried in the balance sheet under "Financial liabilities at amortised cost excluding trade payables" and "Trade payables".

Transaction costs that are directly attributable to the acquisition or issue of the financial liability are deducted from the liability's carrying value. This is because financial liabilities are initially recognised at fair value that usually corresponds to the fair value of the sums paid or received in exchange for the liability. The costs are subsequently amortised over the life of the debt by the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument or, when appropriate, through the period to the next interest adjustment date, to the net carrying amount of the financial liability. The calculation includes all fees and costs paid or received between parties to the contract.

Certain borrowings are designated as being hedged by fair value hedges. Gain or loss on hedged borrowing attributable to a hedged risk adjusts the carrying amount of a borrowing and is recognised in the income statement.

## Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include derivatives that do not qualify for hedge accounting as set out in IAS 39 and are measured at fair value.

#### Recognition and measurement of derivative instruments

Derivative instruments are recognised in the balance sheet and measured at fair value. Derivatives used by the Group are not traded in an active market and their fair value is determined by using standard valuation techniques. Fair value is calculated using the net present value of future cash flows related to these contracts, quoted market forward interest rates, quoted market forward foreign exchange rates or, if quoted forward foreign exchange rates are not available, forward rates calculated based on spot foreign exchange rates using the interest rate parity method.

Except for gains and losses on hedging instruments (as explained below), gains and losses arising from changes in fair value of derivatives classified as financial assets and liabilities at fair value through profit or loss are immediately recognised in the income statement. The interest rate component of derivatives held for trading is presented under interest expense within finance cost. The foreign exchange component of derivatives held for trading that economically hedge commercial or financial transactions is presented under foreign exchange gains or losses within other operating income / expense or finance cost, respectively, depending on the nature of the underlying transaction.

The Group treats the whole derivative as its unit of account and presents derivatives either as current or non-current based on the date of last cash flows either within or beyond 12 months from the balance sheet date.

#### Hedging instruments

Derivative instruments may be designated as fair value hedges or cash flow hedges:

- a fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an identified portion of the asset or liability, that is attributable to a particular risk notably interest rate and currency risks and could affect profit or loss,
- a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (such as a future purchase or sale) and could affect profit or loss.

A hedging relationship qualifies for hedge accounting when:

- at the inception of the hedge, there is formal designation and documentation of the hedging relationship,
- at the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated.

The effects of applying hedge accounting are as follows:

- for fair value hedges of existing assets and liabilities, the change in fair value of the hedged portion of the asset or liability attributable to the hedged risk adjusts the carrying amount of the asset or liability in the balance sheet. The gain or loss from the changes in fair value of the hedged item is recognised in profit or loss and is offset by the effective portion of the loss or gain from re-measuring the hedging instrument at fair value. The adjustment to the hedged item is amortised starting from the date when a hedged item ceases to be adjusted by a change in the fair value of the hedged portion of liability attributable to the risk hedged.
- for cash flow hedges, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognised in profit or loss. Amounts recognised directly in other comprehensive income are subsequently recognised in profit or loss in the same period or periods during which the hedged item affects profit or loss. If a hedge of a forecast transaction results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability.

# Derecognition of financial assets and liabilities

#### Financial assets

A financial asset (or where applicable a part of financial assets or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired.
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement, or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the assets,
   or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

# Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

#### Fair value measurements

The Group classifies fair value measurements using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities,
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices),
- Level 3: inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

continued

#### 3. Significant accounting policies (continued)

#### 3.5.13. Inventories

Inventories are stated at the lower of cost and net realisable value, except for mobile handsets or other terminals sold in promotional offers. Inventories sold in promotional offers are stated at the lower of cost or probable net realisable value, taking into account future revenue expected from subscriptions. The Group provides for slow-moving or obsolete inventories based on inventory turnover ratios and current marketing plans.

Cost corresponds to purchase or production cost determined by the weighted average cost method. Net realisable value is the estimated selling price in the ordinary course of business, less selling expenses.

#### 3.5.14. Income tax

The tax expense comprises current and deferred tax.

#### Current tax

The current income tax charge is determined in accordance with the relevant tax law regulations in respect of the taxable profit. Income tax payable represents the amounts payable at the balance sheet date. If the amount paid on account of current income tax is greater than the amount finally determined, the excess is recognised in the balance sheet as an income tax asset.

#### **Deferred taxes**

In accordance with IAS 12 "Income Taxes", deferred taxes are recognised for all temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and their tax bases, as well as for unused tax losses. Deferred tax assets are recognised only when their recovery is considered probable, that is when future taxable profit will be available against which the temporary differences can be utilised. At each balance sheet date unrecognised deferred tax assets are re-assessed. A previously unrecognised deferred tax asset is recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax is not accounted for if it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither accounting nor taxable profit nor loss. IAS 12 requires, in particular, the recognition of deferred tax liabilities on all intangible assets recognised in business combinations (trademarks, subscriber bases, etc.).

A deferred tax asset is recognised for all deductible temporary differences arising from investments in subsidiaries, associates and interests in joint ventures to the extent that, and only to the extent that, it is probable that:

- the temporary difference will reverse in the foreseeable future; and
- taxable profit will be available against which the temporary difference can be utilised.

A deferred tax liability is recognised for all taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures except to the extent that both of the following conditions are satisfied:

- the Group is able to control the timing of the reversal of the temporary difference (e.g. the payment of dividends); and
- it is probable that the temporary difference will not reverse in the foreseeable future.

In accordance with IAS 12, deferred tax assets and liabilities are not discounted. Deferred income tax is calculated using the enacted or substantially enacted tax rates at the balance sheet date.

# 3.5.15. Provisions

In accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", a provision is recognised when the Group has a present obligation towards a third party and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

The obligation may be legal, regulatory or contractual or it may represent a constructive obligation deriving from the Group's actions where, by an established pattern of past practice, published policies or a sufficiently specific current statement, the Group has indicated to other parties that it will accept certain responsibilities, and as a result, has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

The estimate of the amount of the provision corresponds to the expenditure likely to be incurred by the Group to settle its obligation. If a reliable estimate cannot be made of the amount of the obligation, no provision is recorded and the obligation is deemed to be a "contingent liability".

Contingent liabilities – corresponding to (i) possible obligations that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the Group's control, or (ii) to present obligations arising from past events that are not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability – are disclosed in the notes to the Consolidated Financial Statements.

#### Restructuring

A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met and when the Group:

- has a detailed formal plan for the restructuring, and
- has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features
  to those affected by it.

#### Provisions for dismantling and restoring sites

The Group is required to dismantle equipment and restore sites. In accordance with paragraphs 36 and 37 of IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", the provision is based on the best estimate of the amount required to settle the obligation. It is discounted by applying a discount rate that reflects the passage of time and the risk specific to the liability. The amount of the provision is revised periodically and adjusted where appropriate, with a corresponding entry to the asset to which it relates.

#### 3.5.16 Pensions and other employee benefits

Certain employees of the Group are entitled to jubilee awards and retirement bonuses. Jubilee awards are paid to employees upon completion of a certain number of years of service whereas retirement bonuses represent one-off payments paid upon retirement in accordance with the Group's remuneration policies. Both items vary according to the employee's average remuneration and length of service. Jubilee awards and retirement bonuses are not funded. The Group is also obliged to provide certain post-employment benefits to some of its retired employees.

The cost of providing benefits mentioned above is determined separately for each plan using the projected unit credit actuarial valuation method. This method sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation which is then discounted. The calculation is based on demographic assumptions concerning retirement age, rates of future salary increases, staff turnover rates, and financial assumptions concerning future interest rates (to determine the discount rate).

Actuarial gains and losses on jubilee awards plans are recognised as income or expense when they occur. Actuarial gains and losses on post-employment benefits are recognised immediately in their total amount in the other comprehensive income, with no recycling to the income statement. The present value of the defined benefit obligations is verified at least annually by an independent actuary. Demographic and attrition profiles are based on historical data.

#### Termination benefits

The Group recognises termination benefits as a liability and an expense when it is demonstrably committed to either terminate the employment of an employee or group of employees before the normal retirement date, or provide termination benefits as a result of an offer made in order to encourage voluntary redundancy. An entity is demonstrably committed to a termination when it has a detailed formal plan for the termination and is without realistic possibility of withdrawal.

Benefits falling due more than 12 months after the balance sheet date are discounted.

## 3.5.17. Share-based payments

TP S.A. operated an equity-settled, share-based compensation plan under which employees rendered services to the Company and its subsidiaries as consideration for equity instruments of TP S.A. The fair value of the employee services received in exchange for the grant of the equity instruments was recognised as an expense, with a corresponding increase in equity, over the period in which the service conditions were fulfilled (vesting period).

France Telecom S.A. operated its own equity-settled, share-based compensation plan under which employees of the Group rendered services to the Company and its subsidiaries as consideration for equity instruments of France Telecom S.A. In accordance with IFRS 2 "Share-based Payment", the fair value of the employee services received in exchange for the grant of the equity instruments of France Telecom S.A. was recognised in these Consolidated Financial Statements as an expense with a corresponding increase in equity, over the period in which the service conditions were fulfilled (vesting period).

The fair value of the employee services received was measured by reference to the fair value of the equity instruments at the grant date.

Vesting conditions, other than market conditions, were taken into account by adjusting the number of equity instruments included in the measurement of the transaction so that, ultimately, the expense recognised for services received was based on the number of equity instruments that were expected to vest.

#### 4. Main acquisitions, disposals and changes in scope of consolidation

Main acquisitions, disposals and changes in scope of consolidation in the 12 months ended 31 December 2011 are described below.

The Group incorporated Bilbo Sp. z o.o. and Integrated Solutions Sp. z o.o., fully owned subsidiaries, whose scope of activities comprises investment operations and provision of integrated IT and network services, respectively.

On 22 June 2011, the Group and EM Bidco Sp. z o.o. concluded a share sale agreement under which the Group disposed of its 100% shareholding in TP Emitel (see Note 7.1).

On 21 July 2011, the Group and Polska Telefonia Cyfrowa S.A. ("PTC") signed an agreement on reciprocal use of radio access networks. The agreement has been signed for 15 years with an option to extend it.

On the same day, the parties also signed a shareholders agreement, which regulates the governance of NetWorkS! Sp. z o.o. ("NetWorkS!") - a jointly controlled entity incorporated in April 2011, in which the Group and PTC hold a 50% interest each and which conducts networks management, development and maintenance.

On 6 October 2011, the Group purchased 34.16% of shares in Telefony Podlaskie S.A. from the State Treasury for PLN 12 million paid in cash and consequently increased its shareholding to 89.27%. As a result, non-controlling interests and retained earnings were decreased by PLN 11 million and PLN 1 million, respectively.

There were no significant acquisitions, disposals and changes in scope of consolidation in the 12 months ended 31 December 2010.

#### 5. Revenue

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Fixed line telephony services	4,569	5,157
Subscriptions and voice traffic revenue	3,419	4,033
Wholesale revenue (including interconnect)	1,139	1,109
Other	11	15
Mobile telephony services	7,010	7,065
Voice traffic revenue	4,112	4,193
Interconnect revenue	1,236	1,361
Messaging services and content	1,538	1,436
Other	124	75
Data Services	2,433	2,542
Broadband and TV revenue	1,520	1,569
Data transmission	642	677
Leased lines	269	291
Other	2	5
Radio communications	113	215
Sales of goods and other	797	736
Total revenue	14,922	15,715

Revenue is generated mainly in the territory of Poland. Approximately 3.2% and 3.0% of the total revenue for the 12 months ended 31 December 2011 and 2010, respectively, was earned from entities which are not domiciled in Poland, mostly from interconnect services.

# 6. Operating expense and income

# 6.1. External purchases

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
	0.2000	
Commercial expenses	(2,493)	(2,509)
<ul> <li>cost of handsets and other equipment sold</li> </ul>	(1,364)	(1,301)
<ul> <li>commissions, advertising, sponsoring costs and other</li> </ul>	(1,129)	(1,208)
Interconnect expenses	(1,910)	(2,139)
Network and IT expenses	(876)	(905)
Other external purchases	(1,733)	(1,621)
Total external purchases	(7,012)	(7,174)

Other external purchases include mainly customer support and management services, postage costs, costs of content, rental costs and real estate operating and maintenance costs.

# 6.2. Labour expenses

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Average number of employees (full time equivalent)	24,119	25,687
Wages and salaries	(1,797)	(1,872)
Social security and other charges	(383)	(392)
Long-term employee benefits (1)	41	(36)
Capitalised personnel costs	181	162
Other employee benefits	(73)	(76)
Share-based payments	_	(4)
Total labour expenses	(2,031)	(2,218)

# (1) See Note 25.

# 6.3. Other operating expense and income

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Trade and other receivables impaired or sold, net	(259)	(114)
Taxes other than income tax	(340)	(318)
- property tax and perpetual usufruct charges	(181)	(184)
- frequency fee, fees for subscribers' numbers and telecommunications charges	(96)	(100)
- othertaxes	(63)	(34)
Orange brand fee <sup>(1)</sup>	(125)	(120)
Operating foreign exchange losses, net	(71)	(8)
Other expense and changes in provisions, net <sup>(2)</sup>	(571)	(209)
Total other operating expense	(1,366)	(769)
Recoveries on customer bad debts	138	29
Late payment interest on trade receivables	29	36
Other income	240	128
Total other operating income	407	193

<sup>(1)</sup> See Note 32.2.

Other expense and changes in provisions, net, include mainly changes in provisions for claims and litigation, risks and other charges (see Note 27), except for provision for the dispute with DPTG (see Note 31.e).

<sup>&</sup>lt;sup>(2)</sup> Includes the expense relating to the provision for proceedings by the European Commission related to broadband access amounting to PLN 458 million in 2011 and PLN 50 million in 2010 (see Note 31.d).

#### 6. Operating expense and income (continued)

#### 6.4. Research and development

In the 12 months ended 31 December 2011, research and development costs expensed in the income statement amounted to PLN 60 million. The same amount was expensed in the income statement in the 12 months ended 31 December 2010.

## 7. Gains on disposal of assets

## 7.1. Gain on disposal of TP Emitel

On 22 June 2011, the Group and EM Bidco Sp. z o.o. concluded a share sale agreement under which the Group disposed of its 100% shareholding in TP Emitel, for a total consideration amounting to PLN 1,665 million, consisting of consideration received in cash amounting to PLN 1,737 million and liabilities assumed by the Group. Additionally, the Group incurred transaction costs.

The Group derecognised the following TP Emitel's assets and liabilities:

(in PLN millions)

Assets:	598
- Property, plant and equipment	401
- Trade receivables	42
- Cash and cash equivalents	88
-Other	67
Liabilities:	132
- Trade payables	30
- Employee benefits	27
-Other	75
Net assets disposed of	466

Gain on disposal amounting to PLN 1,183 million is presented separately in the consolidated income statement.

If TP Emitel had not been a part of the Group during the presented periods, consolidated revenue for the 12 months ended 31 December 2011 and 2010 would be lower by PLN 154 million and PLN 295 million, respectively. Under the same assumption, consolidated net income for the 12 months ended 31 December 2011 and 2010 would be lower by PLN 65 million and PLN 98 million, respectively.

TP Emitel was included in the fixed line telecommunications operating segment.

# 7.2. Gains on disposal of other assets

In the 12 months ended 31 December 2011 and 2010, gains on disposal of other assets amounted to PLN 32 million and PLN 59 million respectively and included mainly gains on disposal of properties.

## 8. Impairment

# 8.1. Information concerning the Cash Generating Units

Most of the Group's individual assets do not generate cash flow independently from other assets due to the nature of the Group's activities. The entire fixed network, the entire mobile network and internet portal are treated as separate Cash Generating Units.

The Group considers certain indicators, including market liberalisation and other regulatory and economic changes in the Polish telecommunications market, in assessing whether there is any indication that an asset may be impaired. As at 31 December 2011 and 2010 the Group performed impairment tests of all Cash Generating Units (including goodwill – see Note 12). No impairment loss was recognised in 2011 and 2010 as a result of these tests.

The following key assumptions were used to determine the value in use of CGUs:

- value of the market, penetration rate and market share, decisions of the regulator in terms of pricing, accessibility of services, the level of commercial expenses required to replace products and keep up with existing competitors or new market entrants, the impact of changes in net revenue on direct costs and
- the level of investment spending, which may be affected by the roll-out of necessary new technologies.

The amounts assigned to each of these parameters reflect past experience adjusted for expected changes over the timeframe of the business plan, but may also be affected by unforeseeable changes in the political, economic or legal framework.

Main CGUs		Fixed network	Mobile network network	Internet portal
			At 31 December 201	1
Basis of recoverable amount		Value in use	Value in use	Value in use
Source used		Business plan	Business plan	Business plan
		4 years cash flow	4 years cash flow	4 years cash flow
		projections	projections	projections
Growth rate to perpetuity		0%	0%	3%
Pre-tax discount rate		11.0%	11.5%	14.0%
Main CGUs	Fixed network	Mobile network	Internet portal	Radio diffusion network <sup>(1)</sup>
		At 31 De	ecember 2010	
Basis of recoverable amount	Value in use	Value in use	Value in use	Value in use
	Business	Business	Business	Business
Source used	plan	plan	plan	plan
	5 years cash flow	5 years cash flow	5 years cash flow	5 years cash flow
	projections	projections	projections	projections
Growth rate to perpetuity	0%	6 09	6 19	6 2.5%
Pre-tax discount rate	11.0%	11.5%	14.0%	11.7%

<sup>(1)</sup> Relates to TP Emitel disposed of in 2011 (see Note 7.1).

Sensitivity of recoverable amounts

Management believes that no reasonably possible change to any of the above key assumptions would cause the carrying value of fixed network, mobile network and internet portal to materially exceed their recoverable amounts.

# 8.2. Goodwill

In the 12 months ended 31 December 2011 and 2010, there was no goodwill written off. Details regarding impairment tests of goodwill are presented in Note 8.1.

# 8.3. Other property, plant and equipment and intangible assets

In the 12 months ended 31 December 2011 and 2010, the impairment loss on property, plant and equipment and intangible assets charged to the income statement amounted to PLN 9 million and PLN 11 million respectively, primarily including a net impairment loss as a result of a review of certain Group's properties.

# 9. Finance income and expense

# 12 months ended 31 December 2011

(in PLN millions)			Finance costs, n	et			Operating inco	ome
	nterest Income	Interest expense and other financial charges	Foreign exchange gains / (losses)	Discounting expense	Finance income / (costs), net	Interest income	Foreign exchange gains / (losses)	Impairment losses
Loans and receivables	111	_	(5)	_	106	29(2)	12	(129)(3)
- including cash and cash equivalents	109	_	(5)	_	104	-	_	_
Liabilities at amortised cost	-	(309)(1)	(365)	(95)	(769)	-	(114)	_
Derivatives	-	(141)	377	30	266	-	304	_
<ul> <li>hedging derivatives</li> </ul>	_	(54)	221	_	167	_	16	_
<ul> <li>derivatives held for trading</li> </ul>	_	(87)	156	30	99	_	288	_
Non-financial items (4)	-	_	_	(35)	(35)	_	(273)	-
Total	111	(450)	7	(100)	(432)	29	(71)	(129)

<sup>(1)</sup> Includes mainly interest expense on bonds and bank borrowings and change in fair value of liabilities hedged by fair value hedges.

# 12 months ended 31 December 2010

						, a c : 2 c c c : . c						
(in PLN millions)			Finance costs, n	et			Operating inco	ome				
	nterest ncome	Interest expense and other financial charges	Foreign exchange gains / (losses)	Discounting expense	Finance income / (costs), net	Interest income	Foreign exchange gains / (losses)	Impairment losses				
Loans and receivables	85	_	29	_	114	36 (2)	(6)	(107) (3)				
- including cash and cash equivalents	83	-	29	_	112	-	_	_				
Liabilities at amortised cost	-	(331) (1)	163	(36)	(204)	_	15	_				
Derivatives	_	(153)	(169)	(10)	(332)	_	(52)	_				
<ul> <li>hedging derivatives</li> </ul>	_	(64)	(97)	_	(161)	_	(6)	_				
<ul> <li>derivatives held for trading</li> </ul>	_	(89)	(72)	(10)	(171)	_	(46)	_				
Non-financial items <sup>(4)</sup>	_	_	_	(37)	(37)	_	35	_				
Total	85	(484)	23	(83)	(459)	36	(8)	(107)				

 $<sup>^{(1)}</sup> Includes \ mainly \ interest \ expense \ on \ bonds \ and \ bank \ borrowings \ and \ change \ in fair \ value \ of \ liabilities \ hedged \ by \ fair \ value \ hedges.$ 

During the 12 months ended 31 December 2011 and 2010 there was no significant ineffectiveness on cash flow hedges and fair value hedges.

# 10. Income tax

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Current income tax	(169)	(420)
Deferred tax change <sup>(1)</sup>	302	86
Less: Deferred tax charged to other comprehensive income	_	7
Total income tax	133	(341)

 $<sup>^{(1)}</sup>$  Excludes deferred tax change as a result of acquisitions and disposals of subsidiaries (see Note 4).

<sup>(2)</sup> Includes late payment interests on trade receivables.
(3) Includes impairment losses on trade receivables.

<sup>(4)</sup> Includes mainly provisions and employee benefits.

 $<sup>\</sup>sp(2)$  Includes late payment interests on trade receivables.

<sup>(3)</sup> Includes impairment losses on trade receivables.

<sup>(4)</sup> Includes mainly provisions and employee benefits.

The reconciliation between the income tax expense and the theoretical tax calculated based on the Polish statutory tax rate is as follows:

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Consolidated net income before tax	1,785	449
Less: Gain on disposal of TP Emitel (tax neutral)	(1,183)	_
Dispute with DPTG (see Notes 31.e and 33)	-	1,061
Proceedings by the European Commission (see Note 31.d) (1)	513	50
Consolidated net income before tax, adjusted	1,115	1,560
Statutory tax rate	19%	6 19%
Theoreticaltax	(212)	(296)
Tax relief on new technologies (for years 2006–2011)	148	-
Reassessment of deferred tax asset on dispute with DPTG	233	(31)
Change in unrecognised deferred tax asset and other	(4)	10
Expense not deductible for tax purposes, net	(32)	(24)
Total income tax	133	(341)

 $<sup>{}^{(1)}</sup> Includes \, for eign \, exchange \, effect.$ 

As at 31 December 2011, the Company reassessed the tax realisation of deductible temporary differences on DPTG provision and increased deferred tax assets by PLN 233 million.

Expenses not deductible for tax purposes consist of certain cost items, which, under Polish tax law, are specifically determined as non-deductible.

Telekomunikacja Polska S.A., PTK - Centertel Sp. z o.o. and TP Invest Sp. z o.o. comprise the TP Tax Capital Group.

Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through future taxable profits is probable. Tax losses are permitted to be utilised over 5 consecutive years with a 50% utilisation restriction for each annual tax loss in a particular year. During the 12 months ended 31 December 2011 and 2010, the Group entities utilised PLN 111 million and PLN 138 million, respectively, of their tax losses previously incurred. As at 31 December 2011, there were no significant unused tax losses in the Group entities.

## Deferred tax

The net deferred tax assets/(liabilities) consist of the following:

	Consolidated	balance sheet	Consolidated in	come statement	
(in PLN millions)					
	At 31 December 2011	At 31 December 2010	12 months ended 31 December 2011	12 months ended 31 December 2010	
Property, plant and equipment and intangible assets	(11)	(91)	77	55	
Impairment of financial assets	68	69	(1)	16	
Finance (income)/expense, net	(28)	(11)	(15)	(62)	
Accrued (income)/expense, net	672	420	252	81	
Employee benefit plans	52	60	(10)	3	
Deferred income	113	116	(3)	(3)	
Tax losses and other differences	33	31	2	(11)	
Deferred tax assets and liabilities, net	899	594	_	_	
Total deferred tax	-	-	302	79	

Unrecognised deferred tax asset relates mainly to temporary differences, which based on the Group's management assessment could not be utilised for tax purposes. As at 31 December 2011 and 2010, deductible temporary differences, for which no deferred tax asset was recognised, amounted to PLN 121 million and PLN 110 million gross, respectively. Additionally, unrecognised deferred tax asset relates to those tax losses, which are expected to expire rather than to be realised. As at 31 December 2010, tax losses for which no deferred tax asset was recognised, amounted to PLN 18 million gross. As at 31 December 2011, there were no significant tax losses for which no deferred tax asset was recognised.

# 11. Components of other comprehensive income

# 11.1. Cash flow hedges

The change in fair value of cash flow hedges recognised in other comprehensive income is presented below:

(in PLN millions)	12 mont	ths ended 31 Dec	cember 2011	12 mont	ns ended 31 Dec	cember 2010
	Before tax	Tax	After tax	Before tax	Tax	Aftertax
Effective part of gains/(losses) on hedging instrument	158	(30)	128	(134)	26	(108)
Reclassification to the income statement, adjusting:	(117)	22	(95)	120	(23)	97
- interest expense presented in finance costs, net	39	(7)	32	46	(9)	37
- foreign exchange differences presented in finance costs, net	(152)	28	(124)	69	(13)	56
- foreign exchange differences presented in other operating expens	se (4)	1	(3)	6	(1)	5
- external purchases	-	_	-	(1)	_	(1)
Transfer to the initial carrying amount of the hedged item	(33)	6	(27)	(4)	1	(3)
Total gains/(losses) on cash flow hedges	8	(2)	6	(18)	4	(14)

During the 12 months ended 31 December 2011 and 2010, there was no material forecast transaction for which hedge accounting was discontinued as it was no longer expected to occur.

Gains/(losses) on cash flow hedges cumulated in other comprehensive income as at 31 December 2011 are expected to mature and affect the income statement in the years 2012-2014.

# 11.2. Actuarial losses on post-employment benefits

Actuarial losses on post-employment benefits (see Note 25) charged to other comprehensive income are presented below:

(in PLN millions)	12 mont	hs ended 31 De	cember 2011	12 montl	ns ended 31 De	cember 2010
	Beforetax	Tax	After tax	Before tax	Tax	Aftertax
Actuarial gains/(losses) on retirement bonuses	3	(1)	2	(12)	2	(10)
Actuarial losses on other post-employment benefits	(14)	3	(11)	(4)	1	(3)
Total actuarial losses on post-employment benefits	(11)	2	(9)	(16)	3	(13)

# 12. Goodwill

 $Goodwill\ arising\ from\ consolidated\ subsidiaries\ is\ as\ follows:$ 

(in PLN millions)		At 31 [	December 2011			At 31 December 2	010
	CGU	Cost	Accumulated impairment	Net	Cost	Accumulated impairment	Net
PTK-Centertel	Mobile network	3,909	_	3,909	3,909	_	3,909
Ramsat	Mobile network	22	_	22	22	_	22
Wirtualna Polska	Internet portal	247	(162)	85	247	(162)	85
Total goodwill		4,178	(162)	4,016	4,178	(162)	4,016

# 13. Other intangible assets

(in PLN millions)	At 31 December 2011				
Telecommunications licenses	Cost	Accumulated amortisation	Impairment	Net	
	2,345	(1,212)	_	1,133	
Software	5,337	(3,623)	_	1,714	
Other intangibles	219	(98)	(13)	108	
Total other intangible assets	7,901	(4,933)	(13)	2,955	

	Cost	Accumulated amortisation	Impairment	Net	Net
Telecommunications licenses	2,345	(1,067)		1,278	1,424
Software	4,757	(3,256)	_	1,501	1,269
Other intangibles	168	(73)	(13)	82	74
Total other intangible assets	7,270	(4,396)	(13)	2,861	2,767
Movements in the net book value of other intangib	ole assets were as follows:				
(in PLN millions)				12 months ended 31 December 2011	12 months ended 31 December 2010
Opening balance net of accumulated amortisation	n and impairment			2,861	2,767
Acquisitions of intangible assets				753	720
Disposals and retirements				(2)	(6)
Amortisation				(670)	(618)
Impairment				_	(1)
				13	(1)
Reclassifications and other, net					0.004
Reclassifications and other, net  Closing balance  Details of the Group's principal intangible assets (in PLN millions)	telecommunications licenses) a	are as follows:		<b>2,955</b> Net bo	2,861
Closing balance  Details of the Group's principal intangible assets (	telecommunications licenses) a  Acquisition date	are as follows:  Concession term	Acquisition value (undiscounted)	,	, , , , , , , , , , , , , , , , , , ,
Closing balance  Details of the Group's principal intangible assets (in PLN millions)		Concession		Net bo	pok value At 31 December
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession	Acquisition date	Concession term	(undiscounted)	Net bo At 31 December 2011	ook value At 31 December 2010
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession	Acquisition date	Concession term	(undiscounted)	Net bo At 31 December 2011	ook value At 31 December 2010
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession	Acquisition date 1997 1999	Concession term  2012 2014	(undiscounted) 318 402	Net bo At 31 December 2011  16 66	At 31 December 2010 41 91
Closing balance  Details of the Group's principal intangible assets (	Acquisition date 1997 1999	Concession term  2012 2014	(undiscounted) 318 402 2,495	Net bo At 31 December 2011  16 66 1,051	At 31 December 2010 41 91 1,146
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession  Total telecommunications licenses  14. Property, plant and equipment	Acquisition date 1997 1999	Concession term  2012 2014	(undiscounted)  318 402 2,495 3,215	Net bo At 31 December 2011  16 66 1,051	At 31 December 2010 41 91 1,146
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession  Total telecommunications licenses  14. Property, plant and equipment	Acquisition date 1997 1999	Concession term  2012 2014	(undiscounted)  318 402 2,495 3,215	Net bo At 31 December 2011  16 66 1,051 1,133	At 31 December 2010 41 91 1,146
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession  Total telecommunications licenses  14. Property, plant and equipment  (in PLN millions)	Acquisition date 1997 1999	2012 2014 2023	(undiscounted)  318 402 2,495 3,215  At Accumulated	Net bo At 31 December 2011  16 66 1,051 1,133  31 December 2011	At 31 December 2010  41  91 1,146 1,278
Closing balance  Details of the Group's principal intangible assets ( (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession  Total telecommunications licenses  14. Property, plant and equipment (in PLN millions)  Land and buildings	Acquisition date 1997 1999	Concession term  2012 2014 2023	(undiscounted)  318 402 2,495 3,215  At Accumulated depreciation	Net bo At 31 December 2011  16 66 1,051 1,133  31 December 2011  Impairment	At 31 December 2010  41 91 1,146 1,278
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession GSM 900 Concession UMTS Concession Total telecommunications licenses  14. Property, plant and equipment (in PLN millions)  Land and buildings Networks and terminals	Acquisition date 1997 1999	Concession term  2012 2014 2023  Cost 3,394	(undiscounted)  318 402 2,495 3,215  At Accumulated depreciation (1,340)	Net both At 31 December 2011  16 66 1,051 1,133  31 December 2011  Impairment (101)	At 31 December 2010  41 91 1,146 1,278  Net
Closing balance  Details of the Group's principal intangible assets (in PLN millions)  DCS 1800 Concession  GSM 900 Concession  UMTS Concession  Total telecommunications licenses	Acquisition date 1997 1999	Concession term  2012 2014 2023  Cost 3,394 39,733	(undiscounted)  318 402 2,495 3,215  At Accumulated depreciation  (1,340) (27,246)	Net both At 31 December 2011  16 66 1,051 1,133  31 December 2011  Impairment (101)	At 31 December 2010  41  91  1,146  1,278  Net  1,953 12,486

45,334

(30,314)

(108)

14,912

At 31 December 2010

At 1 January 2010

Total property, plant and equipment

(in PLN millions)

# 14. Property, plant and equipment (continued)

(in PLN millions)	At 31 December 2010 At 1				January 2010
	Cost	Accumulated depreciation	Impairment	Net	Net
Land and buildings	3,619	(1,374)	(98)	2,147	2,293
Networks and terminals	39,963	(26,112)	(4)	13,847	15,029
IT equipment	2,119	(1,573)	-	546	486
Investment grants	(243)	111	-	(132)	(148)
Other	415	(316)	(7)	92	83
Total property, plant and equipment	45,873	(29,264)	(109)	16,500	17,743

Investment grants are non-repayable and relate mainly to certain property, plant and equipment received by TP S.A. from Public Telephone Committees (Społeczne Komitety Telefonizacji).

Movements in the net book value of property, plant and equipment were as follows:

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
(III LIVINIIIOIO)	01 December 2011	01 December 2010
Opening balance net of accumulated depreciation and impairment	16,500	17,743
Acquisitions of property, plant and equipment	1,853	1,996
Disposals and retirements	(42)	(43)
Depreciation	(3,033)	(3,174)
Impairment	(9)	(10)
Derecognition (1)	(401)	_
Dismantling costs, reclassifications and other, net	44	(12)
Closing balance	14,912	16,500

<sup>(1)</sup> Disposal of TP Emitel (see Note 7.1).

The carrying value of equipment held under finance leases as at 31 December 2011 and 2010 amounted to PLN 13 million and PLN 19 million, respectively. There were no additions during the 12 months ended 31 December 2011 of equipment held under finance leases. During the 12 months ended 31 December 2010, acquisitions of equipment financed through finance leases amounted to PLN 3 million. Leased assets cannot be sold, donated, transferred by title or pledged and are a collateral for the related finance lease liability.

## 15. Investments accounted for using the equity method

Investments accounted for using the equity method consist mainly of the 50% interest in NetWorkS! - a jointly controlled entity incorporated in April 2011 (see Note 4).

Summarised financial information of NetWorkS! is set out below:

(in PLN millions)	At 31 December 2011
Total non-current assets	42
Total current assets	42
Total non-current liabilities	1
Total current liabilities	51
Total net assets	32
The Group's share of net assets	16

(in PLN millions)	12 months ended 31 December 2011
Total income	69
Total expenses	(67)
Profit	2
The Group's share of profit	1

# 16. Financial assets

## 16.1. Assets available for sale

The Group's assets available for sale are presented below:

(in PLN millions)		At 31 December 2011			At 31 December 2010			
	Cost	Impairment	Net	Cost	Impairment	Net		
Exatel S.A.	14	(11)	3	14	(11)	3		
Other	1		1	2	(1)	1		
Total assets available for sale	15	(11)	4	16	(12)	4		

Financial assets available for sale are measured at historical cost less accumulated impairment losses and mainly comprise shares for which there is no active market and fair value cannot be reliably measured.

# 16.2. Loans and receivables excluding trade receivables

The Group's loans and receivables excluding trade receivables are presented below:

(in PLN millions)		At 31 December 2011			At 31 December 2010		
	Cost	Impairment	Net	Cost	Impairment	Net	
Finance lease receivables	17	_	17	17	_	17	
Long - term deposits	-	_	_	12	_	12	
Other	3	_	3	3	-	3	
Total loans and receivables excluding trade receivables	20	-	20	32	-	32	
Current	8	_	8	10	_	10	
Non-current	12	-	12	22	-	22	

The Group's maximum exposure to credit risk is represented by the carrying amounts of loans and receivables.

# 16.3. Financial assets at fair value through profit or loss

The Group's assets at fair value through profit or loss are presented below:

(in PLN millions)	Fairv	Fairvalue			
	At 31 December 2011	At 31 December 2010			
erivatives – held for trading <sup>(1)</sup>	357	71			
Marketable securities – held for trading <sup>(1)</sup>	9	9			
Total financial assets at fair value through profit or loss	366	80			
Current	234	28			
Non-current	132	52			

<sup>(1)</sup> Included in net financial debt calculation (see Note 19).

The Group's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Group enters into derivatives contracts with leading financial institutions. Limits are applied to monitor the level of exposure on the financial counterparties. In case the counterparty's financial soundness is deteriorating, the Group applies the appropriate measures mitigating the default risk.

# 16. Financial assets (continued)

## 16.4. Financial assets measured at fair value

The following tables provide an analysis of the Group's financial assets that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable (see Note 3.5.12).

(in PLN millions)		At 31 Dec	ember 2011		
		Fair value n	neasurement		
	Level 1	Level 2	Level 3	Tota	
Financial assets at fair value through profit or loss	9	357	_	366	
Derivatives – held for trading	=-	357	-	357	
Marketable securities – held for trading	9	_	_	9	
Hedging derivatives	_	145	-	145	
Total financial assets measured at fair value	9	502	-	511	
(in PLN millions)	At 31 December 2010				
		Fair value n	e measurement		
	Level 1	Level 2	Level 3	Total	
Financial assets at fair value through profit or loss	9	71	_	80	
Derivatives – held for trading	_	71	_	71	
Marketable securities – held for trading	9	_	_	9	
Hedging derivatives	-	51	_	51	
Total financial assets measured at fair value	9	122	-	131	

During the 12 months ended 31 December 2011 and 2010, there was no transfer between Level 1 and Level 2 fair value measurements, and no transfer into and out of Level 3 fair value measurement.

# 17. Trade receivables, other assets and prepaid expenses

	At 31 December	At 31 December
(in PLN millions)	2011	2010
Trade receivables, net	1,506	1,637
VAT receivables	136	105
Other taxes receivables	2	34
Other <sup>(1)</sup>	89	127
Total other assets	227	266
Inactivated mobile phones and terminals in the external dealership network	60	55
Other prepaid expenses	18	39
Total prepaid expenses	78	94

<sup>(1)</sup> Mainly includes receivables related to: advances and prepayments to suppliers, sales of fixed assets, re-invoicing costs of advertising and promotion, compensations and penalties.

The Group considers there is no concentration of credit risk with respect to trade receivables due to its large and diverse customer base consisting of individual and business customers. The Group's maximum exposure to credit risk at the reporting date is best represented by the carrying amounts of receivables recognised in the balance sheet.

Movement in the impairment of trade receivables in the 12 months ended 31 December 2011 and 2010 is presented below:

(in PLN millions)	12 months ended 31 December 2011	12 months ended 31 December 2010
Beginning of period	339	293
Impairment losses, net	129	107
Impaired receivables sold or written-off and other movements	(167)	(61)
End of period	301	339

As at 31 December 2011 and 2010, the analysis of trade receivables that are past due but not impaired is as follows:

#### At 31 December 2011

(in DI Ni milliana)

Total trade receivables, net	1,506						
Trade receivables - individually analysed for impairment	42						
Trade receivables - collectively analysed for impairment	1,464	951	449	52	12		
	Carrying amount	Neither impaired nor past due	Less than 180 days	Between 180 and 360 days	More than 360 days		
(in PLN millions)	Past due						

Doot due

## At 31 December 2010

Total trade receivables, net	1,637				
Trade receivables - individually analysed for impairment	25				
Trade receivables - collectively analysed for impairment	1,612	1,085	464	51	12
	Carrying amount	Neither impaired nor past due	Less than 180 days	Between 180 and 360 days	More than 360 days
(in PLN millions)			Past due		

# 18. Cash and cash equivalents

The Group's cash and cash equivalents are as follows:

(in PLN millions)	At 31 December 2011	At 31 December 2010
Cash on hand	-	1
Current bank accounts and overnight deposits	627	296
Deposits up to 3 months	2,233	1,839
Securities with a maturity up to 3 months	_	311
Total cash and cash equivalents	2,860	2,447

The Group's cash surplus is invested into short-term highly-liquid financial instruments e.g. bank deposits and T-bills. The term of the investments depends on the immediate cash requirements of the Group. Short term deposits are made for varying periods of between one day and three months. The instruments earn interest which depends on the current money market rates and the term of investment.

As at 31 December 2011 and 2010, cash and cash equivalents included an equivalent of PLN 20 million and PLN 18 million, respectively, denominated in foreign currencies.

The Group's maximum exposure to credit risk at the reporting date is best represented by carrying amounts of cash and cash equivalents. The Group deposits its cash and cash equivalents with leading financial institutions with investment grade. Limits are applied to monitor the level of exposure on the financial counterparties. In case the counterparty's financial soundness is deteriorating, the Group applies the appropriate measures mitigating the default risk.

#### 19. Net financial debt

Net financial debt corresponds to the total gross financial debt (converted at the period-end exchange rate), after net derivative instruments (liabilities less assets) classified as at fair value through profit or loss, cash flow hedges and fair value hedges, less cash and cash equivalents, marketable securities and including the impact of the effective portion of cash flow hedges.

The maturity analysis of the Group's financial liabilities is based on contractual undiscounted payments.

As at 31 December 2011 and 2010, amounts in foreign currency were translated at the NBP period-end exchange rates. The variable interest payments arising from the financial instruments were calculated using the latest interest rates fixed before 31 December 2011 and 2010, respectively. Financial liabilities that can be repaid at any time at the Group's discretion are classified as current or non-current, depending on the expected repayment date; non-current balance is assigned to the period of the final contractual maturity date.

The table below provides a breakdown of net financial debt by category and maturity analysis of financial liabilities based on contractual undiscounted cash flows:

## At 31 December 2011

				Undisco	unted contra	ctual cash flo	ows (1)			
(in PLN millions)					Non-curre	ent				
			Within					More	Total	
		Carrying	1	1-2	2-3	3-4		than 5	non-	
	Note	amount	year	years	years	years	years	years	current	Total
Trade payables (excl. UMTS) (A)	28	3,136	3,136	_	_	-	_	_	_	3,136
UMTS license payables (B)	28	888	66	66	124	124	124	755	1,193	1,259
Bonds	20	3,241	186	186	3,278	_	_	-	3,464	3,650
Bank borrowings	20	1,684	719	961	44	43	5	24	1,077	1,796
Finance lease liabilities		12	8	3	3	_	_	-	6	14
Financial liabilities at amortised cost (2)		4,937	913	1,150	3,325	43	5	24	4,547	5,460
Derivatives - net (3)	21	(384)	(140)	65	9	_	_	-	74	(66)
Gross financial debt after derivatives (C)		4,553	773	1,215	3,334	43	5	24	4,621	5,394
Total financial liabilities										
(A) + (B) + (C)		8,577	3,975	1,281	3,458	167	129	779	5,814	9,789
Marketable securities	16	9								
Cash and cash equivalents	18	2,860								
Sub - total (D)		2,869								
Effective portion of cash flow hedges (E)		10								
Net financial debt (C)-(D)+(E)		1,694								

 $<sup>\</sup>ensuremath{^{(1)}}$  Includes both nominal and interest payments.

<sup>&</sup>lt;sup>(2)</sup> Excluding trade payables and UMTS license payables.

<sup>(3)</sup> Both assets and liabilities are included.

## At 31 December 2010

Ondiscounted Contractual Cash nows	Undiscounted	contractua	l cash flows (1
------------------------------------	--------------	------------	-----------------

(in PLN millions)					Non-curr	ent				
			Within					More	Total	
		Carrying	1	1-2	2-3	3-4	4-5	than 5	non-	
	Note	amount	year	years	years	years	years	years	current	Total
Trade payables (excl. UMTS) (A)	28	3,099	3,099	_	_	-	_	-	_	3,099
UMTS license payables (B)	28	808	59	59	59	111	111	788	1,128	1,187
Bonds	20	4,118	1,410	167	167	2,939	_	-	3,273	4,683
Bank borrowings	20	1,867	287	691	951	39	38	25	1,744	2,031
Finance lease liabilities		18	7	7	3	3	_	-	13	20
Financial liabilities at amortised cost (2)		6,003	1,704	865	1,121	2,981	38	25	5,030	6,734
Derivatives - net <sup>(3)</sup>	21	268	166	64	62	293	-	-	419	585
Gross financial debt after derivatives (C)		6,271	1,870	929	1,183	3,274	38	25	5,449	7,319
Total financial liabilities (A) + (B) + (C)		10,178	5,028	988	1,242	3,385	149	813	6,577	11,605
Marketable securities	16	9								
Cash and cash equivalents	18	2,447								
Sub - total (D)		2,456								
Effective portion of cash flow hedges (E)		2								
Net financial debt (C)-(D)+(E)		3,817								

As at 31 December 2011 and 2010, most of the Group's trade payables mature within 3 months.

# 20. Financial liabilities at amortised cost excluding trade payables

## 20.1. Bonds

The table below provides an analysis of bonds issued by the Group:

(in PLN millions)						Amount	outstanding at (1)
Issuer	Series	Nominal value (in millions of currency)	Nominal interest rate	Issue date	Redemption date	31 December 2011	31 December 2010
TPSA Eurofinance France S.A.	Т	300 EUR	4.625%	5 July 2004	5 July 2011	_	1,214
TPSA Eurofinance France S.A	A1	500 EUR	6.000%	22 May 2009	22 May 2014	2,281	2,042
TPSA Eurofinance France S.A	A2	200 EUR	6.000%	17 July 2009	22 May 2014	960	862
Total bonds issued by the Group						3,241	4,118
Current						113	1,315
Non-current						3,128	2,803

 $<sup>^{(1)}</sup>$  Includes accrued interest and the fair value adjustment to the bonds hedged by fair value hedge.

On 5 July 2011, TPSA Eurofinance France S.A. redeemed at maturity bonds series T of the total nominal value of EUR 300 million which were issued on 5 July 2004.

The weighted average effective interest rate on the Group's bonds, before swaps, amounted to 5.76% as at 31 December 2011 and 5.41% as at 31 December 2010.

<sup>(1)</sup> Includes both nominal and interest payments.
(2) Excluding trade payables and UMTS license payables.

<sup>(3)</sup> Both assets and liabilities are included.

# Financial statements continued

# 20. Financial liabilities at amortised cost excluding trade payables (continued)

# 20.2. Bank borrowings

The table below provides an analysis of bank borrowings by creditor:

Amount outstanding at (1) 31 December 2010 31 December 2011 Currency PLN Currency PLN Creditor Repayment date (millions) (millions) (millions) (millions) Floating rate 15 December 2015 33 EUR 147 42 EUR 165 European Investment Bank 15 June 2012 17 EUR 74 50 EUR 197 European Investment Bank 15 June 2012 26 PLN 26 78 European Investment Bank 78 PLN European Investment Bank 17 September 2012 - 15 September 2013 1,400 PLN 1,400 1,398 PLN 1,398 Bank Handlowy (syndicated) 22 October 2015 (9) PLN<sup>(2)</sup> (9) (11) PLN<sup>(2)</sup> (11) Bank Handlowy (syndicated) 18 April 2013 (3) PLN<sup>(2)</sup> (3)(8) PLN(2) (8) Other credit lines 1 1 PLN Fixed rate Instituto de Credito Oficial 2 January 2021 14 USD 49 16 USD 47 Total bank borrowings of the Group 1,867 1,684 Current 649 227 Non-current 1,035 1,640

The weighted average effective interest rate on the Group's bank borrowings, before swaps, amounted to 4.62% as at 31 December 2011 and 3.54% as at 31 December 2010.

 $<sup>\</sup>ensuremath{^{(1)}}$  Includes accrued interest and bank borrowings issue costs.

<sup>&</sup>lt;sup>(2)</sup> Paid arrangement fees.

# 21. Derivatives

As at 31 December 2011 and 2010, the majority of the Group's derivatives portfolio constitutes financial instruments for which there is no active market (over-the-counter derivatives) i.e. the interest rate and currency swaps. To price these instruments the Group applies standard valuation techniques, where the prevailing market zero-coupon curves constitute the base for calculation of discounting factors. A fair value of swap transaction represents discounted future cash flows converted into PLN at the period-end exchange rate.

The derivative financial instruments used by the Group are presented below:

Fair value<sup>(2)</sup> (in PLN millions)

				(In PLN	millions)
Type of instrument (1)	Hedged risk	Hedged nominal amount (in millions of currency)	Maturity	Financial Asset	Financial Liability
			At 31 December 2	011	
Derivative instruments - fair value he	dge				
CCIRS	Currency and interest rate risk	110 EUR	2014	35	_
IRS	Interest rate risk	110 EUR	2014	29	_
Total of fair value hedges		64	-		
Derivative instruments - cash flow he	edge				
CCIRS	Currency and interest rate risk	283 EUR	2014	56	_
CCS	Currency risk	33 EUR	2012-2014	16	_
NDF	Currency risk	20 EUR	2012	0	(0)
IRS	Interest rate risk	33 EUR	2014	9	_
IRS	Interest rate risk	1,276 PLN	2012-2014	_	(65)
Total of cash flow hedges				81	(65)
Derivative instruments – held for trad	ling				
CCIRS	Currency and interest rate risk	313 EUR	2012-2014	56	(2)
NDF	Currency risk	693 EUR	2012	213	_
NDF	Currency risk	22 USD	2012	7	_
IRS	Interest rate risk	307 EUR	2014	81	_
IRS	Interest rate risk	1,269 PLN	2014	0	(51)
Total of derivatives held for trading				357	(53)
Total of derivative instruments				502	(118)
Current				225	_
Non-current				277	(118)

<sup>(1)</sup> CCIRS - cross currency interest rate swap, CCS - cross currency swap, IRS - interest rate swap, NDF - non-deliverable forward, FWD - forward.

<sup>&</sup>lt;sup>(2)</sup> Value 0 or (0) represents an asset or a liability below PLN 500 thousand, respectively.

## 21. Derivatives (continued)

Fair value<sup>(2)</sup> n PLN millions

				(in PLN	millions)
Type of instrument (1)	Hedged risk	Hedged nominal amount (in millions of currency)	Maturity	Financial Asset	Financial Liability
			At 31 December 2	010	
Derivative instruments - fair value he	dge				
CCIRS	Currency and interest rate risk	180 EUR	2011-2014	-	(31)
CCS	Currency risk	10 EUR	2011	_	(1)
IRS	Interest rate risk	180 EUR	2014	35	_
Total of fair value hedges		35	(32)		
Derivative instruments - cash flow he	edge				
CCIRS	Currency and interest rate risk	303 EUR	2014	_	(109)
CCS	Currency risk	184 EUR	2011-2014	5	(47)
NDF	Currency risk	4 USD	2011	1	_
IRS	Interest rate risk	53 EUR	2014	10	_
IRS	Interest rate risk	1,419 PLN	2012-2014	_	(57)
Total of cash flow hedges				16	(213)
Derivative instruments – held for trading					
CCIRS	Currency and interest rate risk	314 EUR	2011-2014	25	(82)
NDF	Currency risk	668 EUR	2011	2	(28)
NDF	Currency risk	29 USD	2011	0	(6)
FX option	Currency risk	50 EUR	2011	3	(5)
IRS	Interest rate risk	217 EUR	2014	41	_
IRS	Interest rate risk	1,089 PLN	2011-2014	_	(24)
Total of derivatives held for trading				71	(145)
Total of derivative instruments				122	(390)
Current				20	(109)
Non-current				102	(281)

<sup>(1)</sup> CCIRS – cross currency interest rate swap, CCS – cross currency swap, IRS – interest rate swap, NDF – non-deliverable forward, FWD – forward. (2) Value 0 or (0) represents an asset or a liability below PLN 500 thousand, respectively.

The Group's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Group enters into derivatives contracts with leading financial institutions. Limits are applied to monitor the level of exposure on the financial counterparties. In case the counterparty's financial soundness is deteriorating, the Group applies the appropriate measures mitigating the default risk.

The following tables provide an analysis of the Group's financial liabilities that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable (see Note 3.5.12).

(in PLN millions)	At 31 December 2011					
		Fairvalu	e measurement			
	Level 1	Level 2	Level 3	Total		
Financial liabilities at fair value through profit or loss	_	53	_	53		
Derivatives – held for trading	-	53	-	53		
Hedging derivatives	-	65	-	65		
Total financial liabilities measured at fair value	-	118	-	118		
(in PLN millions)		At 31 D	ecember 2010			
		Fairvalu	e measurement			
	Level 1	Level 2	Level 3	Total		
Financial liabilities at fair value through profit or loss	_	145	_	145		
Derivatives – held for trading	-	145	-	145		
Hedging derivatives		245	_	245		
Total financial liabilities measured at fair value	- 390 -					

During 12 months ended 31 December 2011 and 2010, there was no transfer between Level 1 and Level 2 fair value measurements, and no transfer into and out of Level 3 fair value measurement.

#### 22. Objectives and policies of financial risk management

# 22.1. Principles of financial risk management

The Group is exposed to some risks arising mainly from financial instruments that are issued and held as part of its operating and financing activities. That exposure can be principally classified as market risk (encompassing currency risk and interest rate risk), liquidity risk and credit risk. The Group manages the financial risks with the objective to limit its exposure to adverse changes in foreign exchange rates and interest rates, to stabilise cash flows and to ensure an adequate level of financial liquidity and flexibility.

The principles of the Group Financial Risk Management Policy have been approved by the Management Board. Operationally, financial risk management is conducted by TP Group Corporate Finance according to developed strategies confirmed by the Treasury Committee under the direct control of the Chief Financial Officer.

Group Financial Risk Management Policy defines principles and responsibilities within the context of an overall financial risk management and covers the following areas:

- risk measures used to identify and evaluate the exposure to financial risks,
- selection of appropriate instruments to hedge against identified risks,
- valuation methodology used to determine the fair value of derivatives,
- methods for testing hedging effectiveness for accounting purposes,
- transaction limits for and credit ratings of the leading financial institutions with which the Group concludes hedging transactions.

## 22.2. Hedge accounting

The Group has entered into numerous derivative transactions to hedge exposure to currency risk and interest rate risk. The derivatives used by the Group include: cross currency interest rate swaps, cross currency swaps, interest rate swaps, currency options, currency forwards and non-deliverable forwards.

Certain derivative instruments are classified as fair value hedges or cash flow hedges and the Group applies hedge accounting principles as stated in IAS 39 (see Note 3.5.12). The fair value hedges are used for hedging changes in the fair value of financial instruments that are attributable to particular risk and could affect the income statement. Cash flow hedges are used to hedge the variability of future cash flows that is attributable to particular risk and could affect the income statement.

Derivatives are used for hedging activities and it is the Group's policy that the derivative financial instruments are not used for trading (speculative) purposes. However, certain derivatives held by the Group are classified as held for trading as they do not fulfil all requirements of hedge accounting as set out in IAS 39 and hedge accounting principles are not applied to those instruments. The Group considers those derivative instruments as economic hedges because they, in substance, protect the Group against currency risk and interest rate risk.

Detailed information on derivative financial instruments, including hedging relationship, that are used by the Group is presented in Note 21.

#### 22. Objectives and policies of financial risk management (continued)

#### 22.3. Currency risk

The Group is exposed to foreign exchange risk arising from financial liabilities denominated in foreign currencies, namely bonds and bank borrowings denominated in EUR and USD (see Note 20) and trade receivables, trade payables and provisions of which a significant balance relates to the UMTS license payable (see Note 28), provision for the dispute with DPTG (see Notes 31.e and 33) and provision for the proceedings by the European Commission (see Note 31.d).

The Group's hedging policy, minimising the impact of fluctuations in exchange rates, is set on a regular basis. The acceptable exposure to a selected currency is a result of the risk analysis in relation to an open position in that currency, given the financial markets' expectations of foreign exchange rates movements during a specific time horizon.

Within the scope of the given hedging policy, the Group hedges its exposure entering mainly into cross currency swaps, cross currency interest rate swaps and forward currency contracts, under which the Group agrees to exchange a notional amount denominated in a foreign currency into PLN. As a result, the gains/losses generated by derivative instruments compensate the foreign exchange losses/gains on the hedged items. Therefore, the variability of the foreign exchange rates has a limited impact on the consolidated income statement, as well as consolidated other comprehensive income.

The table below presents the hedge ratio of the Group's major currency exposures. The ratio compares the hedged nominal value of a currency exposure to the total nominal value of the exposure.

	Hedge ratio				
Currency exposure	At 31 December 2011	At 31 December 2010			
Bonds and bank borrowings	99.7%	99.8%			
UMTS license payable	54.8%	57.0%			
DPTG provision (see Notes 31.e and 33)	75.6%	74.9%			
EC proceedings provision (see Note 31.d)	77.8%	n/a			

The Group is also actively hedging the exposure to foreign exchange risk generated by operating and capital expenditures.

The Group uses the sensitivity analysis described below to measure currency risk.

The Group's major exposures to foreign exchange risk (net of hedging activities) and potential foreign exchange gains/losses on these exposures resulting from a hypothetical 10% appreciation/depreciation of the PLN against other currencies are presented in the following table.

	Effective exposure after hedging impacting consolidated income statement				Sensitivity	to a change of the	PLN against othe	er currencies
	Dec	At 31 cember 2011	Dec	At 31 cember 2010	Dec	At 31 cember 2011	Dec	At 31 cember 2010
(in millions of currency)					+10%	-10%	+10%	-10%
Hedged item	Currency	PLN	Currency	PLN	PLN		PLN	
Bonds and bank borrowings (USD) UMTS license payable	3	10	3	9	1	(1)	1	(1)
(EUR) DPTG provision (EUR)	129	570	129	511	57	(57)	51	(51)
(see Notes 31.e and 33) EC proceedings provision (EUR)	134	592	136	539	59	(59)	54	(54)
(see Note 31.d)	28	124	_	_	12	(12)	_	-
Total		1,296		1,059	129	(129)	106	(106)

The sensitivity analysis presented above is based on the following principles:

- unhedged portion of the notional amount of liabilities is exposed to foreign exchange risk (effective exposure),
- derivatives satisfying hedge accounting requirements and those classified as economic hedges are treated as risk-mitigation transactions,
- cash and cash equivalents are excluded from the analysis.

The changes in fair value of derivatives classified as cash flow hedges of forecast transactions affect consolidated other comprehensive income. The sensitivity analysis prepared by the Group as at 31 December 2011 and 2010 displayed there was no significant impact on other comprehensive income resulting from a hypothetical 10% appreciation/depreciation of the PLN against other currencies.

#### 22.4. Interest rate risk

The interest rate risk is a risk that the fair value or future cash flows of the financial instrument will change due to interest rates changes. The Group has interest bearing financial liabilities consisting mainly of bonds and bank borrowings (see Note 20).

The Group's interest rate hedging policy limiting exposure to unfavourable movements of interest rates is set on a regular basis. The preferable split between fixed and floating rate debt is the result of the analysis indicating the impact of the potential interest rates evolution on the financial costs.

According to the given hedging strategy, the Group uses interest rate swaps and cross currency interest rate swaps to hedge its interest rate risk. As a result of the hedge the structure of the liabilities changes to the desired one, as liabilities based on the floating/fixed interest rates are effectively converted into fixed/floating obligations.

As at 31 December 2011 and 2010, the Group's proportion between fixed/floating rate debt (including hedging activities) was 52/48% and 47/53%, respectively.

The Group uses the sensitivity analysis described below to measure interest rate risk.

The table below provides the Group's exposures to interest rate risk (net of hedging activities) assuming a hypothetical decrease/increase in the interest rates by 1 per cent.

(in PLN millions)	Potential increase /(decrease) in value resulting from 1% change of interest rates				
	At 31 De	At 31 December 2011			
	+1%	-1%	+1%	-1%	
Finance costs, net	29	(28)	53	(53)	
Other comprehensive income	(1)	1	3	(4)	
Fair value of gross financial debt after derivatives	(60)	66	(62)	62	

The sensitivity analysis presented above is based on the following principles:

- finance costs, net include the following items exposed to interest rate risk: a) interest cost on financial debt based on floating rate, after derivatives classified as hedges for accounting purpose b) the change in the fair value of derivatives that do not qualify for hedge accounting,
- the effective portion of the change in the fair value of derivatives classified as cash flow hedges is recognised directly in other comprehensive income,
- as at 31 December 2011, the fair value of gross financial debt after derivatives (excluding finance lease and arrangement fees) was PLN 4,774 million (as at 31 December 2010, PLN 6,382 million).

## 22.5. Liquidity risk

The liquidity risk is a risk of encountering difficulties in meeting obligations associated with financial liabilities. The Group's liquidity risk management involves forecasting future cash flows, analysing the level of liquid assets in relation to cash flows, monitoring balance sheet liquidity and maintaining a diverse range of funding sources and back-up facilities.

In order to increase efficiency, the liquidity management process is optimised through a centralised treasury function of the Group, as liquid asset surpluses generated by entities constituting the Group are invested and managed by the central treasury. The Group's cash surplus is invested into short-term highly-liquid financial instruments e.g. bank deposits and T-bills.

The Group also manages liquidity risk by maintaining committed, unused credit facilities, which create a liquidity reserve to secure solvency and financial flexibility. As at 31 December 2011, the Group had the following unused credit facilities amounting to PLN 3,790 million (as at 31 December 2010, PLN 3,605 million):

- PLN 2,023 million of credit lines,
- EUR 400 million of back-up credit facility.

Liquidity risk is measured by applying following ratios calculated and monitored by the Group regularly:

- liquidity ratios,
- maturity analysis of undiscounted contractual cash flows resulting from the Group's financial liabilities,
- average debt duration.

### 22. Objectives and policies of financial risk management (continued)

#### 22.5. Liquidity risk (continued)

The liquidity ratio, which represents the relation between available financing sources (i.e. cash and credit facilities) and debt repayments during next 12 and 18 months, is presented in the following table:

(in PLN millions)	Liquidit	y ratios
	At 31 December 2011	At 31 December 2010
Liquidity ratio - next 12 months	1,036%	429%
Unused credit facilities	3,790	3,605
Cash and cash equivalents	2,860	2,447
Debt repayments <sup>(1)</sup>	642	1,410
Liquidity ratio (incl. derivatives) - next 12 months	1,325%	384%
Derivatives <sup>(2)</sup>	(140)	166
Liquidity ratio - next 18 months	572%	398%
Unused credit facilities	3,790	3,605
Cash and cash equivalents	2,860	2,447
Debt repayments <sup>(1)</sup>	1,163	1,521
Liquidity ratio (incl. derivatives) - next 18 months	631%	355%
Derivatives <sup>(2)</sup>	(109)	185

<sup>(1)</sup> Undiscounted principal payments on debt.

The maturity analysis for the contractual undiscounted cash flows resulting from the Group's financial liabilities as at 31 December 2011 and 2010 is presented in Note 19. The average duration for the existing debt portfolio as at 31 December 2011 is 2.0 years (as at 31 December 2010, 2.4 years).

# 22.6. Credit risk

The Group's credit risk management objective is defined as supporting business growth while minimising financial risks by ensuring that customers and partners are always in a position to pay amounts due to the Group.

The main function of the Credit Committee under the control of the Chief Financial Officer is to coordinate and consolidate credit risk management activities across the Group, which involve:

- clients' risk assessment,
- monitoring clients' business and financial standing,
- managing accounts receivable and bad debts.

The policies and rules regarding consolidated credit risk management for the Group were approved by the Credit Committee.

There is no significant concentration of credit risk within the Group.

Further information on credit risk is discussed in Notes 16, 17, 18 and 21.

# 22.7. Price risk

Pursuant to the Polish telecommunication law, prices for telecommunication services should be based on transparent and objective criteria.

In case of operators which are SMPs, UKE determines requirements for regulatory accounting and calculation of costs of telecommunication services. Fees for services provided on the relevant markets in which TP S.A. or PTK–Centertel is a SMP must be approved by UKE before they become binding.

Cost calculations of wholesale services, which are provided based on regulatory obligations, are subject to examination and approval by UKE. If fees proposed by the operator, which is a SMP, are assessed as not in conformity with relevant regulations, UKE may change these fees.

The President of UKE declared in Memorandum of Understanding (see Note 30.3) that wholesale rates for regulated services, and for Bitstream Access (under certain conditions), will be maintained at unchanged levels until the end of 2012.

<sup>(2)</sup> Undiscounted net cash flows on derivatives; negative/positive amount represents positive/negative net result on cash flows.

Retail prices for services provided on the relevant retail markets where TP S.A. is a SMP are subject to UKE acceptance. TP S.A. may launch promotions and price changes which have not been objected to by the President of UKE. Moreover, the retail price changes should be announced with at least one settlement period in advance.

The Group believes that it fulfils all requirements in relation to regulatory accounting and cost calculations as stipulated in the telecommunication law.

#### 22.8. Management of covenants

As at 31 December 2011 and 2010, TP S.A. was a party to loan and guarantee agreements containing financial covenant, upon which the Group should meet the following financial ratio: Net Debt / EBITDA to be no higher than 3.5:1 confirmed on a semi-annual basis. The covenant was met in years 2011 and 2010.

#### 23. Management of capital

The Group manages its capital through a balanced financial policy, which aims at providing both relevant funding capabilities for business development and at securing a relevant financial structure and liquidity.

The Group's capital management policy takes into consideration three key elements:

- business performance together with applicable investments and development plans,
- cash distribution policy and debt repayment schedule,
- the Group's credit rating and financial market environment.

In order to combine these factors the Group periodically establishes a framework for the financial structure. The current Group's objectives in that area are the following:

- Net Gearing ratio maximum at the range of 35% 40%,
- Net financial debt to EBITDA ratio remaining below 1.5

The table below provides the capital ratios as at 31 December 2011 and 2010 and presents the sources of capital involved in their calculation. The Group regards capital as the total of equity and net financial debt.

(in PLN millions)	At 31 December 2011	At 31 December 2010
Interest bearing bonds and bank borrowings and finance lease	4,937	6,003
Cash and cash equivalents	2,860	2,447
Marketable securities	9	9
Net financial debt before hedging	2,068	3,547
Derivatives <sup>(1)</sup>	(374)	270
Net financial debt	1,694	3,817
Equity	14,334	14,634
Equity and Net financial debt before hedging	16,402	18,181
Equity and Net financial debt	16,028	18,451
EBITDA <sup>(2)</sup>	4,780	5,772
Net Gearing before hedging ratio <sup>(3)</sup>	12.6%	19.5%
Net Gearing ratio <sup>(4)</sup>	10.6%	20.7%
Net financial debt before hedging / EBITDA <sup>(2)</sup> ratio	0.4	0.6
Net financial debt / EBITDA <sup>(2)</sup> ratio	0.4	0.7

<sup>(1)</sup> Marked-To-Market valuation of derivative portfolio (excluding effective portion of cash flow hedges); negative/positive amount represents positive/negative valuation.

The above policy imposes financial discipline, providing appropriate flexibility needed to sustain profitable development and the Group's cash distribution policy as set on an annual basis with a focus on delivering an attractive remuneration to the Group's shareholders. There are no external capital requirements imposed on the Group.

<sup>(</sup>a) Gain on disposal of TP Emitel and dispute with DPTG are excluded from EBITDA, because they do not relate to the Group's current operations.

<sup>(3)</sup> Net Gearing before hedging = Net financial debt before hedging / (Net financial debt before hedging + Equity).

<sup>(4)</sup> Net Gearing = Net financial debt / (Net financial debt + Equity).

#### 24. Fair value of financial instruments

As at 31 December 2011 and 2010, the carrying amount of cash and cash equivalents, current trade receivables and current trade payables, current loans and receivables and current financial liabilities at amortised cost approximates their fair value due to relatively short term maturity of those instruments or cash nature.

As at 31 December 2011 and 2010, the carrying amount of financial liabilities at amortised cost which bear variable interest rates approximates their fair value.

A comparison by classes of carrying amounts and fair values of those Group's financial instruments, for which the estimated fair value differs from the book value, is presented below.

(in PLN millions)		At 31 December 2010		
	Carrying amount (1)	Estimated fair value	Carrying amount (1)	Estimated fair value
Bonds with fixed interest rate	3,241	3,467	4,118	4,232
Bank borrowings with fixed interest rate	49	46	47	42
UMTS license payables	888	979	808	870
Total	4,178	4,492	4,973	5,144

 $<sup>\</sup>ensuremath{^{(1)}}\mbox{Carrying}$  amount includes accrued interest.

The fair value of financial instruments is calculated by discounting expected future cash flows at the prevailing zero-coupon rates for a given currency. A theoretical zero-coupon curve is derived from the SWAP rate curve adjusted by the appropriate credit spread. Fair value amounts are translated to PLN at the National Bank of Poland period-end exchange rate.

# 25. Employee benefits

(in PLN millions)	At 31 December 2011	At 31 December 2010
Jubilee awards	125	162
Retirement bonuses and other post-employment benefits	186	198
Salaries, other employee-related payables and payroll taxes due	214	248
Total employee benefits	525	608
Current	240	266
Non-current	285	342

Certain employees and retirees of the Group are entitled to long-term employee benefits in accordance with the Group's remuneration policy (see Note 3.5.16). These benefits are not funded.

The changes in the present and carrying value of obligations related to long-term employee benefits for the 12 months ended 31 December 2011 and 2010 are detailed in the table below:

(in PLN millions)		12 months ended 31 December 2011			1	12 months ended 31 December 2010			
	Jubilee awards	Retirement bonuses	Other post- employment benefits	Total	Jubilee awards	Retirement bonuses	Other post- employment benefits	Total	
Present/carrying value of obligatio at the beginning of the period	n 162	124	74	360	151	103	73	327	
Current service cost <sup>(1)</sup>	9	7	1	17	9	6	1	16	
Past service cost <sup>(1)</sup>	(14)	2	_	(12)	_	_	_	_	
Interest cost <sup>(2)</sup>	8	7	4	19	8	6	4	18	
Benefits paid	(14)	(3)	(6)	(23)	(26)	(3)	(8)	(37)	
Actuarial (gains)/losses for the period	(6) (1)	(3) (3)	14(3)	5	20(1)	12(3)	4(3)	36	
Curtailment(1)(4)	(15)	(23)	(2)	(40)	_	_	_	_	
Derecognition <sup>(5)</sup>	(5)	(5)	(5)	(15)	_	_	_	_	
Present/carrying value of obligation at the end of the period	125	106	80	311	162	124	74	360	

The valuation of obligations as at 31 December 2011 and 2010 was performed using the following assumptions:

	At 31 December 2011	At 31 December 2010
Discountrate	6.1%	6.0%
Wage increase rate	3.0% – 3.5%	3.0%
Expected average remaining working lives (in years)	6.9 – 16.6	9.3-21.5

Present value of defined benefit obligation at the end of current and previous four annual periods is presented below:

(in PLN millions)	Jubilee awards	Retirement bonuses	Other post- employment benefits	Total
Asat				
31 December 2011	125	106	80	311
31 December 2010	162	124	74	360
31 December 2009	151	103	73	327
31 December 2008	152	87	94	333
31 December 2007	167	91	78	336

<sup>(1)</sup> Recognised under labour expense in the consolidated income statement.

<sup>&</sup>lt;sup>(3)</sup> Recognised under actuarial losses on post-employment benefits in the consolidated statement of comprehensive income.

<sup>(4)</sup> Curtailment resulting mainly from the new Social Agreement concluded in the fourth quarter of 2011 (see Note 27).

<sup>(5)</sup> Disposal of TP Emitel (see Note 7.1).

#### 26. Share-based payments

#### 26.1. Group incentive programme

On 28 April 2006, the General Meeting of Shareholders of TP S.A. approved an incentive programme ("the Program") for the key managers and executives ("the Beneficiaries") of Telekomunikacja Polska and its selected subsidiaries in order to further motivate management in their efforts aimed at the Group development and maximisation of its value. As a result of the Program, on 9 October 2007 TP S.A. issued 6,202,408 registered bonds with a nominal value, equal to issue price, of PLN 0.01 each with pre-emption rights to subscribe for Company shares with priority over the existing shareholders. A total of 6,047,710 bonds were subscribed and allocated to the Beneficiaries, the remaining 154,698 bonds had not been subscribed and were redeemed.

Pre-emption rights attached to the bonds to subscribe for the Company's shares may be exercised until 9 October 2017. One bond gives a right to subscribe for one ordinary share. The shares acquired upon exercising pre-emption right attached to the bonds are ordinary bearer shares and are not subject to any restriction in trading. The right to subscribe for the shares shall be vested exclusively in the bondholders. The issue price of the shares is PLN 21.57 per share.

The following table illustrates the number and exercise price of equity instruments granted by TPS.A.:

	12 months ende	12 months ended 31 December 2010		
	number	exercise price (PLN)	number	exercise price (PLN)
Outstanding at the beginning of the period	3,935,226	21.57	4,357,425	21.57
Cancelled during the year	(346,548)	_	(422,199)	_
Outstanding at the end of the year	3,588,678	21.57	3,935,226	21.57

During the vesting period (years 2007-2010) the fair value of services received, recognised in labour expenses and equity, amounted to PLN 17 million.

#### 26.2. France Telecom S.A. free share award plan

In 2007 France Telecom S.A. established a free share, equity-settled, award plan ("NExT plan"). Under the NExT plan 988,400 shares of France Telecom S.A. were offered to employees and executives of the Group. The grant date was established on 18 March 2008 that is the date when the main terms and conditions of the plan were announced to TP Group's employees. The fair value of equity instruments at grant date was PLN 63.57 (an equivalent of EUR 17.95 translated at NBP period-end exchange rate at 18 March 2008).

During the vesting period (years 2008-2010) the fair value of services received, recognised in labour expenses and equity, amounted to PLN 62 million.

## 27. Provisions

For the 12 months ended 31 December 2011 the movements of provisions were as follows:

(in PLN millions)	At 1 January 2011	Increases	Reversals (utilisations)	Reversals (releases)	Foreign exchange effect	Discounting effect	At 31 December 2011
Provisions for claims and litigation (see Note 31), risks and other charges	2,194	606	(47)	(30)	273	4	3,000
Restructuring provisions	42	172	(45)	_	_	1	170
Provisions for dismantling	195	65	(8)	_	_	12	264
Total provisions	2,431	843	(100)	(30)	273	17	3,434
Current	2,242						3,130
Non-current	189						304

For the 12 months ended 31 December 2010 the movements of provisions were as follows:

(in PLN millions)	At 1 January 2011	Increases	Reversals (utilisations)	Reversals (releases)	Foreign exchange effect	Discounting effect	At 31 December 2010
Provisions for claims and litigation (see Note 31), risks and other charges	1,098	1,196	(53)	(12)	(35)	_	2,194
Restructuring provisions	126	34	(123)	_	_	5	42
Provisions for dismantling	199	_	(2)	(13)	_	11	195
Total provisions	1,423	1,230	(178)	(25)	(35)	16	2,431
Current	1,208						2,242
Non-current	215						189

The discount rate used to calculate the present value of provisions amounted to 2.75% - 6.18% as at 31 December 2011 and 4.95% - 6.00% as at 31 December 2010.

## Restructuring provisions

The restructuring provisions as at 31 December 2011 consisted mainly of the estimated amount of termination benefits for employees scheduled to terminate employment in TP S.A. under the new 2012-2013 Social Agreement.

In the fourth quarter of 2011, TPS.A. concluded with Trade Unions the new Social Agreement under which up to 2,300 employees may take advantage of the voluntary departure package in years 2012 - 2013. Additionally, TPS.A. concluded a separate agreement specifying that in 2012 a maximum of 1,150 employees may take advantage from the above mentioned package. The value of voluntary departure package varies depending on individual salary, employment duration and year of resignation. The basis for calculation of the employment restructuring provision is the estimated number, remuneration and service period of employees who will accept the voluntary termination until the end of 2013.

## **Dismantling provisions**

The dismantling provisions relate to dismantling or removal of items of property, plant and equipment (mainly telecommunication poles and items of mobile access network) and restoring the site on which they are located. Based on environmental regulations in Poland, items of property, plant and equipment which may contain hazardous materials should be dismantled and utilised by the end of their useful lives by entities licensed by the State for this purpose.

The amount of dismantling provisions is based on the estimated: number of items that should be utilised / sites to be restored, period of utilisation / time to restoration, current utilisation / restoration cost (obtained through a tender process) and inflation.

# 28. Trade payables, other liabilities and deferred income

# 28.1. Trade payables

(in PLN millions)	At 31 December 2011	At 31 December 2010
Trade payables	1,810	1,611
Fixed assets payables	1,326	1,488
UMTS licence payables	888	808
Total trade payables	4,024	3,907
Current	3,199	3,156
Non-current <sup>(1)</sup>	825	751

<sup>(1)</sup> Includes only UMTS licence payables.

## 28.2. Other liabilities

(in PLN millions)	At 31 December 2011	At 31 December 2010
VAT payables	124	142
Other taxes payables	20	56
Other	73	22
Total other liabilities	217	220
Current	202	220
Non-current	15	_

## 28. Trade payables, other liabilities and deferred income (continued)

#### 28.3.Deferred income

(in PLN millions)	At 31 December 2011	At 31 December 2010
and Extramology	2011	
Subscription (including unused minutes in subscription system)	217	257
Unused minutes in the pre-paid system	192	178
Connection fees	121	140
Other	63	24
Total deferred income	593	599
Current	545	533
Non-current	48	66

# 29. Equity

## 29.1. Share capital

As at 31 December 2011 and 2010, the share capital of the Company amounted to PLN 4,007 million and was divided into 1,336 million fully paid ordinary bearer shares of PLN 3 each. During the year ended 31 December 2011, the Company acquired 11 million of its own shares for the total consideration of PLN 200 million (see Note 29.3).

The ownership structure of the share capital as at 31 December 2011 and 2010 was as follows:

(in PLN millions) At 31 December 201			nber 2011	At 31 December 2010			
	% of votes	% of shares	Nominal value	% of votes	% of shares	Nominal value	
France Telecom S.A.	50.21	49.79	9 1,995	49.79	49.79	9 1,995	
Capital Group International, Inc. (1)	5.10	5.0	6 203	5.06	5.00	6 203	
Other shareholders	44.69	44.3	0 1,775	45.15	45.15	5 1,809	
Treasury shares	_	0.8	5 34	_	_	_	
Total	100.00	100.0	0 4.007	100.00	100.0	0 4.007	

 $<sup>^{(1)}</sup>$  Number of shares according to the notification by Capital Group International, Inc. on 15 October 2010.

The Group has no information regarding valid agreements or other events that may result in changes in the proportions of shares held by the shareholders, except for the purchase of treasury shares (see Note 29.3).

# 29.2. Dividends

An ordinary dividend of PLN 1.50 per share, i.e. PLN 2,003 million, was paid on 7 July 2011 and 1 July 2010 following resolutions of the General Shareholders' Meeting of TP S.A.

# 29.3. Purchase of treasury shares

On 13 October 2011, an Extraordinary General Shareholders' Meeting of TP S.A. adopted a resolution authorising the Company to buy back its own shares for the purpose of their redemption ("the Programme"). The Programme will be carried out until the total amount of funds allocated to the Programme is PLN 800 million, but not later than

31 December 2012. On 20 October 2011, the Management Board determined detailed terms of the Programme. The Programme concerns Company's shares listed on the Warsaw Stock Exchange and is executed through a brokerage bank. TP S.A. has received information from France Telecom S.A. that it does not participate in the Programme.

As at 31 December 2011, the Company purchased a total of 11,313,409 own shares, which account for 0.85% of the Company's share capital, for a total consideration of PLN 200 million. No additional own shares were purchased by the Company until the date of the authorisation of these Consolidated Financial Statements.

#### 30. Unrecognised contractual obligations

Management considers that, to the best of its knowledge, there are no existing unrecognised contractual obligations as at 31 December 2011 and 2010, other than those described below, likely to have a material impact on the current or future financial position of the Group.

#### 30.1. Commitments related to operating leases

When considering the Group as a lessee, operating lease commitments mainly relate to the lease of buildings and land. Lease costs recognised in the consolidated income statement for the years ended 31 December 2011 and 2010 amounted to PLN 418 million and PLN 404 million, respectively. Most of the agreements are denominated in foreign currencies. Some of the above agreements are indexed with price indices applicable for a given currency.

Future minimum lease payments under non-cancellable operating leases, as at 31 December 2011 and 2010, were as follows:

(in PLN millions)	At 31 December 2011	At 31 December 2010
within one year	227	211
after one year but not more than five years	372	233
more than five years	321	55
Total minimum future lease payments	920	499

The increase in future minimum lease payments under non-cancellable operating leases as at 31 December 2011 resulted mainly from an agreement for the development and lease of new premises for the Group.

When considering the Group as a lessor, future minimum lease payments under non-cancellable operating leases as at 31 December 2011 and 2010 amounted to PLN 55 million and PLN 100 million, respectively.

## 30.2. Investment commitments

Investment commitments contracted for at the balance sheet date but not recognised in the financial statements were as follows:

(in PLN millions)	At 31 December 2011	At 31 December 2010
Property, plant and equipment	609	761
Intangibles	99	73
Total investment commitments	708	834
Amounts contracted to be payable within 12 months after the balance sheet date	665	695

Investment commitments represent mainly purchases of telecommunications network equipment, IT systems and other software (including investment commitments related to Memorandum of Understanding with UKE – see below).

## 30.3. Memorandum of Understanding with UKE

On 22 October 2009, TP S.A. and UKE signed a Memorandum of Understanding concerning implementation of transparency and non-discrimination in inter-operator relations. In 2010 - 2011, TP S.A. carried out activities in accordance with a schedule established together with UKE and was systematically implementing technical and organisational solutions, in order to secure non-discriminatory relations with other operators including equal access to information. It is anticipated that as TP S.A. fulfils the arrangements, the President of UKE will withdraw the consideration of functional separation of TP S.A. which had been considered by UKE as a regulatory tool to implement effective competition on regulated telecommunication wholesale markets in Poland.

TP S.A. was to invest in the development of 1.2 million broadband access lines up to 22 October 2012 (0.479 million new lines and 0.721 million upgraded existing lines), of which 1 million lines with bandwidths of at least 6 Mbps. As at 31 December 2011, TP S.A. had finalised the development of 0.859 million broadband access lines.

On 30 January 2012, TP S.A. and UKE signed a modification of the Memorandum of Understanding under which the development of the remaining 0.341 million broadband access lines will be finalised by 31 March 2013, of which 0.22 million lines with bandwidths of at least 30 Mbps.

#### 31. Litigation and claims (including contingent liabilities)

#### a. Issues related to the incorporation of Telekomunikacja Polska

Telekomunikacja Polska was established as a result of the transformation of the state-owned organisation Poczta Polska Telegraf i Telefon ("PPTiT") into two entities – the Polish Post Office and Telekomunikacja Polska. During the transformation process and transfer of ownership rights to the new entities, certain items of property and other assets that are currently under Telekomunikacja Polska's control were omitted from the documentation recording the transfer and the documentation relating to the transformation process is incomplete in this respect. This means that Telekomunikacja Polska's rights to certain properties may be questioned.

In addition, as the regulations concerning the transformation of PPTiT are unclear, the division of certain responsibilities of PPTiT may be considered to be ineffective, which may result in joint and several liability in respect of Telekomunikacja Polska's predecessor's obligations existing at the date of transformation.

The share premium in the equity of Telekomunikacja Polska includes an amount of PLN 713 million which, in accordance with the Notary Deed dated 4 December 1991, relates to the contribution of the telecommunication business of PPTiT to the Company. As the regulations relating to the transformation of PPTiT are unclear, the division of certain rights and obligations may be considered to be ineffective. As a result, the share premium balance may be subject to changes.

## b. Tax contingent liability

Tax settlements, together with other areas of legal compliance (e.g. customs or foreign exchange law) are subject to review and investigation by a number of authorities, which are entitled to impose fines, penalties and interest charges. Value added tax, corporate income tax, personal income tax and other taxes or social security regulations are subject to frequent changes, which often leads to the lack of system stability. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. These facts create tax risks in Poland that are more significant than those typically found in countries with more developed tax systems.

Tax authorities may examine accounting records up to five years after the end of the year in which the tax becomes due. Consequently, the Group may be subject to additional tax liabilities, which may arise as a result of additional tax audits. TP S.A. and certain of its subsidiaries were subject to audits by the tax office in respect of taxes paid. Certain of these audits have not yet been finalised. The Group believes that adequate provisions have been recorded for known and quantifiable risks in this regard.

# c. Proceedings by UKE and UOKiK

According to the Telecommunications Act, the President of UKE may impose on a telecommunications operator a penalty of up to a maximum amount of 3% of the operator's prior year's revenue, if the operator does not fulfil certain requirements of the Telecommunications Act. According to the Act on Competition and Consumer Protection, in case of non-compliance with its regulations, the President of the Office of Competition and Consumer Protection ("UOKiK") is empowered to impose on an entity penalties of up to a maximum amount of EUR 50 million for refusal to provide requested information or up to a maximum amount of 10% of an entity's prior year's revenue for a breach of the law.

# Proceedings by UKE related to broadband access

On 25 September 2006, UKE imposed a fine of PLN 100 million on TP S.A. for the infringement of the obligation to determine the price of the services on the basis of the cost of their provision and on clear, objective and non-discriminatory criteria, as a result of not implementing the offer to sell Neostrada (Internet services) separately from the fixed line subscription (allocating costs of local loop entirely to fixed line subscription). On 22 February 2007, after TP S.A. had separated providing Neostrada from fixed line services, UKE imposed a fine of PLN 339 million on TP S.A. for non-performance of the regulatory obligation to submit its Neostrada price list for UKE's approval, and for failing to demonstrate that TP S.A. had met the requirements of the Polish Telecommunication Law that the price of services (in particular the additional charge for the maintenance of the local loop paid by the Neostrada customers who do not subscribe for TP S.A.'s traditional fixed-line analogue services on the same local loop) be based on their cost and determined on clear, objective and non-discriminatory criteria.

TPS.A. believes that UKE has no right to challenge the Neostrada price since it is not defined as a regulated service and that the criteria used for setting Neostrada price were transparent and objective.

TP S.A. did not pay either of these fines and appealed against these decisions to the Court of Competition and Consumer Protection ("SOKiK"). Both appeal proceedings were suspended by SOKiK in connection with, among other matters, the proceeding of the European Commission against the Republic of Poland at the European Court of Justice on attempts of UKE to regulate retail tariffs for broadband access services without carrying out a prior market analysis. On 6 May 2010 the European Court of Justice ruled that by regulating retail tariffs for broadband access services without carrying out a prior market analysis, Poland has failed to fulfil its obligations under the Universal Service Directive in conjunction with the Framework Directive.

After resumption of the appeal proceedings, SOKiK, on 18 April 2011, overruled the UKE's decision imposing the fine of PLN 339 million. UKE appealed against the SOKiK verdict to the Court of Appeal on 6 June 2011 and, on 3 February 2012, the Court dismissed the appeal. Therefore the verdict of SOKiK annulling the fine is binding. UKE can lodge a cassation appeal to the Supreme Court.

On 12 July 2011, SOKiK annulled for the second time the fine of PLN 100 million. UKE appealed that verdict on 28 November 2011. The Company has not yet been notified of the hearing date of the Court of Appeal. SOKiK invalidated the fine for the first time in 2007.

#### Proceedings by UOKiK related to IP traffic

On 20 December 2007, Office of Competition and Consumer Protection ("UOKiK") issued a decision concluding that TPS.A. had engaged in practices restricting competition when it downgraded IP traffic coming from domestic operators' networks to TPS.A.'s network via foreign operators' networks and imposed a fine of PLN 75 million on the Company. TPS.A. disagreed with the decision of UOKiK and did not pay the fine. On 2 January 2008, TPS.A. appealed to SOKiK against the decision. On 11 April 2011, SOKiK reduced the fine to the amount of PLN 38 million. TPS.A. appealed to the Court of Appeal on 20 June 2011 and UOKiK appealed on 19 August 2011. The Company has not yet been notified of the hearing date of the Court of Appeal.

## Proceedings by UOKiK related to mobile television

On 21 September 2010, UOKiK initiated competition proceedings against PTK-Centertel, Polkomtel S.A., Polska Telefonia Cyfrowa S.A. and P4 Sp. z o.o. claiming that they concluded an agreement regarding their relations with Info TV FM Sp. z o.o.

Info TV FM Sp. z o.o. is a telecommunications operator working in the field of radio diffusion and providing its services to radio and television broadcasters. 4MNO Sp. z o.o. (formerly Mobile TV Sp. z o.o.) is a company in which the four above companies involved in the proceedings are shareholders. UOKiK gave its prior approval to set up Mobile TV Sp. z o.o. Both companies applied to UKE for a license to broadcast in the frequency band designed for the provision of audio-visual media services in DVB-H technology.

In March 2009, Info TV FM Sp. z o.o. was granted permission to use these frequencies. However, none of the four companies decided to introduce mobile television services to its customers.

On 23 November 2011, UOKiK issued a decision imposing fines on the four companies (on PTK-Centertel – PLN 35 million) for alleged agreement restricting competition on the domestic retail and wholesale market for mobile television based on DVB-H technology. On 7 December 2011, PTK-Centertel appealed against that decision.

The Management Board of PTK-Centertel did not agree on common actions with the other companies aimed at restricting the introduction of DVB-H service based on the offer of Info TV FM Sp. z o.o. It decided not to introduce mobile television services due to the market situation and for commercial reasons.

As at 31 December 2011, the Group recognised provisions for known and quantifiable risks related to proceedings against the Group initiated by UKE and UOKiK, which represent the Group's best estimate of the amounts, which are more likely than not to be paid. The actual amounts of penalties, if any, are dependent on a number of future events the outcome of which is uncertain, and, as a consequence, the amount of the provision may change at a future date. Information regarding the amount of the provisions has not been separately disclosed, as in the opinion of the Company's Management such disclosure could prejudice the outcome of the pending cases.

# d. Proceedings by the European Commission related to broadband access

In September 2008, the European Commission conducted an inspection at the premises of TP S.A. and PTK-Centertel. The aim of the inspection was to gather evidence of a possible breach by TP S.A. of competition rules on the broadband Internet market. On 17 April 2009, the European Commission notified TP S.A. of initiation of proceedings on the supposed refusal to provide services and non-price discrimination on the Polish wholesale market of broadband access to the Internet. On 1 March 2010, TP S.A. received a Statement of Objections from the European Commission regarding an alleged abuse of dominant position, by refusing to supply access to its wholesale broadband services. The Company responded to the Statement of Objections and provided the European Commission with requested information. TP S.A. received from the European Commission the letter of facts dated 28 January 2011 presenting evidence collected after the issue of the Statement of Objections as well as findings of the European Commission. TP S.A. responded to the letter of facts on 7 March 2011.

On 22 June 2011, the European Commission imposed on TP S.A. a EUR 127.6 million fine (approximately PLN 508 million) for abuse of dominant position on the wholesale broadband access market, before October 2009. TP S.A. has recorded a provision for the whole amount of the fine. In accordance with the decision the fine could have been provisionally paid or secured by a bank guarantee. On 27 September 2011, TP S.A. provided the bank guarantee to the European Commission.

The Company strongly disagrees with the decision and the disproportionate level of the fine, particularly as it believes that the European Commission did not take into account several important factors. The situation on the wholesale broadband market has been systematically improving since 2007. By constructing and providing fixed broadband infrastructure, the Company has been effectively remedying the difficulties on the Polish broadband market and it has been increasing the penetration rate of the broadband services. The irregularities pointed out by the European Commission were voluntarily removed by the Company in the past.

The decision is not final and TP S.A., in liaison with its legal advisors, appealed against it to the General Court of the European Union on 2 September 2011. The European Commission answered to the appeal on 13 January 2012. Based on previous similar cases, the judgment of the General Court should be delivered within the next two or three years. This judgment could be appealed to the Court of Justice by any of the parties.

## 31. Litigation and claims (including contingent liabilities) (continued)

#### e. Dispute with DPTG

Information on the matter has been consistently referred to in the consolidated financial statements of the Group since 2001 together with the development of the case over the years.

In 2001, a dispute arose over the interpretation of a contract for the sale and installation by the Danish company DPTG of a fibre optical transmission system (known as "North-South Link", or "NSL") for the State-owned PPTiT, the predecessor of TP SA. The contract, signed in 1991 and for which work was completed in 1994, provided for payment of part of the contract price by allocating to DPTG 14.8% of certain profit from the NSL for fifteen years from the system's installation, that is, from February 1994 to January 2009. In 1999, the parties came into disagreement regarding the calculation of this revenue. In 2001, DPTG initiated ad hoc arbitration proceedings before the Arbitration Tribunal (under UNCITRAL rules) sitting in Vienna.

In June 2008, the Arbitration Tribunal decided to split the case into two periods and to render firstly an award settling DPTG's rights for the period from February 1994 to June 2004 (Phase I). On 3 September 2010, the Tribunal issued its partial award for Phase I. It settled DPTG's claims at DKK 2,946 million (approximately EUR 396 million) including interest. Acting in the best interests of the Company and its shareholders, TP S.A. did not pay the partial award and took legal actions to resist the award issued by the Arbitration Tribunal.

On 14 January 2011, DPTG filed its claim for Phase II, which amounted to DKK 2,386 million (approximately EUR 320 million) including interest.

On 12 January 2012, the Management Board of TP S.A., acting in the best interest of the Company and its shareholders, signed a settlement agreement that concluded this dispute. Pursuant to the agreement, TP S.A. paid DPTG a total of EUR 550 million (approximately PLN 2.4 billion) and DPTG withdrew all its motions for enforcement of the Phase I partial award as well as its claim for Phase II and any other existing related claims. DPTG also waived any possible new claim in relation to the dispute.

As a consequence, the Company increased the provision by EUR 8 million (PLN 35 million) to EUR 550 million (PLN 2,429 million) as at 31 December 2011.

## f. Other contingent liabilities and provisions

Apart from the above mentioned, operational activities of the Group are subject to legal and administrative regulations and the Group is a party to a number of legal proceedings and commercial contracts related to its operational activities. The Group believes that adequate provisions have been recorded for known and quantifiable risks.

# 32. Related party transactions

## 32.1. Management Board and Supervisory Board compensation

Management Board compensation was as follows:

(in PLN thousands)		? months ended December 2011	·-	2 months ended December 2010
	Paid Accru	ued but not paid	Paid Accru	ued but not paid
Short-term benefits excluding employer social security payments <sup>(1)</sup>	10,545	1,380	9,318	1,472
Post-employment and other benefits	636	_	_	_
Termination benefits	636	-	2,225	-
Total	11,817	1,380	11,543	1,472

<sup>(1)</sup> Gross salaries, bonuses and non-monetary benefits.

Remuneration and bonuses, compensation and termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) paid or accrued but not paid in accordance with contractual commitments, by TP S.A. to TP S.A.'s Management Board and Supervisory Board members during the 12 months ended 31 December 2011 and 2010 are presented below:

Persons that were Members of the Management Board of the Company as at 31 December 2011:

(in PLN thousands)		12 months ended 31 December 2011		12 months ended 31 December 2010
	Paid	Accrued but not paid	Paid	Accrued but not paid
Maciej Witucki	2,892	382	3,019	495
Vincent Lobry	2,233	215	2,131	297
Piotr Muszyński	2,101	337	1,811	330
Jacques de Galzain	1,732(1)	232	_	_
Jacek Kowalski	1,141(1)	214	-	_
Total	10,099	1,380	6,961	1,122

<sup>(1)</sup> From the date of appointment.

 $Persons \, that \, were \, Members \, of \, the \, Management \, Board \, of \, the \, Company \, in \, 2011 \, or \, previous \, periods: \, and \, in \, Company \, in \, 2011 \, or \, previous \, periods \, in \,$ 

(in PLN thousands)	busands) 12 months ended 31 December 2011			
	Paid	Accrued but not paid	Paid	Accrued but not paid
Roland Dubois	1,718(1)	_	2,357	350
Richard Shearer	_	-	2,225(2)	_
Total	1,718	-	4,582	350

<sup>&</sup>lt;sup>(1)</sup>Includes remuneration and bonuses until the termination date, compensation and termination indemnities.

In addition to the amounts presented above, during the 12 months ended 31 December 2011 no cost was recognised in respect of TP S.A.'s incentive programme as the vesting period of the programme ended in 2010. During the 12 months ended 31 December 2010, the estimated cost of share-based payments under TP S.A.'s incentive programme allocated to the Company's Management Board amounted to PLN 0.6 million.

<sup>(2)</sup> Termination benefit accrued in 2009 and paid in 2010.

#### 32. Related party transactions (continued)

#### 32.1. Management Board and Supervisory Board compensation (continued)

In the years ended 31 December 2011 and 2010, the members of TP S.A.'s Management Board did not receive any remuneration, bonuses, compensation or termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) from the Group's subsidiaries, associates or joint ventures.

Supervisory Board compensation was as follows:

(in PLN thousands)	12 months ended 31 December 2011	12 months ended 31 December 2010
Prof. Andrzej Koźmiński	350	333
Benoit Scheen <sup>(2)</sup>	-	-
Nathalie Clere (2)	-	-
Timothy Boatman	262	250
Thierry Bonhomme <sup>(2)</sup>	-	_
Jacques Champeaux	175	167
Dr. Mirosław Gronicki	175	167
Marie-Christine Lambert (2)	-	-
Pierre Louette <sup>(2)</sup>	-	-
Prof. Jerzy Rajski	175	167
Gerard Ries <sup>(2)</sup>	-	_
Dr. Wiesław Rozłucki	175	167
Antonio Anguita <sup>(1)(2)</sup>	-	_
Vivek Badrinath <sup>(1)(2)</sup>	-	_
Olivier Barberot <sup>(1)(2)</sup>	-	-
Olivier Faure (1)(2)	-	-
Ronald Freeman <sup>(1)</sup>	262	250
Raoul Roverato(1)(2)	-	-
Olaf Swantee(1)(2)	-	-
Total	1,574	1,501

<sup>(1)</sup> Persons that were not members of the Supervisory Board of the Company as at 31 December 2011 but were members of the Supervisory Board of TP S.A. in 2011 or previous periods.

In the years ended 31 December 2011 and 2010, the members of TP S.A.'s Supervisory Board did not receive any remuneration, bonuses, compensation or termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) from the Group's subsidiaries, associates or joint ventures.

In the years ended 31 December 2011 and 2010, the Group did not enter into any significant transactions with members of the TP S.A.'s Management Board or the Supervisory Board or their spouses, relatives up to second degree, individuals who are guardians or wards of the above persons or other persons with whom they have personal connections and did not grant them any loans, advances or guarantees.

In the years ended 31 December 2011 and 2010, the Group did not enter into any significant transactions with companies which were controlled or jointly controlled by the members of the TP S.A.'s Management Board or the Supervisory Board or their spouses, relatives up to second degree, individuals who are guardians or wards of the above persons or other persons with whom they have personal connections.

<sup>(2)</sup> Persons appointed to the Supervisory Board of the Company employed by France Telecom S.A. do not receive remuneration for the function performed.

## 32.2. Related party transactions

As at 31 December 2010, France Telecom S.A. owned 49.79% of shares of the Company and held 49.79% of votes at the General Shareholders' Meeting. As a result of the purchase of the Company's own shares for the purpose of their redemption (see Note 29.3), the percentage of votes held increased to 50.21% as at 31 December 2011. France Telecom S.A. has the power to appoint the majority of TP S.A.'s Supervisory Board members. The Supervisory Board appoints and dismisses members of the Management Board.

The Group's income earned from related parties comprises mainly research and development services, interconnect and data transmission. The purchases from the France Telecom Group mainly comprise costs of interconnect and leased lines, network services, IT services, consulting services and brand fees.

The Group's income earned and purchases from entities accounted for using the equity method comprise mainly transactions with NetWorkS! (see Note 4).

(in PLN thousands)	12 months ended 31 December 2011	12 months ended 31 December 2010
Sales of goods and services to:	216	197
TP Group's entities accounted for using the equity method	17	_
France Telecom S.A. (parent)	147	139
France Telecom (group)	52	58
Purchases of goods (including inventories, tangible and intangible assets) and services from:	375	323
TP Group's entities accounted for using the equity method	34	
France Telecom S.A. (parent)	117	121
France Telecom (group)	224	202
- including Orange Brand Services Limited (brand licence agreement)	125	120
Dividends paid:	997	997
France Telecom S.A. (parent)	997	997

In April 2005, PTK-Centertel and Orange Brand Services Limited (UK) (hereinafter referred to as "Orange") concluded a licence agreement under which PTK-Centertel acquired rights to operate under the Orange brand. The brand licence agreement provides that Orange receives a fee of 1.6% of operating revenue for full use of the Orange brand as well as access to the Orange roaming and interconnection arrangements, technology, advanced mobile handsets and consultancy services. The agreement was concluded for 10 years with the possibility of renewal.

On 24 July 2008, TP S.A., France Telecom S.A. and Orange concluded a licence agreement under which TP S.A. will acquire rights to operate under the Orange brand. The brand licence agreement provides that Orange will be receiving a fee of 1.6% of the Company's operating revenue earned under the Orange brand. The agreement was concluded for 10 years with the possibility of renewal.

(in PLN millions)	At 31 December 2011	At 31 December 2010
Receivables from:	143	96
TP Group's entities accounted for using the equity method	10	_
France Telecom S.A. (parent)	108	66
France Telecom (group)	25	30
Payables to:	236	189
TP Group's entities accounted for using the equity method	9	_
France Telecom S.A. (parent)	147	102
France Telecom (group)	80	87

# 33. Subsequent events

On 12 January 2012, the Management Board of TP S.A. signed a settlement agreement that concluded the dispute with DPTG (see Note 31.e).

On 27 January 2012, the Group concluded a share sale agreement with Comp S.A. under which the 100% shareholding in PayTel S.A. was disposed of for a total consideration amounting to PLN 6 million.

# Auditor's opinion

#### To the Shareholders and Supervisory Board of Telekomunikacia Polska S.A.

We have audited the attached consolidated financial statements¹ of the Telekomunikacja Polska Group ("the Group") with Telekomunikacja Polska S.A., with its registered office in Warsaw at Twarda 18 St., as the Parent Company ("TP S.A.", "the Company"), which comprise consolidated balance sheet prepared as of 31 December 2011, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows for the financial year from 1 January 2011 to 31 December 2011 and notes comprising a summary of significant accounting policies and other explanatory information.

Preparation of consolidated financial statements and a report on the activities of the Group in line with the law is the responsibility of the Management Board of the Parent Company.

The Management Board of the Parent Company and members of its Supervisory Board are obliged to ensure that the consolidated financial statements and the report on the activities of the Group meet the requirements of the Accounting Act of 29 September 1994 (Journal of Laws of 2009, No. 152, item 1223, as amended), hereinafter referred to as the "Accounting Act".

Our responsibility was to audit and express an opinion on compliance of the consolidated financial statements with the accounting principles (policy) adopted by the Group, express an opinion whether the financial statements present fairly and clearly, in all material respects, the financial and economic position as well as the financial result of the Group.

Our audit of the financial statements has been planned and performed in accordance with:

- section 7 of the Accounting Act,
- national auditing standards, issued by the National Council of Statutory Auditors in Poland and
- International Standards on Auditing.

We have planned and performed our audit of the consolidated financial statements in such a way as to obtain reasonable assurance to express an opinion on the financial statements. Our audit included, in particular, verification of the correctness of the accounting principles (policy) applied by the Parent Company and the subsidiaries, verification – largely on a test basis – of the basis for the amounts and disclosures in the consolidated financial statements, as well as overall evaluation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the audited consolidated financial statements in all material respects:

- present fairly and clearly the information material to evaluate the economic and financial position of the Group as of 31 December 2011 as well as its profit
  in the financial year ended 31 December 2011,
- have been prepared in accordance with the International Accounting Standards, International Financial Reporting Standards and related interpretations
  published as European Commission regulations, and in all matters not regulated in the standards in accordance with the provisions of the Accounting
  Act and secondary legislation to the Act,
- comply with the provisions of law applicable to the Group which affect the contents of the consolidated financial statements.

The Report on the activities of the Group<sup>2</sup> for the 2011 financial year is complete within the meaning of Article 49.2 of the Accounting Act and the Decree of the Minister of Finance of 19 February 2009 on current and periodic information to be disclosed by issuers of securities and consistent with underlying information disclosed in the audited consolidated financial statements.

Krzysztof Sowada Key Certified Auditor conducting the audit No. 10944	
represented by	entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors

Warsaw, 13 February 2012

The above audit opinion together with audit report is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

<sup>1</sup> as presented on pages 46-103

 $<sup>^{\</sup>rm 2}$  as included in the filed financial statements for Warsaw Stock Exchange

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