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POLISH FINANCIAL SUPERVISION AUTHORITY

Annual report R for the year 2011

(year)

(according to par. 82 s. 1 pkt 3 of the Decree of Minister of Finance dated 19 February 2009 - Journal of Laws No. 33, item 259)
for the issuers in sectors of production, construction, trade or services

for the **year 2011**, i.e. from **1 January 2011 to 31 December 2011**

including, separate financial statements prepared under: **International Financial Reporting Standards**
in currency: **PLN**

date of issuance: **14 February 2012**

TELEKOMUNIKACJA POLSKA SA
(full name of issuer)

TPSA (abbreviated name of the issuer)

Telecommunication (tel) (classification according to WSE / sector)

00-105 (post code)

Warsaw (location)

Twarda (street)

18 (number)

22 527 23 23 (telephone)

22 527 23 41 (fax)

investor.relations@telekomunikacja.pl (e-mail)

telekomunikacja.pl (www)

526-02-50-995 (NIP)

012100784 (REGON)

Deloitte Audyt Sp. z o.o.
(auditor)

SELECTED FINANCIAL DATA	PLN '000		EUR '000	
	year / 2011	year / 2010	year / 2011	year / 2010
I. Revenue	7 840 000	8 434 000	1 893 674	2 106 183
II. Operating income/(loss)	995 000	(258 000)	240 332	(64 429)
III. Profit before income tax	1 604 000	1 147 000	387 430	286 435
IV. Net income	1 951 000	1 023 000	471 245	255 469
V. Earnings per share (in PLN/EUR) (basic and diluted)	1.46	0.77	0.35	0.19
VI. Weighted average number of shares (in millions) (basic and diluted)	1 334	1 336	1 334	1 336
VII. Total comprehensive income	1 942 000	1 003 000	469 071	250 474
VIII. Net cash provided by operating activities	3 329 000	4 380 000	804 087	1 093 797
IX. Net cash used in investing activities	(85 000)	(1 075 000)	(20 531)	(268 455)
X. Net cash used in financing activities	(2 925 000)	(3 033 000)	(706 505)	(757 417)
XI. Total net change in cash and cash equivalents	316 000	272 000	76 327	67 925
	Balance as at 31/12/2011	**Balance as at 31/12/2010**	**Balance as at 31/12/2011**	**Balance as at 31/12/2010**
XII. Total current assets	4 146 000	3 658 000	938 689	923 667
XIII. Total non-current assets	24 331 000	24 959 000	5 508 739	6 302 300
XIV. Total assets	28 477 000	28 617 000	6 447 428	7 225 967
XV. Total current liabilities	8 266 000	7 420 000	1 871 491	1 873 595
XVI. Total non-current liabilities	7 572 000	8 297 000	1 714 363	2 095 043
XVII. Total equity	12 639 000	12 900 000	2 861 574	3 257 329
XVIII. Share capital	4 007 000	4 007 000	907 218	1 011 792

The balance sheet data as at 31 December 2011 and 2010 presented in the table "Selected financial data" was translated into Euro at the average exchange rate of the National Bank of Poland on the balance sheet dates. The income statement data, together with the statement of comprehensive income and statement of cash flows data for the years ended 31 December 2011 and 2010, were translated into Euro at an exchange rate which is the arithmetical average of the average NBP rates published by the NBP on the last day of each month of years ended 31 December 2011 and 2010.

The exchange rates used in translation of balance sheet, income statement, statement of comprehensive income and cash flow data are presented below:

1 Euro	31 December 2011	31 December 2010
Balance Sheet	4.4168 PLN	3.9603 PLN
Income statement, Comprehensive income, Cash Flow data	4.1401 PLN	4.0044 PLN

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.

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 and faster.

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 zloty 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.

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 not just my senior management team but also 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 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.

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
Telekomunikacja Polska

AUDITOR'S OPINION

To the Shareholders and Supervisory Board of Telekomunikacja Polska S.A.

We have audited the attached financial statements of Telekomunikacja Polska S.A. with its registered office in Warsaw at Twarda 18 St. ("TP S.A.", "the Company"), which comprise balance sheet prepared as of 31 December 2011, income statement, statement of comprehensive income, statement of changes in equity, 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 financial statements and a report on the activities in line with the law is the responsibility of the Management Board of the Company.

The Management Board of the Company and members of its Supervisory Board are obliged to ensure that the financial statements and the report on the activities 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 financial statements with the accounting principles (policy) adopted by the Company, 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 Company and an opinion on the correctness of the underlying accounting records.

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 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) and material estimates applied by the Company, verification – largely on a test basis – of the accounting evidence and records supporting the amounts and disclosures in the financial statements, as well as overall evaluation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the audited financial statements in all material respects:

- present fairly and clearly the information material to evaluate the economic and financial position of the Company 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 Commission regulations, and in all matters not regulated in the standards – in accordance with the provisions of the Accounting Act, secondary legislation to the Act and based on properly kept accounting records,
- comply with the provisions of law and the articles of association of the Company which affect the contents of the financial statements.

The Report on the activities of the Company for the financial year 2011 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 published by issuers of securities and consistent with underlying information disclosed in the audited 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.

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS OF TELEKOMUNIKACJA POLSKA S.A. FOR THE 2011 FINANCIAL YEAR

I. GENERAL INFORMATION

1. Details of the audited Company

The Company operates under the business name Telekomunikacja Polska S.A. The Company's registered office is located in Warsaw at Twarda 18 St.

The Company operates as a joint stock company established by the notary deed of 4 December 1991 in front of Katarzyna Szachułowicz-Barańska, Notary Public in Warsaw (Repertory A No. 6480/91). The Company was entered in the Commercial Register kept by the District Court in Warsaw, XVI Business-Registry Division in Warsaw, section B, under the number RHB 29979, based on the decision of 13th December 1991. Currently, the Company is recorded in the Register of Entrepreneurs kept by the District Court in Warsaw, XII Business-Registry Division in Warsaw, under KRS No. 0000010681.

The Company has the tax identification number NIP: 526-02-50-995 assigned by Second Tax Office Warszawa – Śródmieście on 4 June 1993.

The REGON number assigned by the Statistical Office is: 012100784.

The Company operates based on the provisions of the Code of Commercial Companies.

In accordance with the Company's Articles of Association, the scope of its activity includes:

- production equipment (tele)communications [PKD 26.30.Z],
- construction of electricity and telecommunications [PKD 42.22.Z],
- electrical installation [PKD 43.21.Z],
- other retail sale performed in unspecialized shops [PKD 47.19.Z],
- retail sale of computers, peripherals and software in specialized stores [PKD 47.41.Z],
- retail sale of telecommunications equipment in specialized stores [PKD 47.42.Z],
- retail sale of audio-video equipment in specialized stores [PKD 47.43.Z],
- retail sale made by selling homes or internet [PKD 47.91.Z],
- other retail sale except stores, stalls or markets [PKD 47.99.Z],
- publishing of books [PKD 58.11.Z],
- issuing and mailing lists (such as address, telephone) [PKD 58.12.Z],
- other publishing [PKD 58.19.Z],
- production activities like movies, videos and television programs [PKD 59.11.Z],
- post-production activities Motion picture, video and television program [PKD 59.12.Z],
- distribution activities like movies, videos and television programs [PKD 59.13.Z],
- operation of sound recording and music [PKD 59.20.Z],
- television programming and broadcasting [PKD 60.20.Z],
- telecommunications activities wired [PKD 61.10.Z],
- the activities in the field of wireless telecommunications, with the exception of satellite telecommunications [PKD 61.20.Z],
- activities in the field of satellite telecommunications [PKD 61.30.Z],
- activity in the rest of telecommunications [PKD 61.90.Z],

- activities with the software [PKD 62.01.Z],
- activities of the consultancy [PKD 62.02.Z],
- activities related to facilities management [PKD 62.03.Z],
- other service activities in the field of information technology and computer [PKD 62.09.Z],
- processing data management web (hosting) and related activities [PKD 63.11.Z],
- the activities of insurance agents and brokers [PKD 66.22.Z],
- the activities of accounting, tax advice [PKD 69.20.Z],
- other advice on business and management [PKD 70.22.Z],
- activities in the field of architecture [PKD 71.11.Z],
- engineering activities and related technical consultancy [PKD 71.12.Z],
- research and experimental development on other natural sciences and engineering [PKD 72.19.Z],
- intermediation in the sale of time and place for the purpose of advertising on radio and television [PKD 73.12.A],
- mediation in the sale of space for advertising purposes in the electronic media (Internet) [PKD 73.12.C],
- market research and public opinion [PKD 73.20.Z],
- other professional, scientific and technical activities not elsewhere classified [PKD 74.90.Z],
- renting and leasing of other machinery, equipment and tangible goods not elsewhere classified [PKD 77.39.Z],
- the activities of security activities in the handling of safety systems [PKD 80.20.Z].

In the audited period the Company conducted mainly the following business activities:
- telecommunications services including voice telephony, data transmission, tele-info, visual, multimedia and related services provided on fixed line and mobile, land and satellite networks,
- investing, service and trade activities related to telecommunications services and infrastructure,
- research and development activities in the field of telecommunications.

As of 31 December 2011, the Company's share capital amounted to PLN 4,007 million and was divided into 1,336 million ordinary shares with a face value of PLN 3 each. The ownership structure of the share capital as at 31 December 2011 was as follows:

	% of votes	*Nominal value (in PLN millions)*
France Telecom S.A.	50.21	1,995
Capital Group International, Inc.[1]	5.10	203
Other shareholders	44.69	1,775
Telekomunikacja Polska S.A. (treasury shares)	-	34
Total	**100.00**	**4,007**

During the financial year no changes in the Company's share capital value took place.

In the year ended 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.

Apart from described above, the Company has no information regarding valid agreements or other events that may result in changes in the proportions of shares held by the shareholders.

[1] The number of shares according to the notification by Capital Group International, Inc. on 15 October 2010.

After the balance-sheet date there were no changes in the Company's share capital.

As of 31 December 2011, the Company's equity amounted to PLN 12,639 million.

The Company's financial year is the calendar year.

Telekomunikacja Polska S.A. presented investments in subsidiaries and related party transactions respectively in the Note 29 to the financial statements.

As at the opinion's date, the composition of the Company's Management Board was as follows:
- Maciej Witucki – President of the Management Board,
- 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.

From 1 January 2011 until the opinion date the following changes took place in the composition of Management Board:
- on 14 January 2011 Roland Dubois resigned from the position of Management Board Member of TP S.A.,
- on 27 January 2011 Supervisory Board of TP S.A. appointed two new board members: Jacques De Galzain and Jacek Kowalski. On the same date Supervisory Board accepted Roland Dubois resignation as a board member of TP S.A. and reappointed for another period Piotr Muszyński.

The above changes were filed in the proper court register on 3 February 2011.

2. Information about the financial statements for the prior financial year

The activities of the Company in 2010 resulted in a net profit of PLN 1,023 million. The financial statements of the Company for 2010 were audited by a certified auditor. The audit was performed by authorized entity Deloitte Audyt Sp. z o.o. On 22 February 2011 the certified auditor issued an unqualified opinion on those financial statements with an emphasis of matter paragraph, stating as follows:

"As more fully explained in explanatory note 29 to the attached financial statements, the Company is involved in a number of legal, arbitration and administrative proceedings. Any costs that may result from these proceedings are provided for when they become probable and when the amount may be reliably quantified. The amount of any provision is based on an assessment of the risk level in each case and represents the Company's best estimate of the amounts that are more likely than not to be payable. Occurrence of events during the proceedings, the outcome of which is uncertain, may lead to re-assessment of the risk and as a consequence the amount of the provisions may change."

The General Shareholders' Meeting which approved the financial statements for the 2010 financial year was held on 14 April 2011. The General Shareholders' Meeting decided on the following distribution of the net profit for 2010:

- Dividends to shareholders – PLN 1,003 million,
- Reserve capital – PLN 20 million.

In accordance with applicable laws, the financial statements for the 2010 financial year were submitted to the National Court Register (KRS) on 20 April 2011 and filed for publication in Monitor Polski B on 27 April 2011. The financial statements were published in Monitor Polski B No. 1193 on 18 July 2011.

3. Details of the authorized entity and the Key Certified Auditor acting on its behalf

The audit of the financial statements was performed based on the agreement of 9 September 2011 concluded between Telekomunikacja Polska S.A. and Deloitte Audyt Sp. z o.o. with its registered office in Warsaw, al. Jana Pawła II 19, recorded under number 73 on the list of entities authorized to provide audit services kept by the National Council of Statutory Auditors. On behalf of the authorized entity, the audit of the financial statements was conducted under the supervision of Krzysztof Sowada, Key Certified Auditor (No. 10944), from 9 September 2011 to 13 February 2012.

The entity authorized to audit the financial statements was appointed by the resolution of the Supervisory Board of 12 July 2011 based on authorization included in Article 23 p. 2.8 of the Company's Articles of Association.

Deloitte Audyt Sp. z o.o. and Krzysztof Sowada, Key Certified Auditor, confirm that they are authorized to carry out audits and meet the requirements of Article 56 of the Act on statutory auditors and their self-governing body, auditing firms and on public oversight (Journal of Laws of 2009, No. 77, item 649) to express an unbiased and independent opinion on the financial statements of Telekomunikacja Polska S.A.

4. Availability of data and management's representations

The scope of our audit was not limited.

During the audit, all necessary documents and data as well as detailed information and explanations, were provided to the authorized entity and the Key Certified Auditor, as confirmed e.g. in the written representation of the Management Board of 13 February 2012.

II. ECONOMIC AND FINANCIAL POSITION OF THE COMPANY

Presented below are the main items from the income statement as well as financial ratios describing the financial result of the Company and its financial position as compared to the same items in the previous years.

Main items from the income statement (in million PLN)	2011	2010	2009[2]
Revenue	7,840	8,434	9,291
Operating expenses, net	(6,845)	(8,692)	(8,142)
Result from financial activity	609	1,405	2,325
Income tax	347	(124)	(117)
Net profit	1,951	1,023	3,357

Profitability ratios	2011	2010	2009
– gross profit margin Operating income *100% / Revenue	13%	(3%)	12%
– net profit margin Net income *100% / Revenue	25%	12%	36%
– net return on equity Net income *100% / Total equity	15%	8%	24%
Effectiveness ratios			
– assets turnover ratio Revenue / Total assets	0.28	0.29	0.32
– trade receivables turnover in days (Trade receivables, net year end + Trade receivables, net opening balance)/2*365 / Revenue	40	34	32
– trade liabilities turnover in days (Short term trade payables year end + Short term trade payables opening balance)/2*365 / (External purchases + Other operating expense)	165	159	146

[2] After changes in the accounting policies described in note 3.4 to the financial statement for the year ended 31 December 2010.

Liquidity/Net working capital	2011	2010	2009
– debt ratio	56%	55%	52%
(Total current and non-current liabilities) *100% / Total assets			
– equity to assets ratio	44%	45%	48%
Total equity *100% / Total assets			
– net working capital	(4,120)	(3,762)	(1,911)
Current assets - Current liabilities			
– current ratio	0.50	0.49	0.63
Current assets / Current liabilities			
– quick ratio	0.50	0.49	0.63
(Current assets - Inventories, net) / Current liabilities			

The analysis of the above figures and ratios indicated the following trends occurring in the year 2011 in comparison to the year 2010 and 2009:

- increase of gross profit margin ratio,
- increase of trade liabilities and receivables turnover,
- decrease of net working capital,
- increase of liquidity ratios limited in comparison to 2010 only.

III. DETAILED INFORMATION

1. Evaluation of the accounting system

The Company has valid documentation describing the accounting principles (policy) applied, including in particular: definition of the financial year and reporting periods thereof, methods of measuring assets and liabilities and determining the financial result, method of keeping the accounting records and the system of data and file protection. The documentation of the accounting policy was developed in line with the Accounting Act and in respect to the measurement of assets and liabilities plus equity as well as evaluation of presentation of the financial statements – in line with IFRS in the form adopted by the European Union. According to the resolution of Shareholders from 18 June 2005 starting from 1 January 2006 the Company is obliged to prepare its financial statement in line with International Financial Reporting Standards. Recent accounting policy was approved for use starting from 1 January 2011 based on the resolution of the Management Board No. 15 dated 1 February 2011. Principal methods of measuring assets, liabilities and the financial result were presented in the explanatory notes.

Accounting principles selected at the Company's discretion pursuant to IFRS have been selected in a manner that correctly reflects specifics of its business operations, its financial standing and performance. The accounting principles have been applied in a continuous manner and unchanged compared to those applied to the accounting records and financial statements in the preceding financial year.

The Company's accounts are kept using the Oracle computer system in the Company's Shared Service Centre in Lublin. The Oracle system is password-protected against unauthorized access and has functional access controls. The description of the information system complies with the requirements of Article 10 clause 1 point 3 letter c) of the Accounting Act.

The opening balance resulting from the approved financial statements for the prior financial year has been properly introduced into the accounting records of the audited period.

In the audited documentation of business transactions, accounting records and the relationships between accounting entries, financial documents and financial statements complied with the requirements of section 2 of the Accounting Act.

The accounting records and evidence, the documentation of the accounting system and the approved financial statements of the Company are stored in compliance with section 8 of the Accounting Act.

The Company performed a physical count of assets and liabilities within the scope, timing and frequency required by the Accounting Act. Identified differences have been recorded and settled in the accounting records for the audited period.

2. Information about the audited financial statements

The audited financial statements were prepared as of 31 December 2011 and include:

- balance sheet prepared as of 31 December 2011, with total assets and liabilities plus equity of PLN 28,477 million,
- income statement for the period from 1 January 2011 to 31 December 2011, with a net profit of PLN 1,951 million,
- statement of comprehensive income for the period from 1 January 2011 to 31 December 2011, with a total comprehensive income of PLN 1,942 million,
- statement of changes in equity for the period from 1 January 2011 to 31 December 2011, disclosing a decrease in equity of PLN 261 million,
- statement of cash flows for the period from 1 January 2011 to 31 December 2011, showing a cash inflow of PLN 319 million,
- notes, comprising a summary of significant accounting policies and other explanatory information.

The structure of assets and liabilities plus equity as well as items affecting the profit or loss has been presented in the financial statements.

3. Information about selected material items of the financial statements

<u>Property, plant and equipment</u>

Explanatory notes correctly describe changes in fixed assets, including disclosure of any impairment on such assets.

<u>Investments in subsidiaries</u>

Explanatory notes correctly describe changes in investments during the financial year.

<u>Loans and receivables excluding trade receivables</u>

The account contains mainly bonds bought from TP S.A. subsidiary TP Invest Sp. z o.o. The transaction was properly described in the financial statements.

<u>Structure of receivables</u>

The ageing analysis of trade receivables was correctly presented in the respective explanatory note. The audited sample did not include expired or redeemed receivables.

<u>Liabilities</u>

Key items of the Company's liabilities include:
- financial liabilities at amortised cost (without trade liabilities) in the amount of PLN 9,517 million,
- trade liabilities in the amount of PLN 2,184 million.

The nature of contracted loans and a description of how they are secured have been presented in explanatory notes. The audited sample did not include expired or redeemed liabilities.

<u>Provisions for liabilities</u>

The structure of the above items is correctly described in the respective explanatory notes.
Provisions for liabilities were determined at reliably estimated amounts.
The items are recognised completely and correctly in all material respects in relation to the financial statements as a whole.

4. Completeness and correctness of drawing up notes and explanations and the report on the activities of the Company

The Company prepared the financial statement based on going concern principle. The explanatory notes give a correct and complete description of valuation principles regarding assets, equity and liabilities, principles of measurement of the financial result and preparation of the financial statements.

The explanatory notes fully describe the reporting items and present the remaining data required by the IFRS in a clear manner.

The financial statements have been supplemented with the Management Board's report on the activities of the Company in the 2011 financial year. The report contains all information required under Article 49.2 of the Accounting Act and regulation of the Decree of the Minister of Finance of 19 February 2009 on current and periodic information to be disclosed by issuers of securities. We have audited the report with respect to the disclosed information derived directly from the audited financial statements.

IV. CLOSING COMMENTS

<u>Management Board's Representation</u>

Deloitte Audyt Sp. z o.o. and the Key Certified Auditor received a representation letter from the Company's Management Board, in which the Board stated that the Company complied with the laws in force.

....
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

TELEKOMUNIKACJA POLSKA S.A.

IFRS SEPARATE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011

Contents

INCOME STATEMENT

(in PLN millions, except for earnings per share)

	Note	12 months ended 31 December 2011 (audited)	12 months ended 31 December 2010 (audited)
Revenue	**4**	**7,840**	**8,434**
External purchases	5	(3,786)	(3,453)
Labour expenses	5	(1,334)	(1,571)
Other operating expense	5	(943)	(531)
Other operating income	5	468	284
Restructuring costs	24	(152)	(15)
Gains on disposal of assets	6	26	65
Gain on disposal of TP Emitel	6	1,251	-
Dispute with DPTG	28.e	(35)	(1,061)
Depreciation and amortisation	11,12	(2,324)	(2,399)
Impairment of non-current assets	7	(16)	(11)
Operating income/(loss)		**995**	**(258)**
Dividend income	8	962	1,906
Interest income	8	389	403
Interest expense and other financial charges	8	(818)	(857)
Foreign exchange gains/(losses)	8	104	(18)
Discounting expense	8	(28)	(29)
Finance income, net		**609**	**1,405**
Income tax	9	347	(124)
Net income		**1,951**	**1,023**
Earnings per share (in PLN) (basic and diluted)	**3.4**	**1.46**	**0.77**
Weighted average number of shares (in millions) (basic and diluted)	3.4	1,334	1,336

STATEMENT OF COMPREHENSIVE INCOME

(in PLN millions)

	Note	12 months ended 31 December 2011 (audited)	12 months ended 31 December 2010 (audited)
Net income		**1,951**	**1,023**
Gains/(losses) on cash flow hedges	10	9	(9)
Actuarial losses on post-employment benefits	10	(20)	(16)
Income tax relating to components of other comprehensive income	10	2	5
Other comprehensive loss, net of tax		**(9)**	**(20)**
Total comprehensive income		**1,942**	**1,003**

BALANCE SHEET

(in PLN millions)

	Note	At 31 December 2011 (audited)	At 31 December 2010 (audited)
ASSETS			
Intangible assets	11	1,396	1,247
Property, plant and equipment	12	12,100	12,657
Investments in subsidiaries	13	7,228	7,636
Financial assets available for sale	13	4	4
Loans and receivables excluding trade receivables	13	2,845	3,147
Financial assets at fair value through profit or loss	13	148	57
Hedging derivatives	18	129	45
Deferred tax assets	9	481	166
Total non-current assets		**24,331**	**24,959**
Inventories		54	41
Trade receivables	14	852	857
Loans and receivables excluding trade receivables	13	328	304
Financial assets at fair value through profit or loss	13	225	20
Income tax assets		-	6
Other assets	14	88	126
Prepaid expenses	14	15	36
Cash and cash equivalents	15	2,584	2,268
Total current assets		**4,146**	**3,658**
TOTAL ASSETS		**28,477**	**28,617**
EQUITY AND LIABILITIES			
Share capital	26	4,007	4,007
Share premium		832	832
Treasury shares	26	(200)	-
Other reserves	10,23	6	15
Retained earnings		7,994	8,046
Total equity		**12,639**	**12,900**
Financial liabilities at amortised cost excluding trade payables	16,17	6,951	7,556
Financial liabilities at fair value through profit or loss	18	53	90
Hedging derivatives	18	65	191
Employee benefits	22	241	269
Provisions	24	201	127
Other liabilities	25	15	-
Deferred income	25	46	64
Total non-current liabilities		**7,572**	**8,297**
Financial liabilities at amortised cost excluding trade payables	16,17	2,566	2,580
Financial liabilities at fair value through profit or loss	18	-	55
Hedging derivatives	18	-	54
Trade payables	25	2,184	2,100
Employee benefits	22	158	167
Provisions	24	3,039	2,176
Income tax payable		13	39
Other liabilities	25	204	180
Deferred income	25	102	69
Total current liabilities		**8,266**	**7,420**
TOTAL EQUITY AND LIABILITIES		**28,477**	**28,617**

STATEMENT OF CHANGES IN EQUITY

(in PLN millions)

	Number of shares in issue (not in millions)	Share capital	Share premium	Treasury shares	Other reserves				Retained earnings	Total
					Hedging instruments	Actuarial losses on post-employment benefits	Deferred tax	Share-based payments		
Balance at 1 January 2010 *(audited)*	**1 335 649 021**	**4,007**	**832**	**-**	**11**	**(51)**	**7**	**64**	**9,026**	**13,896**
Total comprehensive income for the 12 months ended 31 December 2010		-	-	-	(9)	(16)	5	-	1,023	1,003
Share-based payments		-	-	-	-	-	-	4	-	4
Dividends		-	-	-	-	-	-	-	(2,003)	(2,003)
Balance at 31 December 2010 *(audited)*	**1 335 649 021**	**4,007**	**832**	**-**	**2**	**(67)**	**12**	**68**	**8,046**	**12,900**
Balance at 1 January 2011 *(audited)*	**1 335 649 021**	**4,007**	**832**	**-**	**2**	**(67)**	**12**	**68**	**8,046**	**12,900**
Total comprehensive income for the 12 months ended 31 December 2011		-	-	-	9	(20)	2	-	1,951	1,942
Purchase of treasury shares	(11 313 409)	-	-	(200)	-	-	-	-	-	(200)
Dividends		-	-	-	-	-	-	-	(2,003)	(2,003)
Balance at 31 December 2011 *(audited)*	**1 324 335 612**	**4,007**	**832**	**(200)**	**11**	**(87)**	**14**	**68**	**7,994**	**12,639**

STATEMENT OF CASH FLOWS

(in PLN millions)

	Note	*12 months ended* 31 December 2011 (audited)	31 December 2010 (audited)
OPERATING ACTIVITIES			
Net income		1,951	1,023
Adjustments to reconcile net income to funds generated from operations			
Depreciation and amortisation	11,12	2,324	2,399
Impairment of non-current assets	7	16	11
Gains on disposal of assets	6	(1,277)	(65)
Change in provisions		492	938
Income tax	9	(347)	124
Finance income, net, excluding realised exchange rate effect on cash and cash equivalents		(631)	(1,396)
Operational foreign exchange and derivatives (gains)/losses, net		52	(5)
Share-based payments		-	4
Change in working capital (trade)			
Decrease/(increase) in inventories		(13)	1
Decrease/(increase) in trade receivables		40	(134)
Increase/(decrease) in trade payables		2	176
Change in working capital (non-trade)			
Decrease/(increase) in prepaid expenses and other receivables		65	(45)
Increase/(decrease) in accrued expenses, other payables and deferred income		9	21
Dividends received		962	1,906
Interest received		96	82
Interest and interest rates effect on derivatives paid, net		(522)	(572)
Exchange rate effect on derivatives, net		68	(48)
Income tax received/(paid)		42	(40)
Net cash provided by operating activities		**3,329**	**4,380**
INVESTING ACTIVITIES			
Purchases of property, plant and equipment and intangible assets	11,12	(1,939)	(1,892)
Increase/(decrease) in amounts due to fixed assets suppliers		48	558
Decrease in receivables related to leased fixed assets		8	10
Exchange rate effect on derivatives economically hedging capital expenditures, net		4	1
Proceeds from sale of property, plant and equipment and intangible assets		37	89
Cash paid for investments in subsidiaries		(9)	-
Proceeds from sale of investments in subsidiaries	13	1,725	192
Decrease in marketable securities and other financial assets	13	(2)	(1)
Exchange rate effect on other derivatives, net		43	(32)
Net cash used in investing activities		**(85)**	**(1,075)**
FINANCING ACTIVITIES			
Redemption of bonds	16,17	(1,189)	-
Repayment of long-term debt	16,17	(233)	(230)
Increase/(decrease) in bank overdrafts and other short-term borrowings	16,17	717	(750)
Purchase of treasury shares	26	(200)	-
Dividends paid	26	(2,003)	(2,003)
Exchange rate effect on derivatives, net		(17)	(50)
Net cash used in financing activities		**(2,925)**	**(3,033)**
Net change in cash and cash equivalents		319	272
Effect of changes in exchange rates and other impacts on cash and cash equivalents		(3)	-
Cash and cash equivalents at the beginning of the period		2,268	1,996
Cash and cash equivalents at the end of the period		**2,584**	**2,268**

1. Corporate information

1.1. Telekomunikacja Polska S.A.

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 Company 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"). In addition, the Company provides leased lines and other telecommunications value added services, sells telecommunications equipment, provides data transmission, multimedia services and various Internet services. 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").

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

The Company'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. is deemed to be a SMP on certain markets.

1.2. The Management Board and the Supervisory Board of the Company

The Management Board of the Company at the date of the authorisation of these Separate 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 Separate 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 Separate 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 Separate 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 Separate 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 Separate 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 Separate Financial Statements have been prepared on the going concern basis.

Telekomunikacja Polska S.A. is the parent company of the Telekomunikacja Polska Group ("the Group", "TP Group") and prepares consolidated financial statements for the year ended 31 December 2011.

These Separate 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 Company has opted for earlier application,
- accounting positions adopted by the Company in accordance with paragraphs 10 to 12 of IAS 8 (Use of judgements).

Use of estimates

In preparing the Company'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*
3.5.9, 7	Impairment of cash generating units and individual tangible and intangible assets	Key assumptions used to determine recoverable amounts: impairment indicators, models, discount rates, growth rates.
3.5.10, 13.2	Impairment of loans and receivables	Methodology used to determine recoverable amounts.
3.5.12, 9	Income tax	Assumptions used for recognition of deferred tax assets.
3.5.14, 22	Employee benefits	Discount rates, salary increases, expected average remaining working lives.
3.5.10, 18, 21	Fair value of derivatives and other financial instruments	Model and assumptions underlying the measurement of fair values.
3.5.13, 24, 28	Provisions	Provisions for termination benefits and restructurings: discount rates and other assumptions. The assumptions underlying the measurement of provisions for claims and litigation.
3.5.6, 3.5.7	Useful lives of tangible and intangible assets	The useful lives and the amortisation method.
24	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.
3.5.2, 4	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 Company's involvement acting as principal versus agent).
3.5.11	Allowance for slow moving and obsolete	Methodology used to determine net realisable value of inventories.

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 Company'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 Separate 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 1 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 Company 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 Company 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 Company 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 3.5.2 *Separable components of packaged and bundled offers*).

3.3. Options available under IFRSs and used by the Company

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

Standards		*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	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.
IAS 27	Consolidated and separate financial statements	Investments in subsidiaries and associates are accounted at cost.
IAS 38	Intangible assets	Intangible assets are measured at cost less any accumulated depreciation and any accumulated impairment losses.

3.4. Presentation of the financial statements

<u>Presentation of the balance sheet</u>

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

<u>Presentation of the income statement</u>

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

<u>Earnings per share</u>

The net income per share for each period is calculated by dividing the net income for the period 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 23).

3.5. Significant accounting policies

3.5.1. Effect of changes in foreign exchange rates

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 Company into the functional currency at the spot exchange rate prevailing as at the transaction date. Monetary assets and liabilities which are denominated in foreign currencies are remeasured at each balance sheet date at the period-end exchange rate quoted by National Bank of Poland (“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 3.5.10.

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 remeasurement 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 remeasurement 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 remeasurement to fair value of other currency derivative instruments are recognised as financial income or finance cost.

3.5.2. Revenue

Revenue from the Company’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 Company’s activities. Revenue is recorded net of value-added tax and discounts.

Separable components of packaged and bundled offers

Sales of packaged 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 Company's main markets are made up of two components, a product (e.g. 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 broadband services, when equipment is sold through a distributor considered as an agent, modems/laptops and telecommunications services are a single bundled offering with multiple deliverables, and the 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 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 Company has the primary responsibility for providing services desired by the customer;
- the Company has inventory risk (the Company purchases content in advance);
- the Company has discretion in establishing prices directly or indirectly, such as by providing additional services;
- the Company has credit risk.

Revenues from the sale or supply of content are recognised:

- gross when the Company 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 Company bears the inventory risk, when the Company has a reasonable latitude in setting prices charged to the end-customer, when the Company 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 is recognised when they are used or expire.

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.

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 and deferred.
The Company participates in a loyalty program operated by a third party. A third party supplies the awards and the Company is collecting the consideration on behalf of a third party. Revenue is measured as a net amount retained on the Company'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 program that exists in the Company is without a contract renewal obligation.

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

The Company's commercial contracts may contain service level commitments (delivery time, service reinstatement time). If the Company 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.

3.5.3. Subscriber acquisition costs, advertising and related costs

Subscriber acquisition and retention costs, other than loyalty program costs (see Note 3.5.2), 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.

3.5.4. 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.

3.5.5. 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 the Company purchases its own equity instruments, 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.

3.5.6. Intangible assets

Intangible assets, consisting mainly of 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.

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

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 Company,
- the Company'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 Company's research and development projects mainly concern:

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

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.

3.5.7. 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 Company.

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 Company 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 Company 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 Company 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 Company 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 Company as lessor under leases that transfer substantially all 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 and terminals	2 to 30 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.

3.5.8. 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.

3.5.9. Impairment of non-current assets

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 Company 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 Company's individual assets do not generate cash flow independently from other assets.

3.5.10. 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), liabilities at fair value through profit or loss and hedging derivative instruments.

Except for investments in subsidiaries and associates which are accounted for at cost as allowed in IAS 27 “Consolidated and Separate Financial Statements”, 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.

<u>Assets available-for-sale</u>
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.

Dividends earned on investments in subsidiaries and assets available for sale are recognised in the income statement when the right of payment has been established.

<u>Loans and receivables</u>
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, bonds purchased from and loans granted to the Company’s subsidiaries, 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 Company 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 Company 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.

<u>Assets at fair value through profit or loss</u>
Financial assets at fair value through profit or loss are the following financial assets held for trading:

- financial assets acquired by the Company 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

<u>Financial liabilities at amortised cost</u>
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.

<u>Financial liabilities at fair value through profit or loss</u>
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 Company 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 foreign exchange component of other derivatives held for trading is presented under foreign exchange gains or losses within finance cost, net.

The Company 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.

<u>Hedging instruments</u>
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 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

<u>Financial assets</u>
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 Company 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 Company 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.

<u>Financial liabilities</u>
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 Company 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).

3.5.11. Inventories

Inventories are stated at the lower of cost and net realisable value. The Company 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.

3.5.12. 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 assets.

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 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 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.

A deferred tax asset is recognised for all deductible temporary differences arising from investments in subsidiaries and associates, 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.

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.

3.5.13. Provisions

In accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", a provision is recognised when the Company 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 Company's actions where, by an established pattern of past practice, published policies or a sufficiently specific current statement, the Company 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 Company 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 Company'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 Separate Financial Statements.

Restructuring

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

- 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 Company 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.

3.5.14. Pensions and other employee benefits

Certain employees of the Company 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 Company’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 Company 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 Company 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.

3.5.15. 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 Company rendered services to the Company 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 Separate 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. Revenue

(in PLN millions)	*12 months ended 31 December 2011*	*12 months ended 31 December 2010*
Fixed line telephony services	**4,750**	**5,360**
Subscriptions and voice traffic revenue	3,358	3,998
Wholesale revenue (including interconnect)	1,381	1,346
Other	11	16
Data Services	**2,714**	**2,779**
Broadband and TV revenue	1,363	1,446
Data transmission	755	722
Leased lines	594	606
Other	2	5
Sales of goods and other	**376**	**295**
Total revenue	**7,840**	**8,434**

Revenue is generated mainly in the territory of Poland. Approximately 5.1% and 4.6% 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.

5. Operating expense and income

5.1. External purchases

(in PLN millions)	*12 months ended 31 December 2011*	*12 months ended 31 December 2010*
Commercial expenses	(484)	(461)
− *cost of handsets and other equipment sold*	*(63)*	*(55)*
− *commissions, advertising, sponsoring costs and other*	*(421)*	*(406)*
Interconnect expenses	(944)	(1,016)
Network and IT expenses	(655)	(669)
Other external purchases	(1,703)	(1,307)
Total external purchases	**(3,786)**	**(3,453)**

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

5.2. Labour expenses

(in PLN millions)	*12 months ended 31 December 2011*	*12 months ended 31 December 2010*
Average number of employees (full time equivalent)	14,715	18,231
Wages and salaries	(1,187)	(1,333)
Social security and other charges	(267)	(302)
Long-term employee benefits [(1)]	38	19
Capitalised personnel costs	133	109
Other employee benefits	(51)	(60)
Share-based payments	-	(4)
Total labour expenses	**(1,334)**	**(1,571)**

[(1)] See Note 22.

5.3. 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	(91)	(48)
Taxes other than income tax	(256)	(256)
− *property tax and perpetual usufruct charges*	*(173)*	*(200)*
− *frequency fee, fees for subscribers' numbers and telecommunications charges*	*(24)*	*(27)*
− *other taxes*	*(59)*	*(29)*
Operating foreign exchange losses, net	(52)	-
Other expense and changes in provisions, net [(1)]	(544)	(227)
Total other operating expense	**(943)**	**(531)**
Income from shared resources	180	136
Recoveries on customer bad debts	29	14
Late payment interest on trade receivables	18	22
Operating foreign exchange gains, net	-	5
Other income	241	107
Total other operating income	**468**	**284**

[(1)] 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 28.d).

Other expense and changes in provisions, net, include mainly donations and changes in provisions for claims and litigation, risks and other charges (see Note 24), except for provision for the dispute with DPTG (see Note 28.e).

Income from shared resources includes income from intragroup sale of goods or services that reflect either shared resources or an internal organisation of an administrative process (mainly IT and distribution fees).

5.4. Research and development

In the 12 months ended 31 December 2011 and 2010, research and development costs expensed in the income statement amounted to PLN 60 million and PLN 59 million, respectively.

6. Gains on disposal of assets

6.1. Gain on disposal of TP Emitel

On 22 June 2011, TP S.A. together with Bilbo Sp. z o.o. concluded a share sale agreement with EM Bidco Sp. z o.o. under which the 100% shareholding in TP EmiTel Sp. z o.o. ("TP Emitel") was disposed of for a total consideration amounting to PLN 1,653 million, consisting of consideration received in cash amounting to PLN 1,725 million and liabilities assumed by the Company.

Gain on disposal amounting to PLN 1,251 million is presented separately in the income statement.

6.2. 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 26 million and PLN 65 million respectively and included mainly gains on disposal of properties.

7. Impairment

7.1. Information concerning the Cash Generating Units

Most of the Company's individual assets do not generate cash flow independently from other assets due to the nature of the Company's activities. The entire fixed network is treated as a separate Cash Generating Unit.

The Company 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 Company performed impairment tests of the fixed network. 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 the fixed network:
- 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.

CGU	*Fixed network*	
	31 December 2011	*31 December 2010*
Basis of recoverable amount	Value in use	Value in use
Source used	Business plan	Business plan
	4 years cash flow projections	5 years cash flow projections
Growth rate to perpetuity	0%	0%
Pre-tax discount rate	11.0%	11.0%

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 cash generating unit to materially exceed its recoverable amount.

7.2. 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 8 million and PLN 10 million respectively, primarily including a net impairment loss as a result of a review of certain Company's properties.

7.3. Investments in subsidiaries

In the 12 months ended 31 December 2011 and 2010, the net impairment loss on TP S.A.'s investments in subsidiaries amounted to PLN 8 million and PLN 1 million, respectively (see Note 13.1).

8. Finance income and expense

	12 months ended 31 December 2011								
(in PLN millions)	*Finance income, net*						*Operating income*		
	Dividend income	*Interest 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*
Investments in subsidiaries	962	-	-	-	-	**962**	-	-	(8)
Loans and receivables	-	389 (1)	-	(22)	-	**367**	18 (3)	12	(51) (4)
– *including cash and cash equivalents*	-	*88*	-	*(22)*	-	***66***	-	-	-
Liabilities at amortised cost	-	-	(678) (2)	(365)	-	**(1,043)**	-	(44)	-
Derivatives	-	-	(140)	491	-	**351**	-	253	-
– *hedging derivatives*	-	-	*(45)*	*220*	-	***175***	-	-	-
– *derivatives held for trading*	-	-	*(95)*	*271*	-	***176***	-	*253*	-
Non-financial items (5)	-	-	-	-	(28)	**(28)**	-	(273)	-
Total	**962**	**389**	**(818)**	**104**	**(28)**	**609**	**18**	**(52)**	**(59)**

(1) Includes mainly interest income on bonds issued by subsidiaries and cash and cash equivalents.
(2) Includes mainly interest expense on bonds, bank borrowings, loans from subsidiaries and change in fair value of liabilities hedged by fair value hedges.
(3) Includes late payment interests on trade receivables.
(4) Includes impairment losses on trade receivables.
(5) Includes mainly provisions and employee benefits.

(in PLN millions)	*12 months ended 31 December 2010*								
	Finance income, net						*Operating income*		
	Dividend income	*Interest 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*
Investments in subsidiaries	1,906	-	-	-	-	**1,906**	-	-	(1)
Loans and receivables	-	403 [1]	-	9	-	**412**	22 [3]	(6)	(41) [4]
– *including cash and cash equivalents*	-	*80*	-	*9*	-	***89***	-	-	-
Liabilities at amortised cost	-	-	(697) [2]	163	-	**(534)**	-	12	-
Derivatives	-	-	(160)	(190)	-	**(350)**	-	(36)	-
– *hedging derivatives*	-	-	*(64)*	*(97)*	-	***(161)***	-	-	-
– *derivatives held for trading*	-	-	*(96)*	*(93)*	-	***(189)***	-	*(36)*	-
Non-financial items [5]	-	-	-	-	(29)	**(29)**	-	35	-
Total	**1,906**	**403**	**(857)**	**(18)**	**(29)**	**1,405**	**22**	**5**	**(42)**

[1] Includes mainly interest income on bonds issued by subsidiaries and cash and cash equivalents.
[2] Includes mainly interest expense on bonds, bank borrowings, loans from subsidiaries and change in fair value of liabilities hedged by fair value hedges.
[3] Includes late payment interests on trade receivables.
[4] Includes impairment losses on trade receivables.
[5] Includes mainly provisions and employee benefits.

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

9. Income tax

(in PLN millions)	*12 months ended 31 December 2011*	*12 months ended 31 December 2010*
Current income tax	34	(48)
Deferred tax change	315	(71)
Less: Deferred tax charged to other comprehensive income	2	5
Total income tax	**347**	**(124)**

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*
Net income before tax	**1,604**	**1,147**
Less: Gain on disposal of TP Emitel (tax neutral)	*(1,251)*	*-*
Dispute with DPTG (see Notes 28.e and 30)	*-*	*1,061*
Proceedings by the European Commission (see Note 28.d) [1]	*513*	*50*
Dividend income	*(962)*	*(1,906)*
Net income before tax, adjusted	(96)	352
Statutory tax rate	19%	19%
Theoretical tax	**18**	**(67)**
Tax relief on new technologies (for years 2006-2011)	112	-
Reassessment of deferred tax asset on dispute with DPTG	233	(31)
Change in unrecognised deferred tax asset and other	(2)	(13)
Expense not deductible for tax purposes, net	(14)	(13)
Total income tax	**347**	**(124)**

[1] Includes foreign 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.

TP S.A. is a member of the TP Tax Capital Group.

Deferred tax

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

	Balance sheet		*Income 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	(94)	(181)	87	25
Impairment of financial assets	21	19	2	(1)
Finance costs (income)/expense, net	(161)	(92)	(67)	(69)
Accrued (income)/expense, net	618	346	272	(11)
Employee benefit plans	43	47	(8)	(5)
Deferred income	26	23	3	6
Other differences	28	4	24	(21)
Deferred tax assets and liabilities, net	**481**	**166**	**-**	**-**
Total deferred tax	**-**	**-**	**313**	**(76)**

Unrecognised deferred tax asset relates mainly to temporary differences, which based on the Company's management assessment could not be utilized for tax purposes. As at 31 December 2011 and 2010, deductible temporary differences, for which no deferred tax asset was recognised, amounted to PLN 86 million and PLN 85 million gross, respectively.

10. Components of other comprehensive income

10.1. Cash flow hedges

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

(in PLN millions)	*12 months ended 31 December 2011*			*12 months ended 31 December 2010*		
	Before tax	*Tax*	*After tax*	*Before tax*	*Tax*	*After tax*
Effective part of gains/(losses) on hedging instrument	122	(23)	99	(124)	24	(100)
Reclassification to the income statement, adjusting:	(113)	21	(92)	115	(22)	93
- interest expense presented in finance income, net	*39*	*(7)*	*32*	*46*	*(9)*	*37*
- foreign exchange differences presented in finance income, net	*(152)*	*28*	*(124)*	*69*	*(13)*	*56*
Total gains/(losses) on cash flow hedges	**9**	**(2)**	**7**	**(9)**	**2**	**(7)**

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.

10.2. Actuarial losses on post-employment benefits

Actuarial losses on post-employment benefits (see Note 22) charged to other comprehensive income are presented below:

(in PLN millions)	*12 months ended 31 December 2011*			*12 months ended 31 December 2010*		
	Before tax	*Tax*	*After tax*	*Before tax*	*Tax*	*After tax*
Actuarial losses on retirement bonuses	(5)	1	(4)	(12)	2	(10)
Actuarial losses on other post-employment benefits	(15)	3	(12)	(4)	1	(3)
Total actuarial losses on post-employment benefits	**(20)**	**4**	**(16)**	**(16)**	**3**	**(13)**

11. Intangible assets

(in PLN millions)	*At 31 December 2011*			
	Cost	*Accumulated amortisation*	*Impairment*	*Net*
Software	4,113	(2,785)	-	1,328
Other intangibles	139	(59)	(12)	68
Total intangible assets	**4,252**	**(2,844)**	**(12)**	**1,396**

(in PLN millions)	*At 31 December 2010*				*At 1 January 2010*
	Cost	*Accumulated amortisation*	*Impairment*	*Net*	*Net*
Software	3,702	(2,512)	-	1,190	999
Other intangibles	105	(36)	(12)	57	56
Total intangible assets	**3,807**	**(2,548)**	**(12)**	**1,247**	**1,055**

Movements in the net book value of intangible 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 and impairment	**1,247**	**1,055**
Acquisitions of intangible assets	570	566
Disposals and retirements	(2)	(6)
Amortisation	(418)	(366)
Impairment	-	(1)
Reclassifications and other, net	(1)	(1)
Closing balance	**1,396**	**1,247**

12. Property, plant and equipment

(in PLN millions)	*At 31 December 2011*			
	Cost	*Accumulated depreciation*	*Impairment*	*Net*
Land and buildings	3,061	(1,237)	(95)	1,729
Networks and terminals	29,459	(19,335)	(1)	10,123
IT equipment	1,319	(995)	-	324
Investment grants	(241)	124	-	(117)
Other	162	(121)	-	41
Total property, plant and equipment	**33,760**	**(21,564)**	**(96)**	**12,100**

(in PLN millions)	*At 31 December 2010*				*At 1 January 2010*
	Cost	*Accumulated depreciation*	*Impairment*	*Net*	*Net*
Land and buildings	3,035	(1,110)	(90)	1,835	1,969
Networks and terminals	28,466	(17,955)	(4)	10,507	11,138
IT equipment	1,386	(977)	-	409	419
Investment grants	(243)	111	-	(132)	(148)
Other	159	(121)	-	38	43
Total property, plant and equipment	**32,803**	**(20,052)**	**(94)**	**12,657**	**13,421**

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*
Opening balance net of accumulated depreciation and impairment	**12,657**	**13,421**
Acquisitions of property, plant and equipment	1,369	1,327
Disposals and retirements	(23)	(43)
Depreciation	(1,906)	(2,033)
Impairment	(8)	(9)
Dismantling costs, reclassifications and other, net	11	(6)
Closing balance	**12,100**	**12,657**

The carrying value of equipment held under finance leases as at 31 December 2011 and 2010 amounted to PLN 11 million and PLN 17 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 1 million. Leased assets cannot be sold, donated, transferred by title or pledged and are a collateral for the related finance lease liability.

13. Financial assets

13.1. Investments in subsidiaries and assets available for sale

The Company's investments in subsidiaries and assets available for sale are presented below:

(in PLN millions)	*At 31 December 2011*			*At 31 December 2010*		
	Cost	*Impairment*	*Net*	*Cost*	*Impairment*	*Net*
Main companies						
PTK-Centertel Sp. z o.o.	*6,784*	*-*	*6,784*	*6,784*	*-*	*6,784*
TP EmiTel Sp. z o.o. [(1)]	*-*	*-*	*-*	*401*	*-*	*401*
Wirtualna Polska S.A.	*197*	*-*	*197*	*197*	*(14)*	*183*
TP Invest Sp. z o.o.	*101*	*-*	*101*	*101*	*-*	*101*
TP Edukacja i Wypoczynek Sp. z o.o.	*94*	*(17)*	*77*	*102*	*(17)*	*85*
Otwarty Rynek Elektroniczny S.A.	*36*	*(9)*	*27*	*36*	*-*	*36*
Ramsat S.A.	*25*	*-*	*25*	*25*	*-*	*25*
Other	42	(25)	17	33	(12)	21
Total investments in subsidiaries	**7,279**	**(51)**	**7,228**	**7,679**	**(43)**	**7,636**
Exatel S.A.	*14*	*(11)*	*3*	*14*	*(11)*	*3*
Other	*1*	*-*	*1*	*1*	*-*	*1*
Total assets available for sale	**15**	**(11)**	**4**	**15**	**(11)**	**4**

[(1)] The Company was disposed of in 2011 (see Note 6.1).

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.

As at 31 December 2011 and 2010 the Company owned directly the following shares in its subsidiaries:

Entity	*Location*	*Scope of activities*	*Share capital owned by TP S.A. directly*		*Share capital owned by TP S.A. directly and indirectly*	
			31 December 2011	*31 December 2010*	*31 December 2011*	*31 December 2010*
PTK-Centertel Sp. z o.o.	Warsaw, Poland	Mobile telephony services, construction and operation of mobile telecommunications networks.	100.00%	100.00%	100.00%	100.00%
TP EmiTel Sp. z o.o. (1)	Kraków, Poland	TV and radio signals broadcasting, construction, lease and maintenance of technical infrastructure.	-	100.00%	-	100.00%
Wirtualna Polska S.A.	Gdańsk, Poland	Internet portal and related services including internet advertising.	100.00%	100.00%	100.00%	100.00%
OPCO Sp. z o.o.	Warsaw, Poland	Facilities management and maintenance.	100.00%	100.00%	100.00%	100.00%
Otwarty Rynek Elektroniczny S.A.	Warsaw, Poland	Provision of complex procurement solutions, including advisory, implementation and operation of e-commerce platform and IT systems, hosting.	100.00%	100.00%	100.00%	100.00%
TP Edukacja i Wypoczynek Sp. z o.o.	Warsaw, Poland	Hotel services, training and conference facilities.	100.00%	100.00%	100.00%	100.00%
TP Invest Sp. z o.o.	Warsaw, Poland	Services for Group entities, holding management.	100.00%	100.00%	100.00%	100.00%
TP TelTech Sp. z o.o.	Łódź, Poland	Monitoring of alarm signals, servicing telecommunications networks, design and development of telecommunications systems.	2.15%	2.15%	100.00%	100.00%
Contact Center Sp. z o.o.	Warsaw, Poland	Call-centre services and telemarketing.	0.04%	0.04%	100.00%	100.00%
Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. ("PTE TP S.A")	Warsaw, Poland	Management of employee pension fund.	75.00%	100.00%	100.00%	100.00%
Fundacja Orange	Warsaw, Poland	Charity foundation.	50.00%	50.00%	100.00%	100.00%
PayTel S.A. (2)	Warsaw, Poland	E-commerce and electronic services, including GSM prepaid services, bill charging and processing of electronic financial transactions.	100.00%	100.00%	100.00%	100.00%
Ramsat S.A.	Modlnica, Poland	Distributor of PTK-Centertel and TP S.A. products on mass and business market.	100.00%	100.00%	100.00%	100.00%
Integrated Solutions Sp. z o.o. (3)	Warsaw, Poland	Provision of integrated IT and network services.	100.00%	-	100.00%	-
Bilbo Sp. z o.o. (3)	Warsaw, Poland	Investment operations.	100.00%	-	100.00%	-

(1) The Company was disposed of in 2011 (see Note 6.1).
(2) The Company was disposed of in 2012 (see Note 30).
(3) Companies incorporated in 2011.

As at 31 December 2011 and 2010, the voting power held by the Company was equal to the Company's interest in the share capital of its subsidiaries.

Significant acquisitions and disposals in the 12 months ended 31 December 2011 are described below.

On 23 May 2011, the Polish Financial Supervision Authority approved the sale agreement concluded in September 2010 under which 25% shares of PTE TP S.A was disposed to Orange Customer Service Sp. z o.o.

On 22 June 2011, TP S.A. together with Bilbo Sp. z o.o. concluded a share sale agreement with EM Bidco Sp. z o.o. under which the 100% shareholding in TP Emitel was disposed of (see Note 6.1).

There were no significant acquisitions or disposals in the 12 months ended 31 December 2010.

13.2. Loans and receivables excluding trade receivables

The Company'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*
Bonds issued by subsidiaries [1,2,3]	3,148	-	3,148	3,425	-	3,425
Loans receivables from subsidiaries [1]	7	-	7	6	-	6
Other	18	-	18	20	-	20
Total loans and receivables excluding trade receivables	**3,173**	**-**	**3,173**	**3,451**	**-**	**3,451**
Current	328	-	328	304	-	304
Non-current	2,845	-	2,845	3,147	-	3,147

[1] Includes accrued interest receivable.
[2] Included in net financial debt calculation (see Note 16).
[3] On 31 January 2009 the Company and TP Invest Sp. z o.o. concluded agreements, under which, among others, TP S.A. purchased bonds issued by TP Invest Sp. z o.o. Bonds have maturity between 2 weeks and 8 years.

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

13.3. Financial assets at fair value through profit or loss

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

(in PLN millions)	*Fair value*	
	At 31 December 2011	*At 31 December 2010*
Derivatives – held for trading [1]	373	77
Total financial assets at fair value through profit or loss	**373**	**77**
Current	225	20
Non-current	148	57

[1] Included in net financial debt calculation (see Note 16).

The Company's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Company 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 Company applies the appropriate measures mitigating the default risk.

13.4. Financial assets measured at fair value

The following tables provide an analysis of the Company'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 3.5.10).

(in PLN millions)	*At 31 December 2011*			
	Fair value measurement			
	Level 1	*Level 2*	*Level 3*	*Total*
Financial assets at fair value through profit or loss	-	373	-	373
Derivatives – held for trading	-	*373*	-	*373*
Hedging derivatives	-	129	-	129
Total financial assets measured at fair value	**-**	**502**	**-**	**502**

(in PLN millions)	*At 31 December 2010*			
	Fair value measurement			
	Level 1	*Level 2*	*Level 3*	*Total*
Financial assets at fair value through profit or loss	-	77	-	77
Derivatives – held for trading	*-*	*77*	*-*	*77*
Hedging derivatives	-	45	-	45
Total financial assets measured at fair value	**-**	**122**	**-**	**122**

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.

14. Trade receivables, other assets and prepaid expenses

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
Trade receivables, net	**852**	**857**
VAT receivable	31	29
Other taxes receivables	2	1
Other [(1)]	55	96
Total other assets	**88**	**126**
Inactivated terminals in the external dealership network	2	4
Other prepaid expenses	13	32
Total prepaid expenses	**15**	**36**

[(1)] Mainly includes receivables related to: advances and prepayments to suppliers, sales of fixed assets, compensations and penalties.

TP S.A. 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 Company'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	**98**	**129**
Impairment losses, net	51	41
Impaired receivables sold or written-off and other movements	(75)	(72)
End of period	**74**	**98**

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 PLN millions)			*Past due*		
	Carrying amount	*Neither impaired nor past due*	*Less than 180 days*	*Between 180 and 360 days*	*More than 360 days*
Trade receivables - collectively analysed for impairment	809	565	211	32	1
Trade receivables - individually analysed for impairment	43				
Total trade receivables, net	**852**				

At 31 December 2010

(in PLN millions)			*Past due*		
	Carrying amount	*Neither impaired nor past due*	*Less than 180 days*	*Between 180 and 360 days*	*More than 360 days*
Trade receivables - collectively analysed for impairment	840	571	246	17	6
Trade receivables - individually analysed for impairment	17				
Total trade receivables, net	**857**				

15. Cash and cash equivalents

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

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
Current bank accounts and overnight deposits	353	118
Deposits up to 3 months	2,231	1,839
Securities with a maturity up to 3 months	-	311
Total cash and cash equivalents	**2,584**	**2,268**

The Company'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 Company. 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 6 million and PLN 3 million, respectively, denominated in foreign currencies.

The Company's maximum exposure to credit risk at the reporting date is best represented by carrying amounts of cash and cash equivalents. The Company 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 Company applies the appropriate measures mitigating the default risk.

16. 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 bonds purchased from TP S.A. subsidiaries, cash and cash equivalents and including the impact of the effective portion of cash flow hedges.

The maturity analysis of the Company'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 Company'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

(in PLN millions)			Undiscounted contractual cash flows [1]							
				Non-current						
	Note	*Carrying amount*	*Within 1 year*	*1-2 years*	*2-3 years*	*3-4 years*	*4-5 years*	*More than 5 years*	*Total non-current*	*Total*
Trade payables (A)	***25***	**2,184**	**2,184**	**-**	**-**	**-**	**-**	**-**	**-**	**2,184**
Bonds	*17*	4,705	1,653	186	3,278	-	-	-	3,464	5,117
Bank borrowings	*17*	1,684	719	961	44	43	5	24	1,077	1,796
Finance lease liabilities		11	6	3	3	-	-	-	6	12
Loans from subsidiaries [3]	*17*	3,117	715	715	715	715	715	1,550	4,410	5,125
Financial liabilities at amortised cost – excluding trade payables		**9,517**	**3,093**	**1,865**	**4,040**	**758**	**720**	**1,574**	**8,957**	**12,050**
Derivatives - net [2]	*18*	(384)	(140)	65	9	-	-	-	74	(66)
Gross financial debt after derivatives (B)		**9,133**	**2,953**	**1,930**	**4,049**	**758**	**720**	**1,574**	**9,031**	**11,984**
Total financial liabilities (A) + (B)		**11,317**	**5,137**	**1,930**	**4,049**	**758**	**720**	**1,574**	**9,031**	**14,168**
Bonds issued by subsidiaries [3]	*13*	3,148								
Cash and cash equivalents	*15*	2,584								
Assets included in the calculation of net financial debt (C)		**5,732**								
Effective portion of cash flow hedges (D)		11								
Net financial debt (B)-(C)+(D)		**3,412**								

[1] Includes both nominal and interest payments.
[2] Both assets and liabilities are included.
[3] Bonds are included in the calculation as they are settled net with loans from subsidiaries.

At 31 December 2010

(in PLN millions)			Undiscounted contractual cash flows [1]							
				Non-current						
	Note	*Carrying amount*	*Within 1 year*	*1-2 years*	*2-3 years*	*3-4 years*	*4-5 years*	*More than 5 years*	*Total non-current*	*Total*
Trade payables (A)	***25***	**2,100**	**2,100**	**-**	**-**	**-**	**-**	**-**	**-**	**2,100**
Bonds	*17*	4,842	2,134	167	167	2,939	-	-	3,273	5,407
Bank borrowings	*17*	1,866	287	690	951	38	38	25	1,742	2,029
Finance lease liabilities		16	7	6	3	2	-	-	11	18
Loans from subsidiaries [3]	*17*	3,412	715	715	715	715	715	2,980	5,840	6,555
Financial liabilities at amortised cost – excluding trade payables		**10,136**	**3,143**	**1,578**	**1,836**	**3,694**	**753**	**3,005**	**10,866**	**14,009**
Derivatives - net [2]	*18*	268	166	64	63	293	-	-	420	586
Gross financial debt after derivatives (B)		**10,404**	**3,309**	**1,642**	**1,899**	**3,987**	**753**	**3,005**	**11,286**	**14,595**
Total financial liabilities (A) + (B)		**12,504**	**5,409**	**1,642**	**1,899**	**3,987**	**753**	**3,005**	**11,286**	**16,695**
Bonds issued by subsidiaries [3]	*13*	3,425								
Cash and cash equivalents	*15*	2,268								
Assets included in the calculation of net financial debt (C)		**5,693**								
Effective portion of cash flow hedges (D)		2								
Net financial debt (B)-(C)+(D)		**4,713**								

[1] Includes both nominal and interest payments.
[2] Both assets and liabilities are included.
[3] Bonds are included in the calculation as they are settled net with loans from subsidiaries.

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

17. Financial liabilities at amortised cost excluding trade payables

17.1. Bonds

The table below provides an analysis of bonds issued by TP S.A.:

(in PLN millions)					*Amount outstanding at [1]*	
Series	*Nominal value (in millions of currency)*	*Nominal interest rate*	*Issue date*	*Redemption date*	*31 December 2011*	*31 December 2010*
T	300 EUR	4.625%	5 July 2004	4 July 2011	-	1,214
A1	500 EUR	6.000%	22 May 2009	22 May 2014	2,281	2,042
A2	200 EUR	6.000%	17 July 2009	22 May 2014	960	862
Short-term bonds[2]	1,467 PLN	Zero-coupon bonds	2011	2012	1,464	724
Total bonds issued by the TP S.A.					**4,705**	**4,842**
Current					1,577	2,040
Non-current					3,128	2,802

[1] Includes accrued interest and the fair value adjustment to the bonds hedged by fair value hedge.
[2] Short-term bonds issued to the Company's subsidiaries under the TP S.A. Bond Issuance Programme of 15 July 2002.

On 4 July 2011, TP 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 bonds were offered through private placement and were purchased exclusively by TPSA Eurofinance France S.A.

TP S.A. issues short-term zero-coupon bonds denominated in PLN. The bonds are offered by private placement to the Group's entities, exclusively within the territory of the Republic of Poland. The bonds are redeemed at their par value.

The weighted average effective interest rate on bonds issued by TP S.A., before swaps, amounted to 5.76% as at 31 December 2011 and 5.43% as at 31 December 2010.

17.2. Bank borrowings

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

		Amount outstanding at [1]			
		31 December 2011		*31 December 2010*	
Creditor	*Repayment date*	*Currency (millions)*	*PLN (millions)*	*Currency (millions)*	*PLN (millions)*
Floating rate					
European Investment Bank	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 PLN	78
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[2]	(9)	(11) PLN[2]	(11)
Bank Handlowy (syndicated)	18 April 2013	(3) PLN[2]	(3)	(8) PLN[2]	(8)
Fixed rate					
Instituto de Credito Oficial	2 January 2021	14 USD	49	16 USD	47
Total bank borrowings borrowed by TP S.A.			**1,684**		**1,866**
Current			649		226
Non-current			1,035		1,640

[1] Includes accrued interest and bank borrowings issue costs.
[2] Paid arrangement fees.

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

17.3. Loans from subsidiaries

On 31 January 2009, the Company and its subsidiary TP Invest Sp. z o.o. concluded agreements, under which, among others, financial liabilities at amortised cost were recognised in the amount of PLN 3,909 million. As at 31 December 2011 and 2010, loans from TP Invest Sp. z o.o. amounted to PLN 3,117 million and PLN 3,412 million, respectively.

18. Derivatives

As at 31 December 2011 and 2010, the majority of Company'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 Company 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 Company are presented below:

				Fair value[(2)] (in PLN millions)	
Type of instrument [(1)]	*Hedged risk*	*Hedged nominal amount (in millions of currency)*	*Maturity*	*Financial Asset*	*Financial Liability*
		At 31 December 2011			
Derivative instruments - fair value hedge					
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 hedge					
CCIRS	Currency and interest rate risk	283 EUR	2014	56	-
CCS	Currency risk	6 EUR	2012	0	-
IRS	Interest rate risk	33 EUR	2014	9	-
IRS	Interest rate risk	1,276 PLN	2012-2014	-	(65)
Total of cash flow hedges				65	(65)
Derivative instruments – held for trading					
CCIRS	Currency and interest rate risk	313 EUR	2012-2014	56	(2)
CCS	Currency risk	27 EUR	2014	16	-
NDF	Currency risk	713 EUR	2012	213	(0)
NDF	Currency risk	22 USD	2012	7	-
IRS	Interest rate risk	307 EUR	2014	81	-
IRS	Interest rate risk	1,269 PLN	2014	-	(51)
Total of derivatives held for trading				373	(53)
Total of derivative instruments				**502**	**(118)**
Current				225	-
Non–current				277	(118)

[(1)] 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.

Type of instrument [(1)]	*Hedged risk*	*Hedged nominal amount (in millions of currency)*	*Maturity*	*Fair value*[(2)] *(in PLN millions)* *Financial Asset*	*Financial Liability*
		At 31 December 2010			
Derivative instruments - fair value hedge					
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 hedge					
CCIRS	Currency and interest rate risk	303 EUR	2014	-	(109)
CCS	Currency risk	149 EUR	2011-2012	-	(47)
IRS	Interest rate risk	53 EUR	2014	10	-
IRS	Interest rate risk	1,419 PLN	2012-2014	-	(57)
Total of cash flow hedges				10	(213)
Derivative instruments – held for trading					
CCIRS	Currency and interest rate risk	314 EUR	2011-2014	25	(82)
CCS	Currency risk	35 EUR	2014	5	-
NDF	Currency risk	668 EUR	2011	2	(28)
NDF	Currency risk	33 USD	2011	1	(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				77	(145)
Total of derivative instruments				**122**	**(390)**
Current				20	(109)
Non–current				102	(281)

(1) 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 Company's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Company 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 Company applies the appropriate measures mitigating the default risk.

The following tables provide an analysis of the Company'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 3.5.10).

(in PLN millions)	*At 31 December 2011*			
	Fair value 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 December 2010*			
	Fair value 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**	**-**	**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.

19. Objectives and policies of financial risk management

19.1. Principles of financial risk management

The Company 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 Company 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 Company 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.

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 Company concludes hedging transactions.

19.2. Hedge accounting

The Company has entered into numerous derivative transactions to hedge exposure to currency risk and interest rate risk. The derivatives used by the Company 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 Company applies hedge accounting principles as stated in IAS 39 (see Note 3.5.10). 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 Company’s policy that the derivative financial instruments are not used for trading (speculative) purposes. However, certain derivatives held by the Company 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 Company considers those derivative instruments as economic hedges because they, in substance, protect the Company against currency risk and interest rate risk.

Detailed information on derivative financial instruments, including hedging relationship, that are used by the Company is presented in Note 18.

19.3. Currency risk

The Company 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 17) and trade receivables, trade payables and provisions of which a significant balance relates to the provision for the dispute with DPTG (see Notes 28.e and 30) and provision for the proceedings by the European Commission (see Note 28.d).

The Company’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 Company hedges its exposure entering mainly into cross currency swaps, cross currency interest rate swaps and forward currency contracts, under which the Company 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 income statement, as well as other comprehensive income.

The table below presents the hedge ratio of the Company'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%
DPTG provision (see Notes 28.e and 30)	75.6%	74.9%
EC proceedings provision (see Note 28.d)	77.8%	n/a

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

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

The Company'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.

(in millions of currency)	*Effective exposure after hedging impacting income statement*				*Sensitivity to a change of the PLN against other currencies*			
	At 31 December 2011		*At 31 December 2010*		*At 31 December 2011*		*At 31 December 2010*	
					+10%	*-10%*	*+10%*	*-10%*
Hedged item	*Currency*	*PLN*	*Currency*	*PLN*	*PLN*		*PLN*	
Bonds and bank borrowings (USD)	3	10	3	9	1	(1)	1	(1)
DPTG provision (EUR) (see Notes 28.e and 30)	134	592	136	539	59	(59)	54	(54)
EC proceedings provision (EUR) (see Note 28.d)	28	124	-	-	12	(12)	-	-
Total		**726**		**548**	**72**	**(72)**	**55**	**(55)**

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 other comprehensive income. The sensitivity analysis prepared by the Company 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.

19.4. 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 Company has interest bearing financial assets consisting mainly of bonds purchased from and loans granted to its subsidiaries (see Note 13) and financial liabilities consisting mainly of bonds and bank borrowings (see Note 17).

The Company'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 Company 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 Company's proportion between fixed/floating rate debt (including hedging activities) was 64/36% and 53/47% respectively.

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

The table below provides the Company'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 December 2011		*At 31 December 2010*	
	+1%	*-1%*	*+1%*	*-1%*
Finance costs, net	28	(27)	53	(53)
Other comprehensive income	(1)	1	3	(4)
Fair value of gross financial debt after derivatives	(62)	(66)	(62)	63

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) interest income calculated on the bonds purchased from and loans granted to subsidiaries based on floating rate and c) 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, loans from subsidiaries and arrangement fees) was PLN 6,239 million (as at 31 December 2010, PLN 7,104 million).

19.5. Liquidity risk

The liquidity risk is a risk of encountering difficulties in meeting obligations associated with financial liabilities. The Company'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 parent company, as liquid asset surpluses generated by the Company and its subsidiaries are invested and managed by the central treasury. The Company's cash surplus is invested into short-term highly-liquid financial instruments e.g. bank deposits and T-bills.

The Company 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 Company had the following unused credit facilities amounting to PLN 3,767 million (as at 31 December 2010, PLN 3,584 million):

- PLN 2,000 million of the revolving credit lines,
- EUR 400 million of back-up credit facility.

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

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

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)	*Liquidity ratios*	
	At 31 December 2011	*At 31 December 2010*
Liquidity ratio - next 12 months	301%	274%
Unused credit facilities	3,767	3,584
Cash and cash equivalents	2,584	2,268
Debt repayments(1)	2,109	2,134
Liquidity ratio (incl. derivatives) - next 12 months	323%	254%
Derivatives(2)	(140)	166
Liquidity ratio - next 18 months	241%	261%
Unused credit facilities	3,767	3,584
Cash and cash equivalents	2,584	2,268
Debt repayments(1)	2,630	2,245
Liquidity ratio (incl. derivatives) - next 18 months	252%	241%
Derivatives(2)	(109)	185

(1) Undiscounted principal payments on debt including PLN 1,467 million short-term bonds issued to Company's subsidiaries under the TP S.A. Bond Issuance Programme of 15 July 2002.
(2) Undiscounted net cash flows on derivatives; negative / positive amount represents positive/negative net result on cash flows.

The maturity analysis for the contractual undiscounted cash flows resulting from the Company's financial liabilities as at 31 December 2011 and 2010 is presented in Note 16. The average duration for the existing debt portfolio as at 31 December 2011 is 1.6 year (2.2 years as at 31 December 2010).

19.6. Credit risk

The Company'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 Company.

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 TP 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 TP Group were approved by the Credit Committee.

There is no significant concentration of credit risk within the Company.
Further information on credit risk is discussed in Notes 13, 14, 15 and 18.

19.7. 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. 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 27.3) that wholesale rates for regulated services, and for Bitstream Access (under certain conditions), will be maintained at unchanged levels until the end of 2012.

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

19.8. 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 Company should meet the following financial ratio: Net Debt / EBITDA calculated on the Group's consolidated results to be no higher than 3.5:1 confirmed on a semi-annual basis. As at 31 December 2011 and 2010, the covenant was met. The covenant was met in years 2011 and 2010.

20. Management of capital

Capital management strategy is developed at the Group level. Capital management policy is described in the Note 23 to Telekomunikacja Polska Group IFRS Consolidated Financial Statements for the year ended 31 December 2011.

21. 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 Company's financial instruments, for which estimated fair value differs from the book value, is presented below.

(in PLN millions)	*At 31 December 2011*		*At 31 December 2010*	
	Carrying amount [(1)]	*Estimated fair value*	*Carrying amount* [(1)]	*Estimated fair value*
Bonds with fixed interest rate	4,705	4,931	4,842	4,955
Bank borrowings with fixed interest rate	49	46	47	42
Loans from subsidiaries with fixed interest rate	3,117	3,336	3,413	3,650
Total financial liabilities	**7,871**	**8,313**	**8,302**	**8,647**
Bonds issued by subsidiaries with fixed interest rate	3,148	3,371	3,425	3,666
Total financial assets	**3,148**	**3,371**	**3,425**	**3,666**

[(1)] 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.

22. Employee benefits

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
Jubilee awards	100	127
Retirement bonuses and other post-employment benefits	163	158
Salaries, other employee-related payables and payroll taxes due	136	151
Total employee benefits	**399**	**436**
Current	158	167
Non-current	241	269

Certain employees and retirees of the Company are entitled to long-term employee benefits in accordance with the Company's remuneration policy (see Note 3.5.14). 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*				*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 obligation at the beginning of the period	**127**	**87**	**71**	**285**	**145**	**89**	**73**	**307**
Current service cost [1]	7	5	1	13	8	4	1	13
Past service cost [1]	(21)	1	-	(20)	-	-	-	-
Interest cost [2]	6	5	4	15	7	5	4	16
Benefits paid	(10)	(2)	(7)	(19)	(24)	(3)	(8)	(35)
Actuarial losses for the period	3 [1]	5 [3]	15 [3]	23	20 [1]	12 [3]	4 [3]	36
Curtailment [1]	(12) [4]	(20) [4]	(2) [4]	(34)	(29) [5]	(20) [5]	(3) [5]	(52)
Present/carrying value of obligation at the end of the period	**100**	**81**	**82**	**263**	**127**	**87**	**71**	**285**

(1) Recognised under labour expense in the income statement.
(2) Recognised under discounting expense in the income statement.
(3) Recognised under actuarial losses on post-employment benefits in the statement of comprehensive income.
(4) Curtailment resulting from the new Social Agreement concluded in the fourth quarter of 2011 (see Note 24).
(5) Curtailment resulting from intragroup employee transfer to Orange Customer Service Sp. z o.o.

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*
Discount rate	6.1%	6.0%
Wage increase rate	3.0% – 3.5%	3.0%
Expected average remaining working lives (in years)	16.0 – 16.6	16.6 – 17.2

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

(in PLN millions) *As at*	*Jubilee awards*	*Retirement bonuses*	*Other post-employment benefits*	*Total*
31 December 2011	100	81	82	263
31 December 2010	127	87	71	285
31 December 2009	145	89	73	307
31 December 2008	144	74	93	311
31 December 2007	159	82	77	318

23. Share-based payments

23.1. 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 TP S.A.:

	12 months ended 31 December 2011		*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 amounted to PLN 17 million. It was recognised in labour expenses in the amount of PLN 14 million, in investments in subsidiaries in the amount of PLN 3 million and as an increase in equity amounting to PLN 17 million.

23.2. 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 51 million.

24. 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 28), risks and other charges	2,147	598	(44)	(29)	273	4	2,949
Restructuring provision	27	152	(28)	-	-	1	152
Provisions for dismantling	129	10	(8)	-	-	8	139
Total provisions	**2,303**	**760**	**(80)**	**(29)**	**273**	**13**	**3,240**
Current	2,176						3,039
Non-current	127						201

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

(in PLN millions)	*At 1 January 2010*	*Increases*	*Reversals (utilisations)*	*Reversals (releases)*	*Foreign exchange effect*	*Discounting effect*	*At 31 December 2010*
Provisions for claims and litigation (see Note 28), risks and other charges	1,058	1,186	(50)	(12)	(35)	-	2,147
Restructuring provision	124	15	(117)	-	-	5	27
Provisions for dismantling	130	-	(3)	(6)	-	8	129
Total provisions	**1,312**	**1,201**	**(170)**	**(18)**	**(35)**	**13**	**2,303**
Current	1,164						2,176
Non-current	148						127

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% - 5.92% as at 31 December 2010.

<u>Restructuring provision</u>
The restructuring provision as at 31 December 2011 consisted 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, TP S.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, TP S.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.

<u>Dismantling provisions</u>
The dismantling provisions relate to dismantling or removal of items of property, plant and equipment (mainly telecommunication poles). 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, period of utilisation, current utilisation cost (obtained through a tender process) and inflation.

25. Trade payables, other liabilities and deferred income

25.1. Trade payables

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
Trade payables	1,125	1,087
Fixed assets payables	1,059	1,013
Total trade payables	**2,184**	**2,100**
Current	2,184	2,100
Non-current	-	-

25.2. Other liabilities

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
VAT payable	110	115
Other taxes payables	14	49
Other	95	16
Total other liabilities	**219**	**180**
Current	204	180
Non-current	15	-

25.3. Deferred income

(in PLN millions)	*At 31 December 2011*	*At 31 December 2010*
Connection fees	99	120
Other	49	13
Total deferred income	**148**	**133**
Current	102	69
Non-current	46	64

26. Equity

26.1. 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 26.3).

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

(in PLN millions)	*At 31 December 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	1,995	49.79	49.79	1,995
Capital Group International, Inc. (1)	5.10	5.06	203	5.06	5.06	203
Other shareholders	44.69	44.30	1,775	45.15	45.15	1,809
Treasury shares	-	0.85	34	-	-	-
Total	**100.00**	**100.00**	**4,007**	**100.00**	**100.00**	**4,007**

(1) Number of shares according to the notification by Capital Group International, Inc. on 15 October 2010.

The Company 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 26.3).

26.2. 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.

26.3. 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 Separate Financial Statements.

27. 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 Company.

27.1. Commitments related to operating leases

When considering the Company as a lessee, operating lease commitments mainly relate to the lease of buildings and land. Lease costs recognised in the income statement for the years ended 31 December 2011 and 2010 amounted to PLN 207 million and PLN 197 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	82	97
after one year but not more than five years	184	110
more than five years	272	2
Total minimum future lease payments	**538**	**209**

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 Company.

When considering the Company as a lessor, future minimum lease payments under non-cancellable operating leases as at 31 December 2011 and 2010 amounted to PLN 96 million and PLN 77 million, respectively.

27.2. 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	526	646
Intangibles	85	74
Total investment commitments	**611**	**720**
Amounts contracted to be payable within 12 months after the balance sheet date	574	581

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).

27.3. 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.

27.4. Guarantees

As at 31 December 2011 and 2010, total guarantees granted by TP S.A. to purchasers of debt securities denominated in EUR and issued by a subsidiary amounted to PLN 3,205 million and PLN 4,089 million, respectively. The decrease resulted mainly from a redemption at maturity of bonds of the EUR 300 million nominal value.
Other guarantees granted by the Company as at 31 December 2011 and 2010 amounted to PLN 15 million and PLN 14 million, respectively.

28. 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 Company may be subject to additional tax liabilities, which may arise as a result of additional tax audits. TP S.A. was subject to audits by the tax office in respect of taxes paid. Certain of these audits have not yet been finalised. The Company 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.

TP S.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 TP S.A. had engaged in practices restricting competition when it downgraded IP traffic coming from domestic operators' networks to TP S.A.'s network via foreign operators' networks and imposed a fine of PLN 75 million on the Company. TP S.A. disagreed with the decision of UOKiK and did not pay the fine. On 2 January 2008, TP S.A. appealed to SOKiK against the decision. On 11 April 2011, SOKiK reduced the fine to the amount of PLN 38 million. TP S.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.

As at 31 December 2011, the Company recognised provisions for known and quantifiable risks related to proceedings against the Company initiated by UKE and UOKiK, which represent the Company'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.

e. Dispute with DPTG

Information on the matter has been consistently referred to in the financial statements of the Company 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 Company are subject to legal and administrative regulations and the Company is a party to a number of legal proceedings and commercial contracts related to its operational activities. The Company believes that adequate provisions have been recorded for known and quantifiable risks.

29. Related party transactions

29.1. Management Board and Supervisory Board compensation

Management Board compensation was as follows:

(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*
Short-term benefits excluding employer social security payments [1]	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**

[1] 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**

(1) From the date of appointment.

Persons that were Members of the Management Board of the Company in 2011 or previous periods:

(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*
Roland Dubois	1,718(1)	-	2,357	350
Richard Shearer	-	-	2,225(2)	-
Total	**1,718**	**-**	**4,582**	**350**

(1) Includes remuneration and bonuses until the termination date, compensation and termination indemnities.
(2) Termination benefit accrued in 2009 and paid in 2010.

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.

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 [(2)]	-	-
Nathalie Clere [(2)]	-	-
Timothy Boatman	262	250
Thierry Bonhomme [(2)]	-	-
Jacques Champeaux	175	167
Dr. Mirosław Gronicki	175	167
Marie-Christine Lambert [(2)]	-	-
Pierre Louette [(2)]	-	-
Prof. Jerzy Rajski	175	167
Gerard Ries [(2)]	-	-
Dr. Wiesław Rozłucki	175	167
Antonio Anguita [(1) (2)]	-	-
Vivek Badrinath [(1) (2)]	-	-
Olivier Barberot [(1) (2)]	-	-
Olivier Faure [(1) (2)]	-	-
Ronald Freeman [(1)]	262	250
Raoul Roverato [(1) (2)]	-	-
Olaf Swantee [(1) (2)]	-	-
Total	**1,574**	**1,501**

[(1)] 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.
[(2)] Persons appointed to the Supervisory Board of the Company employed by France Telecom S.A. do not receive remuneration for the function performed.

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, TP S.A. did not enter into any significant transactions with members of the 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, TP S.A. 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.

29.2. 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 26.3), 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.

TP S.A.'s income earned from its subsidiaries comprises mainly leased lines and interconnect, data transmission, property rental and related fees and fees for distribution of products through its own sales network. The purchases from the subsidiaries comprise mainly customer support and management services, selling fees, costs of interconnect, leased lines, network services, consulting services and property rental and related fees. Costs incurred by the Company in transactions with its subsidiaries also comprise donations to Fundacja Orange.

Revenue earned from France Telecom Group comprises mainly research and development services, interconnect and data transmission. The purchases from the France Telecom Group comprise mainly costs of leased lines, interconnect, network services, IT services and consulting services.

The Company's income earned from TP Group's joint ventures comprises mainly transactions with NetWorkS! Sp. z o.o. (see Note 4 to IFRS Consolidated Financial Statements of the Telekomunikacja Polska Group for the year ended 31 December 2011).

TP S.A.'s financial income earned from its subsidiaries comprises dividends from subsidiaries, including a dividend paid by PTK-Centertel Sp. z o.o. in the amount of PLN 862 million in year 2011 and PLN 1,600 million in year 2010. The financial income also comprises interest on bonds issued by subsidiaries and interest on loans granted to subsidiaries. Financial costs incurred by TP S.A. in transactions with related parties mainly comprise interest on bonds issued to the subsidiaries and interest on loans from the subsidiaries. The Company's financial receivables from its subsidiaries mainly comprise bonds issued by subsidiaries and loans granted to the subsidiaries, together with accrued interests. Financial payables to related parties comprise bonds issued to the subsidiaries and loans from the subsidiaries, together with accrued interests.

(in PLN millions)	*12 months ended 31 December 2011*	*12 months ended 31 December 2010*
Sales of goods and services to:	**1,241**	**1,049**
TP Group	1,063	877
- TP Group (subsidiaries)	1,059	877
- TP Group's joint ventures	4	-
France Telecom Group	178	172
- France Telecom S.A. (parent)	134	127
- France Telecom (group)	44	45
Purchases of goods (including inventories, tangible and intangible assets) and services from:	**1,539**	**1,157**
TP Group (subsidiaries)	1,367	1,009
France Telecom Group	172	148
- France Telecom S.A. (parent)	84	89
- France Telecom (group)	88	59
Financial income:	**1,262**	**2,228**
TP Group (subsidiaries)	1,262	2,228
Financial expense:	**566**	**587**
TP Group (subsidiaries)	566	587
Dividends paid:	**997**	**997**
France Telecom S.A. (parent)	997	997

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:	**318**	**247**
TP Group	210	178
- TP Group (subsidiaries)	206	178
- TP Group's joint ventures	4	-
France Telecom Group	108	69
- France Telecom S.A. (parent)	102	60
- France Telecom (group)	6	9
Financial receivables from:	**3,155**	**3,435**
TP Group (subsidiaries)	3,155	3,435
Payables to:	**383**	**460**
TP Group (subsidiaries)	262	357
France Telecom Group	121	103
- France Telecom S.A. (parent)	98	81
- France Telecom (group)	23	22
Financial payables to:	**7,801**	**8,243**
TP Group (subsidiaries)	7,801	8,243

In addition to the above mentioned transactions, during the 12 months ended 31 December 2011 TP S.A. has conducted share sale transactions with its subsidiaries (see Note 13.1).

Additionally, when considering the Company as a lessor, future minimum lease payments under non-cancellable operating leases concluded with subsidiaries amounted to PLN 53 million as at 31 December 2011 and PLN 59 million as at 31 December 2010.

30. 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 28.e).

On 27 January 2012, TP S.A. concluded a share sale agreement with Comp S.A. under which the investment in PayTel S.A. was disposed of and the loan receivable from PayTel S.A. settled for a total consideration amounting to PLN 6 million.

Management Board's Report on the Activity of

TELEKOMUNIKACJA POLSKA S.A.

in 2011

13 February 2012

This report on the activity of the Telekomunikacja Polska S.A. ("the Company", "the Parent Company", "TP S.A.", "TP") in 2011 has been drawn up in compliance with Article 91 of the Decree of the Minister of Finance of 19 February 2009 on current and periodic information disclosed by issuers of securities and conditions for recognising as equivalent information required by the laws of a non-member state (Journal of Laws of 2009 No. 33, item 259, as amended).

CHAPTER I.
HIGHLIGHTS OF THE FINANCIAL STATEMENTS

as of 31 December 2011 and for the twelve-month period ended thereon

1 SUMMARISED FINANCIAL STATEMENTS

	For 12 months ended				
	31 December 2011		31 December 2010		Change
	in PLN mln	in EUR[1] mln	in PLN mln	in EUR[2] mln	
Income Statement					
Revenue	7,840	1,894	8,434	2,106	-7.0%
EBITDA	3,335	806	2,152	537	54.9%
EBITDA margin	*42.5%*		*25.5%*		17pp
Operating income	995	240	(258)	(64)	n/a
Operating margin	*12.7%*		*n/a*		*n/a*
Net income after tax	1,951	471	1,023	255	90.7%
*Weighted average number of shares (in millions)**	*1,334*		*1,336*		
Earnings per share (in PLN) (basic and diluted)	*1.46*	*0.35*	*0.77*	*0.19*	*89.6%*
Statement of Cash Flows					
Net cash provided by operating activities	3,329	804	4,380	1,094	-24.0%
Net cash used in investing activities, including	(85)	(21)	(1,075)	(268)	-92.1%
Capital expenditures (on accrual basis)	(1,939)	(468)	(1,892)	(472)	2.5%
Net cash used in financing activities	(2,925)	(707)	(3,033)	(757)	-3.5%
Net change in cash and cash equivalents	319	77	272	68	17.3%

	As of				
	31 December 2010		31 December 2009		Change
Balance Sheet	in PLN mln	in EUR[3] mln	in PLN mln	in EUR[4] mln	
Cash and cash equivalents	2,584	585	2,268	573	13.9%
Intangible assets	1,396	316	1,247	315	11.9%
Property, plant and equipment	12,100	2,740	12,657	3,196	-4.4%
Total assets	28,477	6,447	28,617	7,226	-0.5%
Financial liabilities at amortised costs, of which:	9,517	2,155	10,136	2,559	-6.1%
Current	2,566	581	2,580	651	-0.5%
Non-current	6,951	1,574	7,556	1,908	-8.0%
Other liabilities, current and non-current	6,321	1,431	5,581	1,409	13.3%
Total equity	12,639	2,862	12,900	3,257	-2.0%

Notes on convenience translation:
1 – PLN/EUR fx rate of 4.1401 applied
2 – PLN/EUR fx rate of 4.0044 applied
3 – PLN/EUR fx rate of 4.4168 applied
4 – PLN/EUR fx rate of 3.9603 applied
** Weighted average number of shares in 12 months ended 31 December 2011*

1.1 Comments to Income Statement Items

In 2011, TP S.A.'s revenue amounted to PLN 7,840 million in 2011 and was lower by PLN 594 million as compared to 2010. The decrease in revenue resulted mainly from a decrease of PLN 640 million in subscriptions and voice traffic revenue and a decrease of PLN 104 million in broadband revenue which were partially offset by an increase of PLN 102 million in sales of goods and other.

Operating income before depreciation and amortisation expense and impairment of non-current assets (EBITDA) amounted to PLN 3,335 million in 2011 and was PLN 1,183 million higher than in 2010.

Operating result (EBIT) amounted to PLN 995 million in 2011 and was PLN 1,253 million higher than in 2010.

In particular, year-on-year, in 2011:

- Gain on disposal of TP Emitel of PLN 1,251 million;

- Other external purchases increased by PLN 396 million;
- Labour expenses were PLN 237 million lower;
- Restructuring costs were up by PLN 137 million;
- Depreciation and amortisation decreased by PLN 75 million;
- Interconnect expenses decreased by PLN 72 million;
- Provision for dispute with DPTG was increased by PLN 35 million in 2011 in comparison to PLN 1,061 million in 2010,
- Commercial expenses were higher by PLN 23 million;
- Network and IT costs decreased by PLN 14 million;
- Impairment of non-current assets increased by PLN 5 million.

Net financial charges, before dividends from subsidiaries (PLN 962 million in 2011 as compared to PLN 1,906 million in 2010), amounted to PLN 353 million in 2011 and were PLN 148 million lower than in 2010, mainly due to PLN 104 million of net foreign exchange gains (in comparison to PLN 18 million of net foreign exchange losses in 2010).

TP's net income (after dividends from subsidiaries) for the reported period amounted to PLN 1,951 million, which is an increase of PLN 928 million compared with 2010. Earnings per share (after dividends from subsidiaries) increased from PLN 0.77 to PLN 1.46.

1.2 Comments to Cash Flow Statement Items

In 2011, net cash provided by operating activities totalled PLN 3,329 million and was lower by PLN 1,051 million year-on-year. The decrease was mainly a result of a decrease of PLN 944 million in dividends received.

Net cash used in investing activities amounted to PLN 85 million in 2011 and was lower by PLN 990 million compared to 2010. The decrease was a result of higher inflows of PLN 1,532 million in proceeds from sale of subsidiaries which was partially offset by a higher outflow on property, plant and equipment and intangible assets by PLN 557 million and lower proceeds from sale of property, plant and equipment and intangible assets by PLN 52 million.

Net cash outflows from financing activities totalled PLN 2,925 million in 2011 and were by PLN 108 million lower than in 2010. The primary factor contributing to this change was an increase of PLN 1,467 million in bank overdrafts and other short-term borrowings, which was partially offset by outflows of PLN 1,189 million on redemption of bonds and PLN 200 million on purchase of treasury shares.

1.2.1 Capital Expenditures (CAPEX)

TP's CAPEX totalled PLN 1,939 million in 2011 and was PLN 47 million higher than in 2010. TP continued investments resulting from the Memorandum of Understanding signed with UKE on 22 October 2009.

Investment projects included:

- development of broadband internet access network, which also enables provision of television services, as well as related purchases of subscriber terminals;
- implementation of investment projects for sales and after-sales service purposes;
- modernisation and development of IT infrastructure, aimed at optimisation of customer service processes;
- IT systems development, including implementation of investment projects related to the development of service portfolio;
- further development of fiber-optic network and transmission equipment in order to launch new backbone and access lines;
- implementation of investment projects related to the development of the Wirtualna Polska portal and on-line content;
- research and development;
- implementation of "Chinese Walls" in accordance with the Memorandum of Understanding with UKE.

1.3 Comments to Balance Sheet Items

As of 31 December 2011, total equity amounted to PLN 12,639 million and was PLN 261 million lower than one year before. The change is attributed mainly to the dividend paid of PLN 2,003 million and purchase of own shares which amounted to PLN 200 million, which were partially offset by net income of PLN 1,951 million generated in 2011.

In 2011, property, plant, equipment and intangible assets decreased by PLN 408 million year-on-year, mainly as a result of amortisation and depreciation of PLN 2,324 million, which was only partially offset by capital expenditures amounting to PLN 1,939 million.

Total assets decreased by PLN 140 million in the reported period. The change resulted mainly from the aforementioned decrease of PLN 408 million in property, plant, equipment and intangible assets, a decrease of PLN 408 million in investments in subsidiaries and a decrease of PLN 278 million in loans and receivables, excluding trade receivables, which were partially offset by an increase of PLN 315 million of deferred tax assets, an increase of PLN 296 million in financial assets at fair value through profit or loss and an increase of PLN 316 million in cash and cash equivalents.

Non-current and current liabilities increased by PLN 121 million to PLN 15,838 million as of 31 December 2011. The primary factors that contributed to the change were an increase of PLN 937 million in provisions, an increase of PLN 84 million in trade payables and an increase of PLN 15 million in deferred income, which were partially offset by a decrease of PLN 619 million in the Company's debt on account of bonds, bank borrowings and finance leasing and a decrease of PLN 180 million in hedging derivatives.

The structure of liabilities changed in 2011. In 2011, current liabilities increased by PLN 846 million, while non-current liabilities decreased by PLN 725 million. It was mainly a result of an increase of PLN 863 million in short-term provisions and an increase of PLN 84 million in short-term trade payables, which were accompanied by a decrease of PLN 605 million in long-term financial liabilities on account of bonds, bank borrowings and financial leasing and a decrease of PLN 126 million in long-term hedging derivatives.

1.4 Related Parties Transactions

Please see Note 29 to the IFRS Financial Statements for information about TP S.A.'s transactions with related entities.

1.5 Description of Significant Agreements

On 24 March 2011, Bilbo sp. z o.o., a TP's subsidiary, together with TP S.A. signed a preliminary sale agreement with Warsaw-based Kapiri Investments sp. z o.o., whose sole shareholder was Montagu IV (B) LP, for all shares held in Kraków-based TP Emitel.

On 22 June 2011, Bilbo sp. z o.o. and EM Bidco sp. z o.o. (formerly Kapiri Investments) signed the promised sale agreement pursuant to which TP Group sold all shares held in TP Emitel sp. z o.o. (for additional information on the transaction please see section 8.2 below).

On 21 July 2011, TP Group's mobile arm PTK Centertel sp. z o.o. and Polska Telefonia Cyfrowa sp. z o.o. signed an agreement on reciprocal use of radio access networks (for additional information on the agreement please see Management Board's Report on the Activity of the TP Group).

1.6 Subsequent Events

Please see Note 30 to the IFRS Financial Statements enclosed for information on subsequent events.

1.7 Information about the Loan or Borrowing Collaterals or Guarantees Provided by the Issuer or Its Subsidiaries

Please see Note 28 to the IFRS Financial Statements enclosed for information about the loan or borrowing collaterals or guarantees provided by the issuer or its subsidiaries.

1.8 Management of Financial Resources and Liquidity of TP S.A.

TP financed its activities in the reported period mostly by use of cash generated from operating activities, as well as by use of funds raised in bond issues in previous years.

In 2011, TP repaid long-term debt of loans totalling PLN 233 million and redeemed bonds totalling EUR 300 million par. All debt repayments were carried out on schedule.

As of 31 December 2011, TP's interest-bearing liabilities totalled PLN 9,517 million (before derivatives), which is a decrease of PLN 619 million compared to 31 December 2010.

TP's liquidity remained solid, owing to strong cash position, amounting to PLN 2,584 million at 31 December 2011, and available credit facilities totalling the equivalent of PLN 3,767 million (please see section 1.8.3 below for details).

Based on available cash, back-up and revolving credit facilities, as well as external sources of financing, TP has sufficient funds to carry out its investment projects, including capital investments, scheduled for implementation in 2012.

1.8.1 Bonds

On 4 July 2011, TP redeemed at maturity seven-year bonds totalling EUR 300 million par, which had been issued on 5 July 2004 to TPSA Eurofinance France SA.

TP did not issue or redeem any external long-term debt notes in the reported period.

As part of liquidity management, in 2011 TP issued and redeemed short-term bonds acquired by TP Group companies in a programme, which was set up in 2002 and totals PLN 2,500 million. As at the end of 2011, TP’s liabilities on the account of outstanding bonds in the programme increased by PLN 740 million.

Please see Note 17.1 to the IFRS Financial Statements for the detailed information on outstanding external long-term debt notes, including their terms and redemption details.

1.8.2 Loan and Borrowings Agreements

In 2011, TP concluded the following loan agreements:

A current account overdraft agreement concluded by TP with RBS Bank (Polska) S.A. for PLN 62 million. The agreement provides an overdraft facility to secure the Parent Company’s liquidity and current financing in the period between 1 July 2011 and 29 December 2011;

In 2011, TP did not draw any new bank loans upon existing loan agreements.
In the same period, the bank borrowings amounting of PLN 233 million were repaid.

Please see Notes 17.2 to the IFRS Financial Statements for the detailed information on all bank loans (including their maturity dates).

1.8.3 Unused Credit Facilities

As of 31 December 2010, TP had outstanding general-purpose credit facilities amounting to an equivalent PLN 3,767 million, specifically EUR 400 million and PLN 2,000 million.

1.8.4 Loan Covenants

Under agreements concluded, TP as the Parent Company is a party to loan and guarantee agreements imposing an obligation to meet the ratio of net debt to EBITDA not higher than 3.5:1 (tested for the TP Group on a six months’ basis). The value of the ratio on 31 December 2011 was met.

1.8.5 Guarantees and Collaterals

On 19 September 2011, TP signed with ING Bank N.V. Dublin Branch and ING Bank Śląski S.A. an agreement for granting a guarantee of EUR 127.6 for the European Commission to secure TP’s obligations in an appeal procedure against a fine imposed by the European Commission.

On 30 December 2011 TP signed the Annex 1 to the Collateral Agreement with Polska Telefonia Cyfrowa Sp. z o.o. (“PTC”), totalling PLN 6 million, with respect to liabilities of PayTel S.A., a TP’s subsidiary, resulting from an agreement of 3 February 2010 between PayTel S.A. and PTC on co-operation in handling payments to PTC on PayTel S.A.’s network. The annex amended the termination date of the Collateral Agreement. Agreement expired on the same day.

On 12 April 2011, TP granted a joint and several guarantee of up to PLN 2 million with respect to liabilities of its subsidiary TP Teltech Sp. z o.o. pursuant to an agreement between TP Teltech sp. z o.o. and Tele-Fonika Kable Sp. z o.o.

In the reported period, TP requested that the Polish Branch of Societe Generale S.A. issue bank guarantees with respect to liabilities of TP Teltech Sp. z o.o., a TP wholly-owned subsidiary, towards its business partners, while TP promised to cover any claims related to payments under the guarantee. As of 31 December 2011, those guarantees totalled PLN 7 million.

1.8.6 Ratings

The ratings at the end of December 2011 were as follows:

Moody’s Investor Services	A3, stable outlook
Standard and Poor’s Rating Services	BBB+, stable outlook

1.8.7 Hedging Transactions

TP continued to minimise its exposure to foreign exchange volatility in 2011, covering almost 100% of its debt denominated in foreign currencies, 76% of the nominal amount of the DPTG provision and 78% of the nominal amount of a provision for the fine imposed by the European Commission. TP also continued its hedging policy, securing the portions of the exposure on its investment liabilities.

Please see Notes 18 and 19 to the enclosed IFRS Financial Statements for the detailed information about foreign exchange and interest rate hedging.

1.8.8 TP's Financial Liquidity, Net Financial Debt and Status as a Going Concern.

At 31 December 2011, TP's quick and current ratios increased as compared to the end of 2010. Higher liquidity of TP was driven by an increase of PLN 488 million in current assets and decrease of PLN 50 million in current liabilities (less provisions and deferred credits). The liquidity ratios for TP at 31 December 2011 and 31 December 2010, respectively, are presented in the table below.

	31 December 2011	31 December 2010
Current ratio Current assets / current liabilities*	0.81	0.71
Quick ratio Total current assets – inventories / current liabilities*	0.80	0.70
Super-quick ratio Total current assets – inventories – receivables / current liabilities*	0.63	0.53

*Current liabilities less provisions and deferred credits were used to determine the ratio.

TP's net financial debt (after valuation of derivatives) decreased to PLN 3,412 million at the end of 2011 (from PLN 4,713 million at the end of 2010).

Please see Note 19.5 to the enclosed IFRS Financial Statements for additional information about TP's liquidity.

2 STATEMENTS OF THE MANAGEMENT BOARD

2.1 Statement on Adopted Accounting Principles

TP Management Board, composed of:

1. Maciej Witucki - President of the Board,
2. Vincent Lobry - Vice President of the Board,
3. Piotr Muszyński - Vice President of the Board,
4. Jacques de Galzain - Board Member, and
5. Jacek Kowalski - Board Member

hereby confirms that according to its best knowledge the financial statements and comparable data have been drawn up in compliance with the accounting regulations in force and reflect TP S.A.'s property, financial standing and financial result in an accurate, reliable and transparent manner.

This Management Board's Report provides accurate depiction of the development, achievements and standing of TP S.A., including the description of major threats and risks.

2.2 Statement on Appointment of the Licensed Auditor of the TP Group's Financial Statements

TP's Management Board hereby declares that the licensed auditor of the financial statements has been appointed in compliance with the relevant regulations and that both the auditor and the chartered accountants carrying out the audit meet the requirements to develop an impartial and independent opinion on the audited statements in compliance with the relevant regulations and professional standards.

2.3 Agreement with the Licensed Auditor

On 18 May 2011 and 9 September 2011, TP concluded agreements with an entity licensed to audit financial statements for auditing and reviewing the financial statements of TP S.A. and the consolidated financial statements of the Telekomunikacja Polska Group ("the TP Group" or "the Group") for reporting periods of 2011. Based on the agreement, Deloitte Audyt Sp. z o.o. has performed the following:

- reviews of the standalone and consolidated financial statements for the first half of 2011;
- the audit of the standalone financial statements of the Company and the consolidated financial statements of the TP Group for 2011 prepared in accordance with IFRS;
- agreed procedures concerning audit and reviews of standalone and consolidated financial statements in 2011.

The aggregate remuneration (in PLN '000) for auditing and reviewing the above-mentioned financial statements and other services rendered by Deloitte Audyt Sp. z o.o. for 2011 is presented below:

	2011
Audit of annual financial statements of the TP Group, including:	5,946
- Audit of annual financial statements of TP and the consolidated financial statements of the TP Group;	3,920
- Audit of annual financial statements of subsidiaries*.	2,026
Other authentication services to the TP Group, including:	1,865
- Review of financial statements of TP and the consolidated financial statements of the TP Group at 30 June 2011;	1,754
- Other authentication services. **	111
Total amount payable by TP Group	7,811

** The remuneration for audits of subsidiaries is payable under separate contracts between the auditor and each subsidiary.*

*** including remuneration paid for Deloitte Advisory sp. z o.o.*

The aggregate remuneration for auditing and reviewing the above-mentioned financial statements and other services rendered by Deloitte Audyt Sp. z o.o. as of 2010 was as follows: PLN 5,629 thousand for audits/reviews of TP; PLN 122 thousand for audit-related and other services to TP; and PLN 2,071 thousand for audits of subsidiaries.

2.4 Management Board’s Position as to the Achievement of the Previously Published Financial Projections for the Given Period

TP did not publish financial projections concerning its results for 2011.

3 CORPORATE GOVERNANCE STATEMENT

(a) TP's corporate governance policy

The Company, as an issuer of securities listed on the Warsaw Stock Exchange (WSE), is obliged to comply with the corporate governance practices set out in the *Code of Best Practice for WSE Listed Companies*, which is available at http://corp-gov.gpw.pl.

(b) Corporate governance compliance

In 2011, the Company complied with the corporate governance best practice referred to above.

Furthermore, referring to the Section I of the *Best Practice*, the Company informs that:

(1) The Company has applied the recommendations of the European Commission (section I.5) for remuneration of members of supervisory and management bodies. The Supervisory Board is currently reviewing the existing rules for the purpose of further formalisation thereof.

(2) One of the Company's priorities is to ensure equal access of women and men to management positions in the Company (section I.9). Therefore, TP has developed assumptions for a project, which will determine the proportion of employing men and women in managerial posts, as well as a new set of assumptions for the recruitment process. TP has followed a policy of appointing persons with proper competence, professional experience and expertise to its supervisory and management bodies.

(3) TP has not made a decision yet on the application of a rule that a company should enable its shareholders to participate in a General Meeting using electronic communication means through real-life broadcast of General Meetings, real-time bilateral communication, exercise their right to vote during a General Meeting either in person or through a plenipotentiary (sections I.12 and IV.10). Please note that according to the *Best Practice*, the aforementioned rule should be applied not later than 1 January 2013.

(c) Description of major features of TP's internal control and risk management systems with respect to the process of development of standalone and consolidated financial statements

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 TP 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 system of internal control and risk management at TP S.A. and TP Group 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.

TP S.A. 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 TP and TP Group. In 2011, the Disclosure Committee had five meetings.

The key elements of TP'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 programme 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 TP and TP 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 TP and TP 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.

(d) Indication of shareholders holding, directly or indirectly, significant batches of shares, including the number of shares held, the interest in the Share Capital, the corresponding number of votes and the percentage of the total voting power at the General Meeting

Shareholder	Number of shares held	Number of votes at the General Meeting	Percentage of the total voting power at the General Meeting(2)	Nominal value of shares held (in PLN)	Interest in the Share Capital
France Telecom S.A.	664,999,999	664,999,999	50.21%	1,994,999,997	49.79%
Capital Group International, Inc.(1)	67,546,647	67,546,647	5.10%	202,639,941	5.06%
Other shareholders	591,788,966	591,788,966	44.69%	1,775,366,898	44.30%
Subtotal (before treasury shares)	**1,324,335,612**	**1,324,335,612**	**100.00%**	**3,973,006,836**	**99.15%**
TP S.A. (treasury shares)	11,313,409	-	-	33,940,227	0.85%
TOTAL	**1,335,649,021**	**1,335,649,021**	**100.00%**	**4,006,947,063**	**100.00%**

(1) The number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

(2) As a result of buy-back of shares by the Company for the purpose of their redemption, the percentage of the total voting power held by Shareholders at the General Meeting increased as of 31 December 2011.

(e) Indication of holders of any securities granting special control rights and description of such rights

The Company has not issued any securities granting any special control rights to shareholders or other entities.

(f) Indication of any restrictions concerning the exercise of the voting rights on shares, such as restriction of the voting rights to a certain percentage or number of votes or temporary restriction of the voting rights, or regulations according to which, in conjunction with the Company, the rights on securities are separated from the ownership of securities

The Company has not introduced any specific restrictions concerning the exercise of the voting rights on shares.

(g) Indication of any restrictions concerning transfer of ownership of the securities issued by TP

The transfer of ownership of the securities issued by the Company is not subject to any restrictions.

(h) Description of procedures for appointment and removal of managing persons and their rights, particularly the right to make decisions regarding the issuance or redemption of shares

The Management Board consists of between 3 and 10 members, including the President. They are appointed and removed by the Supervisory Board by a simple majority of the votes cast. The term of office for the member of the Management Board is three years. The Management Board's remit comprises the management of all aspects of the Company's affairs, with the exception of the matters which under the Polish Commercial Companies Code or the Articles of Association shall be within the competence of the General Meeting or the Supervisory Board. In particular, the powers of the Management Board include development of the Company's strategy, economic and financial plans; establishment, transformation and liquidation of the Company's business units; and governance of TP Group subsidiaries. Any decisions regarding the issuance or redemption of the Company's shares are exclusively within the competence of the General Assembly.

The powers of the Management Board are detailed in the Management Board by-laws, available at www.tp-ir.pl.

(i) Description of procedures for amending the Articles of Association or the deed of the company

Any amendment to the Articles of Association requires a resolution of the General Assembly adopted by a majority of the three quarters of votes.

(j) Rules of operation of the general meeting and its major responsibilities, and description of the shareholders' rights and the way of exercise thereof, particularly the rules resulting from the general meeting by-laws, if any, unless the information in this respect results directly from mandatory regulations

I. General Assemblies shall be held in Warsaw. The General Meeting shall be valid irrespective of the number of shares represented. According to the adopted by-laws, the General Meeting shall be opened by the Chairman of the Supervisory Board or his deputy, or, in case of their absence, by the President of the Management Board or a person designated by the Management Board. Thereafter, the Chairman shall be elected from among the persons entitled to take part in the General Meeting. After each subsequent matter on the agenda has been presented the Chairman of the General Meeting shall open a discussion giving floor to speakers in the sequence in which they have declared their willingness to speak. Upon the consent of the General Meeting several items of the agenda may be discussed jointly. The participants may speak only on the matters which have been put on the agenda and are being considered at that moment.

II. Pursuant to the Regulations of the General Meeting of TP S.A., the shareholders have the following rights:

(1) The shareholders may take part in the General Meeting and exercise the right of vote in person or by attorneys-in-fact (other representatives).

(2) Each shareholder has the right to candidature for the Chairman of the General Assembly or to put forward one candidature for the position of the Chairman of the General Meeting to the minutes.

(3) When every point on the agenda is considered each shareholder has the right to one speech of 5 minutes and a reply of 5 minutes.

(4) Each shareholder has the right to ask questions on any matters on the agenda.

(5) The shareholder has the right to object a decision of the Chairman of the General Meeting. The General Meeting shall decide in a resolution whether the decision of the Chairman be upheld or reversed.

(6) Each shareholder has the right to suggest amendments or additions to draft resolutions, which are covered by the agenda of the General Meeting, by the time of closing the discussion over the item on the agenda referring to the draft resolution to which the suggestion is related.

(k) Composition and changes thereof in the last financial year, and description of bodies that manage, supervise or administer TP and any committees thereof

I. Composition of the Management Board and changes thereof in 2011

Composition on 1 January 2011:

1. Maciej Witucki - President of the Board
2. Vincent Lobry - Vice President of the Board
3. Piotr Muszyński - Vice President of the Board
4. Roland Dubois - Board Member

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.

Composition on 31 December 2011:

1. Maciej Witucki - President of the Board
2. Vincent Lobry - Vice President of the Board
3. Piotr Muszyński - Vice President of the Board
4. Jacques de Galzain - Board Member
5. Jacek Kowalski - Board Member

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.

II. Composition of the Supervisory Board and its Committees and changes thereof in 2011

Composition on 1 January 2011:

1. Prof. Andrzej K. Koźmiński - Chairman and Independent Board Member

2.	Olivier Barberot	- Deputy Chairman and Chairman of the Strategy Committee
3.	Olivier Faure	- 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.	Ronald Freeman	- Independent Board Member and Chairman of the Remuneration Committee
8.	Dr. Mirosław Gronicki	- Independent Board Member
9.	Marie-Christine Lambert	- Board Member
10.	Prof. Jerzy Rajski	- Independent Board Member
11.	Raoul Roverato	- Board Member
12.	Dr. Wiesław Rozłucki	- Independent Board Member
13.	Olaf Swantee	- Board Member

Mr. Raoul Roverato resigned from his function on the Supervisory Board as from 26 January 2011.

On 27 January 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 24 March 2011.

On the same day, Mr. Pierre Louette was appointed by the Supervisory Board as a Member of the Supervisory Board.

On 14 April 2011, the mandates of Messrs. Timothy Boatman and Gérard Ries expired.

On the same day, Messrs. Timothy Boatman and Gérard Ries were appointed by the Annual General Meeting as Members of the Supervisory Board.

Mr. Olivier Faure resigned from his function on the Supervisory Board as from 11 July 2011.

On 12 July 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 12 October 2011.

On 13 October 2011, the mandates of Ms. Nathalie Clere and Mr. Pierre Louette expired.

On the same day, Ms. Nathalie Clere, Mr. Pierre Louette and Mr. Benoît Scheen were appointed by the Extraordinary General Meeting as Members of the Supervisory Board.

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

Composition on 31 December 2011:

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

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

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

Composition of Committees of the Supervisory Board on 31 December 2011:

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
2. 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 quests.

III. Operations of the Management Board

The operations of the Management Board shall be managed by its President, who shall be the superior of all the Company's employees. Meetings of the Management Board are chaired by the President of the Management Board or, in case of his absence, another member of the Management Board designated by the President. Resolutions may be adopted if all members of the Management Board have been duly notified about the meeting. Resolutions of the Management Board shall be adopted by absolute majority of votes of all appointed members of the Management Board. Individual members of the Management Board shall manage the areas of the Company's operations assigned to them.

The responsibilities and obligations of the Management Board are detailed in the Management Board by-laws, available at www.tp-ir.pl.

IV. Operations of the Supervisory Board

The work of the Supervisory Board is co-ordinated by the Board Chairman with the assistance of the Board Secretary. The Supervisory Board shall hold a meeting at least once a quarter. The Management Board or a member of the Supervisory Board may demand convening a meeting, specifying a suggested agenda thereof. The Chairman of the Supervisory Board shall call a meeting within two weeks of the receipt of the aforementioned motion. In case the Chairman of the Supervisory Board fails to call a meeting within two weeks, the applicant may call it on his own, specifying the date, place and suggested agenda of the meeting. The Supervisory Board shall adopt resolutions by a simple majority of the votes cast and in the presence of at least half of all members of the Supervisory Board. In case of equal votes, the Chairman of the Supervisory Board shall have the decisive vote.

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.

The Supervisory Board by-laws are available at www.tp-ir.pl.

In particular, the Supervisory Board 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 its supervisory responsibilities, it examines the Company's strategic plan and annual budget, monitors the Company's operating and financial performance, formulates opinions on incurring liabilities that exceed the equivalent of €100,000,000, formulates opinions on disposal of the Company's assets in exceed the equivalent of €100,000,000, evaluates the Management Board's report on the Company's activities and the Management Board's proposals regarding distribution of profits or covering losses. In considering these matters, the Board takes into account the social, environmental and ethical considerations that relate to TP's businesses.

Furthermore, an amendment to the Polish Accounting Act, dated September 29, 1994 was published in 2009 which increased the responsibility of the members of the Supervisory Board in regards to the reliability and fair presentation of the Company's financial reporting.

V. Operations of the Committees of the Supervisory Board

(A) The Audit Committee

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.

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;
   b. Any changes to accounting standards, policies and practices;
   c. Major areas of financial reporting subject to judgement;
   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 Board 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.

(B) The Remuneration Committee

The Remuneration Committee's task is to advise the Supervisory Board and Management Board on the general remuneration and nomination policy of TP Group, determining the conditions of employment and remuneration (including the setting of objectives) of the Members of Management Board and giving recommendations to the Supervisory Board regarding salaries and the amounts of bonuses for the members of the Management Board.

(C) The Strategy Committee

The tasks of the Strategy Committee include:

(1) giving its opinion and recommendation to the Supervisory Board on the strategic plans put forward by the Management Board and any further suggestions made by the Supervisory Board regarding such strategic plan(s), and in particular on the main strategic options involved; and

(2) consulting on all strategic projects related to the development of TP and TP Group, the monitoring of the evolution of industrial partnerships within TP Group and projects involving strategic agreements for TP Group. It then reports and makes recommendations on each of these projects to the Supervisory Board.

In particular, the Committee is invited to consider projects such as:

(1) strategic agreements, alliances, and technological and industrial co-operation agreements, including aspects of the strategic partnership between France Telecom and TP Group; and

(2) significant acquisitions and sales of assets.

CHAPTER II.
MANAGEMENT BOARD’S REPORT ON OPERATING AND FINANCIAL PERFORMANCE OF TP S.A.

in 2011

4 FIXED LINE SEGMENT

4.1 Financial Performance

In 2011, TP's fixed line business remained under strong competitive and regulatory pressure. Total revenue declined by 7.0% (year-on-year) in 2011, which can be attributed mainly to the following factors:

- fixed-to-mobile substitution of both access and traffic;
- a regulatory decision reducing retail prices of F2M calls in the wake of MTR cuts in July 2011;
- customer price sensitivity, reflected in migration to WLR and LLU-based offers from competitors;

As a result, TP's retail fixed voice customer base declined by 12.4% year-on-year, while its average revenue per user dropped by 4.1%.

The broadband market was in a stabilization phase, mainly due to intensive price competition. In 2011, broadband revenue fell by 5.7% year-on-year, while retail broadband customer base was up 0.6%.

Fixed line EBITDA margin for the 2011 was 17 percentage points up since the comparable period of last year and EBITDA was higher by PLN 1,183 million, mainly due to:

- gains on disposal of TP Emitel, amounting to PLN 1,251 million;
- PLN 458 million adverse impact of an increase in provisions for claims and litigation, in relation to the fine imposed by the European Commission (as compared to PLN 50 million in 2010);
- deterioration of the underlying EBITDA, driven mainly by the contraction of revenue,
- additionally in 2010 provision for the dispute with DPTG was increased by PLN 1,061 million.

In order to mitigate the decreasing revenue trend on profitability of the fixed line segment, the TP Group is focused on restoring the growth of revenues from broadband and television services as well as further optimisation of its cost base (please see section 6.3 for details).

4.1.1 Fixed Line Voice Services

Fixed line voice services: revenues and key performance indicators

	For 12 months ended		
PLN million, unless indicated otherwise	31 December 2011	31 December 2010	Change
Revenues from fixed line services:	4,750	5,360	-11.4%
Subscription and traffic	3,358	3,998	-16.0%
Wholesale revenue incl. Interconnect	1,381	1,346	2.6%
Other	11	16	-31.3%
Number of fixed lines, '000 (excl. WLR/WLL and VoIP)	5,445	6,219	-12.4%

Fixed-line service retail revenues saw further erosion in 2011 resulting mostly from continuous competitive pressure and fixed-to-mobile substitution. These revenues decreased by PLN 640 million (or 16.0%) year-on-year.

TP has taken steps to contain the erosion of its fixed-line subscriber base. Towards the end of the first quarter, TP launched new tariff plans: 'doMowy', with 12-month or 24-month loyalty agreements. These offer lower prices than the standard offer. Furthermore, the new offer enables customers to make international and fixed-to-mobile calls within the access fee. Introduction of the new plans is aimed at increasing the attractiveness of TP's portfolio and building loyalty of customers through fixed-term agreements.

In September 2011, TP increased an access fee in its 'tp socjalny' [welfare] tariff plan, changing its name to 'tp podstawowy' [basic] plan. The decision resulted from the need to adjust the terms of the plan to the regulatory obligations imposed by the President of UKE on TP as an operator with significant market power in retail markets. In order to mitigate a drop in customer satisfaction caused by the increase, TP enabled subscribers to the plan to use its broadband services and reduced prices of calls.

In line with customer expectations, in the last quarter of 2011 TP began to actively communicate and sell bundled services. Its FunPack HD includes a VoIP voice service which offers unlimited calls to fixed line terminals in Poland.

Owing to attractive prices and pools of minutes embedded in the subscription, 'Business Plans' were TP's most popular tariff solution among business customers in 2011. May saw the introduction of new tariffs: 'Corporate Plans'. Under these plans, customers can make all types of calls and thus pay only the access fee if they choose a package which is optimum for them. The offer, which is addressed mainly to SOHO and SME segments, has already proved a success.

4.1.2 Fixed Line Data Services

Fixed line data services: revenues and key performance indicators

	For 12 months ended		
PLN million, unless indicated otherwise	31 December 2011	31 December 2010	Change
Revenues from data services	2,714	2,779	-2.3%
of which broadband and TV revenue	1,363	1,446	-5.7%
of which data transmission	755	722	4.6%
of which leased lines	594	606	-2.0%
others	2	5	-60%
xDSL(1) lines, '000	2,006	1,994	0.6%
Broadband(2) lines, '000	2,715	2,651	2.4%

(1) Excluding wholesale (BSA/LLU)
(2) Including SDI and wholesale (BSA/LLU)

Fierce competition, coming mostly from CATV operators, contained growth in TP's retail broadband lines to just 0.6% year-on-year. At the same time, TP's broadband revenues fell by PLN 83 million. This drove data revenues down by PLN 65 million or 2.3% as compared to 2010.

Broadband access market – key indicators:

	31 Dec 2011	**31 Dec 2010**	**31 Dec 2009**
Market penetration rate in Poland – broadband lines (in total population)	18%	17.0%	15.9%
Total number of broadband lines in Poland (thousands)	6,865	6,505	6,079
Market share of TP Group (TP + PTK Centertel)	34,2%	35.2%	37.4%

TP's fixed broadband customer base (incl. BSA and LLU) increased by 2.4% in 2011 (year-on-year), mainly as a result of a new offer based on the new "cost plus" pricing structure and launched on 1 October 2010.

TP continued to observe a trend of increasing demand for higher broadband speeds, fuelled by price reductions for the top speed options and introduction of new options based on the VDSL technology.

In 2011 TP continued to promote bundled offers of broadband and digital TV, offered in both IPTV and DTH (satellite digital TV) technologies, coupled with a competitive content offer based on co-operation with the *n Television*.

The most important development for TP's broadband offer in 2011 was the introduction of 40 to 80 Mb/s options (based on the VDSL technology) and the content offer of the *n Television*.

The key offers of *Neostrada* and *Neostrada with TV* in 2011 included:

- 'Internet of Your Dreams': 12-month or 24-month agreements for 2 to 20 Mb/s options. For customers who sign a 24-month agreement, the prices are PLN 54.40 for 2 Mb/s, PLN 59.48 for 6 Mb/s, PLN 64.53 for 10 Mb/s and PLN 69.57 for 20 Mb/s, as well as PLN 79.9 for *Neostrada Fiber* 40 Mb/s and PLN 99.9 for *Neostrada Fiber* 80 Mb/s, respectively.
- *Fun Pack*:
    - 80 Mb/s broadband service;
    - TV service based on DTH or IPTV technology (49 or 56 channels, respectively);
    - Telephone service: unlimited F2F calls in Poland for no extra fee, cheap F2M and ILD calls, crystal-clear HD quality sound.

  For a 24-month agreement, the prices are PLN 104.91 for 2 Mb/s, PLN 109.90 for 6 Mb/s, PLN 114.91 for 10 Mb/s, PLN 119.90 for 20 Mb/s, PLN 129.90 for 40 Mb/s and PLN 149.90 for 80 Mb/s, respectively.
- *n Television* packages: *Welcome to HD*, *HD World*, *HD Movies* and *Full HD*.

TP Group has a broad service portfolio for business, including both easily adaptable services for small to medium companies as well as sophisticated solutions for large corporations. TP has been steadily extending its service portfolio, investing in cutting-edge technologies, in order to offer solutions that meet customer needs.

Rapid growth of the IP VPN service continued throughout 2011. Customers are keen to sign up for the IP VPN service, as it streamlines functioning of their businesses and reduces costs of their business operations.

A further increase in demand for the Internet DSL service has been reported. The ‘e-Store’ option, available since March 2011, has proven an interesting solution for customers.

Also the *Business Package* offer has generated strong interest among business customers. The offer combines broadband access, an attractive tariff plan for voice calls, a security package, website space and email.

The development of Information and Communication Technology (ICT) services continued in 2011. A major development was the introduction of a new offer, ‘IT for Business’, in November. Customers are offered hardware, software and IT support within a single package.

A growing number of customers uses LAN development services and an offer of development of a cable network on customer’s site.

4.2 Market and Competition

Fixed line penetration rate has been steadily falling in Poland. It reached 25.8% of the population at the end of December 2011, as compared to 26.6% at the end of December 2010. Increasing penetration rate and popularity of mobile technologies have led to migration of fixed customer and traffic to mobile networks. In countries like Poland, where the fixed line penetration was low at the time of introduction of mobile technology, mobile telephony is rather a direct substitute to fixed line telephony than a complementary service.

Cable television operators have further expanded the range of fixed line voice and internet access services. In addition, wireless home zone offers promoted by mobile operators have been gaining popularity. Growth in WLR lines slowed down and the volume of services based on local loop unbundling (LLU) stabilised in 2011.

Broadband Internet Access Market

According to TP’s internal estimates, total number of fixed broadband access lines increased by 5.5% in 2011 (y-o-y), which means that the market grew at a slower pace than a year earlier. To a great extent this has been a result of the growth and popularisation of mobile broadband access, which is currently used mostly indoors and seems to be substitutive to fixed broadband access. The penetration of fixed broadband services in total Poland population had reached 18% by the end of December 2011 (compared to 17% at the end of 2010), while the household penetration rate increased to 45%.

It is estimated that value of the broadband market grew by 4.2% in 2011 compared to 6.1% in 2010.

Competitive pressure from cable television (CATV) operators has remained strong. CATV operators’ total market share has been estimated at 28% by volume (at the end of 2011) or 27% by value (in 2011). The market success of CATV results from popularity of bundled offers, which may be effectively sold by CATV operators due to their strong position on the television market. Another important factor is growing broadband speeds offered by CATV operators for the same price, which contributes to growth in average line speed in the Polish market as a whole and raises customers’ expectations.

In May 2011, TP Group introduced fast broadband access offers based on the VDSL2 technology.

The market saw major consolidation developments in 2011. The largest CATV player in the broadband market, UPC, acquired another cable TV operator Aster.

Upon acceptance by UOKiK, Netia acquired Telefonia Dialog and Crowley Data Poland, which will strengthen Netia’s position as TP Group’s biggest competitor in the fixed broadband market in Poland.

Alternative operators mainly Netia still make use of wholesale BSA and LLU based services, though as a result of implementation of the cost-based settlements in Q4 2010, BSA-based access has been visibly surpassed by LLU-based access in terms of profitability. The volume of BSA-based lines actually decreased in 2011 (compared to growth of 71,000 in 2010), while LLU-based lines reached 186,000 at the end of December (compared to 130,000 a year earlier).

TP Group has continued to offer broadband services based on the CDMA technology. The broadband market share of this offer in Poland, by volume, is estimated at 2.7%.

5 MATERIAL EVENTS THAT HAD OR MAY HAVE INFLUENCE ON TP GROUP'S OPERATIONS

Presented below are the key events that, in Management's opinion, have influence on TP Group's operations now or may have such influence in the near future. Apart from this section, the threats and risks that may impact the Group's operational and financial performance are reviewed in detail in the Chapter IV hereof.

5.1 Regulatory Obligations

Pursuant to President of UKE's decisions issued in 2007, TP was designated as an operator having significant market power ("an SMP operator") in relevant retail markets 1 to 7 (according to the European Commission's recommendation of 2003). As a result, some regulatory obligations were imposed on TP with respect to its activity in retail markets. These include:

- Obligation to not overprice retail services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation not to hinder other operators' entry into the retail market for services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation not to restrict competition by underpricing services in the market for services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation of regulatory accounting in line with the manual approved by the President of UKE and service cost calculation based on the Forward Looking Fully Distributed Cost (FL-FDC) methodology in line with the costing description approved by the President of UKE.

With respect to the markets 1/2003 to 7/2003, TP has an obligation to submit costing results and regulatory accounting statements to an independent audit. TP is also subject to an obligation to submit its price lists and terms of service provision for the President of UKE's approval with respect to services covered by the markets 1/2003 to 7/2003.

On 9 May 2011, the President of UKE's decisions imposing the universal service obligation on TP and determining the terms of provision thereof expired. Consequently, TP has no obligation to provide any universal service components on the terms specified in the President of UKE's previous decisions. In particular, TP does not carry out universal service costing and submit its results to an independent audit any more. However, TP still has to perform the obligations resulting from the valid rules of provision of telecommunication services which used to be universal service components. TP is carrying out talks with UKE on changing the rules of provision of the services which used to be rendered as part of the universal service obligation in order to adapt them to the new regulatory situation.

Pursuant to President of UKE's decisions, TP is currently an operator having a significant market power (SMP) in the relevant wholesale markets according to the European Commission's recommendation of 2003. In particular, it has the following regulatory obligations:

- In the domestic market for leased line terminating segment services (market 13/2003): obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide leased line terminating segment services; and
- In the domestic market for leased line trunk segment services, excluding connections between 145 locations (market 14/2003): obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide leased line trunk segment services.

In addition, the President of UKE has issued the following decisions designating TP as an SMP operator in the relevant wholesale markets according to the Commission's recommendation of 2007:

- In the domestic market for call origination on a fixed public telephone network (market 2/2007): obligation to enable end-user service management, offer wholesale services for the purposes of resale (WLR), provide telecommunications infrastructure and enable collocation and other forms of facility sharing;
- In the domestic market for provision of wholesale (physical) access to network infrastructure, including shared or fully unbundled access, in a fixed location (market 4/2007): The scope of the market was extended to include not only copper but also fibre optic loops and subloops. With respect to fibre optic loops, UKE has imposed on TP an obligation to provide conditional access. Wholesale pricing is to be cost-based, with the price squeeze test as the basic method of verification. As a

consequence of the decision, on 29 April 2011 the President of UKE declared that the previous SMP decision for TP with respect to the market 11/2003 had expired;

- In the domestic market for wholesale broadband access services, excluding some local administrative units (market 5/2007). TP has been designated as an SMP operator for the whole territory of Poland except for 11 local administrative units (gminas), including the City of Warsaw. Other areas, which have been subjected to regulation, have been differentiated in terms of regulatory obligations. TP has the obligation to provide access within all areas, but in 10 rural gminas it has no costing or equal treatment obligations. Furthermore, in 230 gminas (less dominated by TP), the Company does not have an obligation to apply a reference offer; however, it has the obligation of equal treatment: on the same terms and conditions as in the areas where the reference offer is required. Fibre optic technology has been included into the product range of the market.

The SMP decision for the market 12/2003 is still in force and applies to 11 administrative units which are not regulated pursuant to the decision for the market 5/2007. The decision will remain in force until the regulatory obligations are cancelled by a separate decision of the President of UKE.

Pursuant to SMP decisions for the markets 2/2007, 3/2007, 4/2007 and 5/2007 as well as 13/2003 and 14/2003, TP has an obligation to charge cost-based telecommunication access fees and an obligation to carry out regulatory accounting in accordance with a manual approved by the President of UKE. The relevant regulatory statements for these markets have to be submitted to an independent audit.

Pursuant to the SMP decision for the market 12/2003 (with respect to 11 administrative units which are not regulated pursuant to the decision for the market 5/2007), TP has an obligation to calculate costs of services and charge access fees based on the operator's justified costs. The service costing results for these markets are subject to an independent audit.

5.2 Co-operation between TP Group and TVN

In March 2011, TP Group began to distribute its basic TV offering enhanced with content provided by TVN. In addition, in June, TP's TV portfolio was extended to include pay TV packages reflecting the 'n – new generation television' offer, as well as a package dedicated to TP subscribers. Following the launch of the distribution of the pre-paid HD TV service on TP Group's distribution network and the distribution of Orange Free on TVN's website, this is a next step in the process of implementation of the long-term framework cooperation agreement signed by TP Group and TVN in October 2010.

Owing to the cooperation, both companies intend to benefit from enhanced attractiveness of the multi-play offering, up-selling potential on each other's customer bases as well as from cost synergies from joint technical, marketing and sales activities.

5.3 Deutsche Telekom and France Telecom-Orange joint venture

On April 2011 Deutsche Telekom AG and France Telecom-Orange have agreed to combine their procurement activities of customer equipment, network equipment, service platforms and possibly also IT infrastructure, in joint venture. Both groups will be able to bring sustained benefits and savings to their respective customers as well as ensuring that their businesses will be more competitive. Suppliers will benefit through the harmonization of equipment and features that will enable them to streamline their development activities and further generate synergies and efficiencies. This partnership can bring efficiencies also for TP Group due to its strategic partnership with FT Group.

5.4 CATV Operators

CATV operators, who hold an aggregate share of approximately 40% in the pay TV market and control almost one third of the broadband market, have an ambition to provide not only primary services, such as internet or voice, but also entertainment. Hence, promotions offering game consoles, IPTV, HD channel portfolio, music-on-demand and 3D television. As usage of such services will generate growing demand for higher capacities, CATV operators modernise their own networks and, more and more frequently, lease third party's fiber-optic lines.

CATV operators, which operate in Poland's biggest cities, are perceived as technological leaders offering the highest internet access speeds. Their common practice is to offer higher speeds or increase the scope of services within a package (e.g. with mobile internet) without increasing the service price.

2011 saw the introduction of convergent services, combining fixed line and mobile products, as well as consolidation of the industry. The most significant development was acquisition of CATV operator Aster by UPC.

5.5 Infrastructure Development

In 2011, TP continued to enhance its data networks infrastructure. This included increasing IP core network capacity and throughput of its data aggregation network, as well as increasing the capacity and geographical coverage for DSLAM equipment. Investments in backbone, aggregate and access networks have been carried out pursuant to the Memorandum of Understanding with UKE. TP has also developed new generation DSL access switches. These are compatible with the VDSL2 access technology, which enables setting up lines of speed up to 80 Mb/s .

In addition, infrastructure for providing *Videostrada tp*, Video-on-Demand (VoD) and Digital-to-Home (DTH) satellite television services has been further expanded.

As part of development of the core infrastructure of the IP network, TP implemented new generation routers of switching capacity of over 1 Tb/s. By the end of 2012, the capacity of the IP core network had been increased by over 20% (compared to the end of 2010) and exceeded 340 Gb/s.

In a programme of DSLAM access node development, by the end of 2011 TP had increased the availability of VDSL-based services to over 1,000 DSLAM nodes, which handle approximately 25% of xDSL users. A total of over 2.3 million households are now within the coverage of VDSL services.

TP's IPTV services covered over 70% of TP's xDSL broadband customer base as at the end of 2011.

In 2011, PTK Centertel continued development of the core network capacity in order to meet the growing demand. The process of implementation of the new-generation core network infrastructure based fully on IP protocol has reached its final stage. Subsequent BSC and RNC radio controllers have been gradually migrated to the R4 network. As at end of 2011, over 90% of GSM and UMTS/HSPA network users were handled using the new-generation core network.

PTK Centertel has also expanded the coverage of its UMTS/HSPA services and increased the capacity of its GSM network, while continuing investments in the CDMA network. The UMTS/HSPA network covered 62% of Poland's population and the CDMA network covered over 88% of Poland's territory at the end of 2011. In addition, the company has continued the implementation of a new mobile data technology, HSPA-DC, reaching the coverage of over 58% of Poland's population by the end of 2011.

5.6 LTE Technology Development and Impact on the Telecommunication Market

The second half of 2011 brought the launch of commercial LTE-based services by Cyfrowy Polsat and Polkomtel, which are members of the same group of companies.

In the short term, apart from enhancing the image of operators offering such services, the LTE introduction will not be a major breakthrough in the broadband market due to the following:

- limited geographical range of LTE;
- low market penetration with terminals which can handle this standard;
- the currently available technologies, HSPA+ and HSPA Dual-carrier, are sufficient to handle most value-added services (including applications, informational services and VOD).

In the long-term, LTE may emerge as a substitute of fixed broadband and mobile access outside big cities, as in such areas the benefits of rapid transfer and easy availability without the necessity to develop fixed line infrastructure may outweigh the limitations of the LTE technology compared to fixed line solutions (i.e. data transfer limits which are inherent in wireless solutions, as the related costs of data transmission are higher than in case of wired technologies). However, this will require that the coverage is expanded. This is in turn dependent on the completion of a process of allocating frequencies dedicated to rural and semi-rural areas, that is frequencies in the 800 MHz band (referred to as the 'digital dividend').

In larger cities, the LTE technology may in the long run mainly enable operators to offer mobile services complementary to fast fixed access based on VDSL, FTTx or DOCSiS 3.0 technologies, which should remain the primary form of broadband access for both households and companies.

5.7 Claims and Disputes, Fines and Proceedings

Please see Note 28 to the IFRS Financial Statements enclosed for detailed information about material disputes and proceedings against TP S.A., including investigation by the European Commission, as well as fines imposed thereon.

5.8 Cost Calculation Results

Under the regulatory obligations resulting from having significant market power in the relevant markets for call origination services on a fixed public telephone network (market 8/2003), bitstream access (market

12/2003) and retail services (markets 1/2003 to 7/2003), in 2011 TP had an obligation to carry out costing of services covered by the aforementioned markets for 2012, and submit the results thereof to an independent auditor selected by UKE. In addition, TP had an obligation to prepare regulatory accounting statements for 2010 and submit them to an independent audit.

In performance of its regulatory obligations, TP submitted a manual for drawing up regulatory statements for 2010 as well as descriptions of service costing for 2012 for the President of UKE's approval. On 16 May 2011, the President of UKE issued a decision on TP's service costing descriptions and regulatory reporting manual. On 31 May 2011, TP applied for the re-examination of the case by the President of UKE, requesting a change of incorrect provisions of the regulatory reporting manual.

On 17 May 2011, the President of UKE called upon Ernst&Young Audit sp. z o.o. to audit TP's service costing for 2012 and regulatory accounting statements for 2010. The audit had ended by 23 August 2011 with the submission of the audit report together with the auditor's opinion to the President of UKE and TP.

Court proceedings regarding costing descriptions and regulatory reporting manuals are pending.

On 28 January 2010, the President of UKE issued a decision on TP's service costing descriptions for 2011 and regulatory reporting manual for 2009. This decision imposed on TP an obligation to carry out wholesale service costing on the avoided-cost basis. In TP's opinion, the wholesale service costing methodology imposed by UKE is inconsistent with both EU and Polish regulations. On 11 February 2010, TP applied for the re-examination of the case by the President of UKE, but on 4 May 2010 the President of UKE issued a decision upholding the previously defined costing methodology. On 2 June 2010, TP filed a complaint against the aforementioned decision of the President of UKE with the Regional Administrative Court. The Court did not share TP's point of view and rejected its complaint on 1 December 2010. On 10 March 2011, TP filed a cassation appeal against the Regional Administrative Court's ruling with the Supreme Administrative Court. The procedure before the Supreme Administrative Court is pending.

Similar court proceedings were initiated in 2010 with respect to costing descriptions for 2010 and the regulatory reporting manual for 2008. On 30 March 2010, the Regional Administrative Court rejected TP's complaint against the President of UKE's decision approving service costing descriptions for 2010 and the regulatory reporting manual for 2008. Consequently, on 14 December 2010, TP filed a cassation appeal against the Regional Administrative Court's ruling with the Supreme Administrative Court. The procedure before the Supreme Administrative Court is pending.

5.9 Functional Separation

On 22 October 2009, TP and the President of UKE signed a Memorandum of Understanding, under which the President of UKE decided to suspend works on the functional separation of TP.

In December 2009, functional separation was included into the EU regulatory framework. Member states should have implemented the package within eighteen months. The European Commission holds that implementation of functional separation and its imposition on an SMP operator shall be considered only after careful market analysis, provided that other remedies have clearly failed to establish effective competition and prospectively will fail to do it in the future. Therefore functional separation shall be only regarded as a last resort remedy. A decision by the President of UKE on imposing extraordinary measures, such as functional separation, can be done only based on agreement from the European Commission. TP would have a right to appeal from such a potential decision.

On 23 April 2010, the Ministry of Infrastructure started preparations for the implementation of the new package of directives to the Polish law. On 20 October 2011, the Ministry published another draft bill amending the Telecommunication Law (as a government-sponsored bill). In February 2012, the draft bill is to be transferred to the relevant parliamentary committee. The draft bill provides for potential functional and structural separation. Owing to pending legislative work, the content of the draft bill may change.

5.10 Memorandum of Understanding with UKE

On 22 October 2009, TP and the President of the Office of Electronic Communications ("UKE") signed a memorandum of understanding ("MoU") for the implementation of transparency and non-discrimination procedures in inter-operator relations. Pursuant to MoU, UKE declared freezing wholesale rates till 2012, while TP was to invest in adding or upgrading 1.2 million broadband access lines in the same period. In addition, TP is implementing technical and organisational solutions to differentiate access rights to information within the organisation ("Chinese Walls") and secure non-discriminatory access to information by alternative operators. 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.

The President of UKE has declared freezing wholesale rates at the level resulting from current framework offers till the end of 2012. The “retail minus” methodology for determining wholesale rates was replaced with the “cost plus” model in 2010. Over the three years TP should invest in 1.2 million broadband accesses, including 0.5 million new lines and 700 thousand to be upgraded. It is expected that approximately 1 million lines will have bandwidths of 6 Mb/s or more. This infrastructure will be deployed not only in conurbations, but also in small towns and across rural areas.

In 2011, TP performed its project obligations according to a schedule adopted together with UKE and systematically implemented the obligations of a permanent nature. As in the preceding year, the key permanent obligation was the application of the non-discrimination rule in TP’s operating activities related to inter-operator relations. Important initiatives in this area include a KPI monitoring process for TP’s wholesale and retail services. In 2011, a new KPI system was developed in consultation with UKE and is being implemented on a production scale. According to the current assumptions, it will be used in parallel to the existing set of KPIs throughout the first half of 2012 and it will fully replace the latter in July 2012. Another major initiative of permanent nature is assuring compliance with the Good Practice Code that sets communication standards and practices to build a non-discriminatory culture within the organisation. A number of rules regulating various aspects of TP’s relations with alternative operators have been developed to facilitate the provision of regulated services. TP has implemented Chinese Wall mechanisms to prevent the access of TP’s retail function to the restricted data in IT systems as well as related legal and organisational changes to protect such data outside IT systems. The programme of Chinese Walls has been complemented by the Restricted Data Protection Programme, which is being introduced at TP. Another initiative aimed at preventing unauthorised access to the restricted data is the introduction of data access restrictions also in selected TP Group companies.

The implementation of a dedicated wholesale IT environment for supporting alternative operator service processes to the extent defined in MoU was almost completed in 2011. The main components of this environment include: ISI – an electronic portal and channel for communications with alternative operators (particularly for placing orders for regulated services); PRM – a system to support the wholesale process execution; and NSRM – a wholesale billing system. In 2012, TP Group will implement the functionalities required due to changes in regulated wholesale service offers in the IT solutions which have been developed. In addition, works related to anonymisation of information on the source of orders, mainly through automation of processes, will continue within IT systems.

On 5 April 2011, the President of UKE introduced the Super Reference Offer (SRO), the decision having been immediately enforceable. Some of TP’s obligations under MoU, mainly related to changes in IT systems, have been extended with SRO requirements. These requirements will be met during works aimed at IT systems harmonisation with SRO, outside the initial scope of MoU, according to a time schedule which has already been agreed with UKE.

From the commencement of the MoU implementation to 31 December 2011, TP constructed and provided infrastructure enabling operation of a total of 859.205 broadband lines (including 402.300 in 2011 alone), which corresponds to 100.7% of the target for that period set in MoU.

The proper implementation of MoU is verified by an external auditor on a quarterly basis. Reports on nine quarterly audits conducted hitherto have generally confirmed the effective implementation of MoU by TP. In addition, TP delivers a monthly report to the President of UKE, describing progress in implementation of the MoU. The report is published by UKE on its web service.

On January 30, 2012 TP S.A. and the President of the Office of Electronic Communications have agreed to modify conditions and schedule of fulfilment of TP S.A.’s investment declaration within the Memorandum of Understanding between TP S.A. and UKE, signed on October 22, 2009. TP S.A. has committed itself to ensure availability of services with capacity of at least 30Mb/s for 220,000 lines out of the 340,795 lines remaining to be invested in based on the Memorandum of Understanding with UKE from 2009. As a consequence, due to a necessary replaning of investment tasks, the schedule for realisation of the aforementioned 220,000 lines has been extended and they can be completed until March 31, 2013, unless unfavourable weather conditions would cause additional arrangements between Parties.

TP S.A.’s Management expects that this modification will not impact the total level of capital expenditures for realisation of investments declared in the Memorandum of Understanding with UKE, with some postponements possible from 2012 to 2013. Furthermore it will allow TP S.A. time needed to invest into attractive speed options and technologies, including VDSL, thus also supporting realisation of the European Digital Agenda in Poland.

5.11 Compensation for Universal Service Costs

Until 8 May 2011, pursuant to the President of UKE’s decision of 5 May 2006, TP used to be an operator designated to provide the universal service. Owing to the economic nature of this service, an operator designated to render it is eligible for compensation equal to the universal service net costs, which is the costs which the operator would not have borne if not for the obligation to provide the universal service.

TP has applied to the President of UKE for compensation of the universal service net cost for the years 2006 to 2009 in the total amount of PLN 803.7 million. In the course of administrative proceedings concerning compensation of the universal service net cost, the Net Cost Components were audited by an independent auditor.

On 24 May 2011, the President of UKE issued decisions on the net cost deficit for the years 2006, 2007, 2008 and 2009, in which she decided:

- To grant TP compensation of the net cost of a service of providing special measures for disabled users, excluding public payphones adapted for use by disabled users, for 2006 in the amount of PLN 744,838.18;
- To grant TP compensation of the net cost of a service of providing special measures for disabled users, excluding public payphones adapted for use by disabled users, for 2007 in the amount of PLN 1,269,111;
- To grant TP compensation of the net cost of a service of providing special measures for disabled users, excluding public payphones adapted for use by disabled users, for 2008 in the amount of PLN 1,829,836;
- To grant TP compensation of the net cost of a service of providing special measures for disabled users, excluding public payphones adapted for use by disabled users, for 2009 in the amount of PLN 1,826,517; and
- To grant TP compensation of the net cost of a public payphone service for 2009 in the amount of PLN 61,324,043.64.

The total compensation granted to TP for providing universal service components for the years 2006–2009 is PLN 66,994,345.82. At the same time, the President of UKE has decided to refuse compensation of the cost of other components of the universal service provided by TP.

On 7 June 2011, TP applied to the President of UKE for the re-examination of all the decisions issued with respect to compensation of the net service cost. On 6 September 2011, the President of UKE upheld the decisions of 24 May 2011 granting compensation for the years 2006–2009 in the total amount of PLN 66,994,345.82. On 5 October 2011, TP filed complaints with the Regional Administrative Court in Warsaw against the President of UKE’s decisions of 6 September 2011. The court proceedings are pending.

On 30 June 2011, TP filed an application with UKE for compensation for 2010. The relevant net cost is PLN 269 million. In the course of administrative proceedings, the Net Cost Components were audited by an independent auditor, who submitted his opinion (without reservations) together with the audit report to the President of UKE.

On 10 January 2012, the President of UKE issued decisions on the net cost deficit for 2010, in which she decided:

- To grant TP compensation of the net cost of a service of providing special measures for disabled users, excluding public payphones adapted for use by disabled users, for 2010 in the amount of PLN 1,044,752; and
- To grant TP compensation of the net cost of a public payphone service for 2010 in the amount of PLN 54,057,623.

The total compensation granted to TP for providing universal service components for 2010 is PLN 55,102,375. At the same time, the President of UKE has decided to refuse compensation of the cost of other components of the universal service provided by TP.

TP intends to exercise its right to apply for the re-examination of the case which ended with the aforementioned decision.

The compensation is paid pro rata by all the operators (including TP and PTK Centertel) with revenues of more than PLN 4 million in the year for which the compensation is due. The President of UKE will determine by way of individual decisions the share of particular operators in the compensation to be paid to the Company.

With regards to some operators, TP has reached an agreement regulating the issue of mutual settlements on the account of the universal service obligation.

In the second half of 2011, the President of UKE initiated four sets of proceedings to determine the share of particular operators in the compensation for the years 2006, 2007, 2008 and 2009.

6 OUTLOOK FOR THE DEVELOPMENT OF TP S.A. AND TP GROUP

6.1 Market Outlook

According to TP's estimates the value of Poland's telecommunication market decreased by 0.4% in the 2011. The main factors which contributed to the market decline in the reported period were erosion of fixed-line voice revenues and MTR reductions. The broadband internet access market is gradually getting saturated, which is reflected in lower growth rates both by volume and by value. Meanwhile retail revenue dynamics of mobile operators made positive impact on telecommunications market.

Growing popularity and availability of smartphones as well as tablets and other units that use mobile internet access is a new, visible trend in the market development.

In the broadband market, the model for determining BSA rates was changed on October 1, 2010. These rates are to be charged by TP Group while reselling telecommunication services to alternative operators. Now, TP Group can much better adjust its prices to the market environment, which raises the attractiveness of TP's offers compared to those of the competition.

As for the activity of TP's rivals, an expected market trend is further bundling of core services offered by particular operators with other telecom services and entertainment offers. Major developments in the business market will include combining telecom offers with ICT offers as well as growth in the machine-to-machine (M2M) segment. TP Group has established Integrated Solutions to address the opportunities in the ICT market.

The telecommunication market has entered a phase which involves concentration as well as establishment of co-operation between former rivals in selected business areas. The first signs of this trend could be seen in the market. These include the following developments:

- UPC has acquired Aster (the transaction has been approved by UOKiK);
- Zygmunt Solorz-Żak has acquired Polkomtel (the transaction has been approved by UOKiK);
- Netia has acquired Dialog and Crowley (the transaction has been approved by UOKiK);
- TP Group has been developing cooperation with TVN Group;
- PTK Centertel and PTC have established a joint-venture company for shared network operation;
- ERA has been rebranded to T Mobile,
- ITI Group and TVN Group concluded agreements with Canal+ Group effecting strategic cooperation

Further mergers and acquisitions are anticipated. It is possible that the structure of the telecommunication and media markets will evolve substantially in the medium term.

6.2 TP Group's Strengths

TP Group operates in an increasingly challenging market. Due to fierce competition and the market structure, actions taken by TP Group need to be determined and consistent. The ability to adapt to the existing conditions and respond to new market trends results from a number of TP Group's strengths.

The major strengths of TP Group are as follows:

- Poland's largest sales network, enabling professional customer service during and after sales; simultaneously, modern distribution channels, particularly on-line, are being developed;
- Broad portfolio of services matching the needs of customers and enabling service integration;
- Unique offering, which includes services from outside the core telecommunication sector (e-health, e-insurance);
- TP Group's brands (TP, Orange, wp.pl) are trusted, associated with quality products and broadly recognised;
- Experienced workforce and well-developed work assessment and competence development system;
- Broad international co-operation and access to know-how of TP's partners from the France Telecom Group, including close co-operation and R&D experience sharing within the Orange Lab network;
- Established and predictable regulatory environment in the wake of the Memorandum of Understanding with UKE.

Owing to all these strengths, TP Group is able to provide its customers with offers which match their needs, while effectively responding to actions of its rivals.

6.3 TP Group's Medium Term Action Plan

TP Group's medium term actions are influenced by two major elements:

- Memorandum of Understanding with UKE; and
- TP Group's strategy.

The Memorandum of Understanding with UKE was signed on 22 October 2009. In terms of the Medium Term Action Plan, MoU:

- brings order to TP's relations with alternative operators;
- determines TP's objectives in terms of investments in the broadband infrastructure (1.2 million broadband access lines in 2010-2012, including 0.5 new ones); and
- introduces changes in TP Group's organisation and culture.

TP Group's action plan aims at strengthening its leadership in core markets, while preserving the Group's financial standing and revenues. The Group will flexibly respond to changing customer needs, offering an attractive range of services. It means the following efforts:

- To attain a strong leadership position in all TP Group's core markets:
  - Fixed line segment – to maximise retention initiatives and minimise revenue erosion in the segment,
  - Mobile segment – to achieve the edge in the post-paid market and further strengthen the Orange brand as well as to increase revenue (ARPU) and improve customer satisfaction through additional services (games, applications, rings, technical assistance forum, payback programme),
  - Internet access – to expand the broadband customer base and further improve service quality by increasing transfer rates and extending the service coverage,
  - Television – to pursue co-operation with TVN in order to provide TP Group's customers with the best quality television based on rich content offering and best technological solutions,
  - Innovativeness – to present attractive integrated offers that will meet the needs of TP Group's customers;
- To systematically develop infrastructure required to offer cutting-edge technological solutions to customers;
- To develop a new offer for business customers in the Information and Communication Technology (ICT) market, particularly through a newly established dedicated company, Integrated Solutions;
- To improve customer care;
- To develop a strong sales network – to develop remote sales channels which increase the offer availability to customers;
- Continuation of the cost savings and transformation program, aimed at reducing the cost base and increasing operating efficiency;
- To use the opportunities resulting from the organisation of Euro 2012, of which TP and Orange are technological partners.

7 TP GROUP'S MAJOR ACHIEVEMENTS IN RESEARCH AND DEVELOPMENT

7.1 Research and Development

TP's Research and Development Centre (TP R&D) is a part of the international Orange Lab network, which consists of 15 Orange R&D units and laboratories in 9 countries (France, Spain, UK, Poland, China, Japan, Egypt, Jordan and USA).

Orange Lab provides innovative solutions, tests new services, develops network quality monitoring methods and carries out development and advance work on new technologies and services. In addition, Orange Lab co-operates with other TP's business units in the development of network and service development strategy.

Orange Labs actively promote innovation across the TP and FT Groups. In 2011, the Polish Orange Lab in conjunction with TP's business units, FT and suppliers presented 53 prototype or commercial solutions (premières) and carried out 31 major events with the participation of representatives of FT, universities, suppliers and government administration, which were attended by a total of over 6,500 visitors.

Polish Orange Lab was involved in developing an innovative image of TP, through the following events:

- Two international conferences: Innovative Technology organised in conjunction with Nokia Siemens Network (May 2011) and Innovation Days with Alcatel-Lucent (September 2011);
- Co-organisation of the International Ideas Festival in Spain: international exhibition of FT Group's best and most innovative ideas selected in local competitions in different countries (award to Orange Labs in the 'People' category for the 'Service for Feedback' idea; November 2011);
- 9th edition of the 'Telecreator' contest, which is aimed at stimulating innovativeness and promoting innovative projects of TP Group's employees and partners;
- 'Accessibility Day' conference (April 2011);
- 'Wireline Solution Forum' international conference (April 2011);
- 'Mobile applications Day' conference (May 2011);
- 'Customer Relations' meetings concerning sales and customer service solutions (October 2011);
- Launch of a prototype exhibition on the 27th floor of the TP building in Twarda St. (February 2011).

In 2011, the most important achievements of the Polish Orange Lab were as follows:

- VAT (VDSL Automatic Tester): design, prototype and implementation;
- Development of the VDSL2 technical pilot for Lightspeed Communications, FT Group company in Bahrain: Mr. Muszyński's recognition of the Polish Orange Lab's contribution to the implementation;
- Debut in the Polish market of the interactive audiobook '*Heart of the Winter*, which has received the Polish Application of October award (granted by the readers of the AppDnia.pl portal) as well as the Editorial Team Choice and Best Application of the Month awards (granted by the editorial team of the portal);
- Development of a widget for Samsung TV sets with access to the orange.pl portal resources, including news, sports news and TV programme: the application was made available to all owners of TV sets with the ConnectedTV function in Poland (September 2011);
- Implementation of 'Icare', which enables quick access to the key data on an Orange customer account;
- Further development of IPTV: development of the first application, 'czat WP.tv', under a framework agreement with Wirtualna Polska; the service enables SMS communication while viewing video materials on IPTV (WP.tv) without the need to pause them;
- Development of the 'Orange Goal' application, a game for mobile terminals with the Android system (implemented in September 2011);
- First commercial launch of the media gateway software (version R007 SP403) for commercial traffic among all FT Group entities (Orange Spain, Orange Business Services, IBNF);
- Market debut of the 'NN Assistant' application for blind or visually impaired people, which helps them to operate mobile phones;
- Opening of the TP Test Campus at the Warsaw University of Technology to promote expertise and competence exchange between TP and the Warsaw University of Technology's students and staff;
- Content Delivery Network (CDN) received an award in the 'Network' category of FT Group's Orange Labs Awards international competition (CDN has been developed as a result of cooperation between experts of Polish Orange Lab, FT R&D CORE and NAD);

- Conclusion of an agreement on joint research and experience sharing with respect to the Long Term Evolution (LTE) technology between range Labs, Warsaw University of Technology and Huawei;
- Cooperation with Polish universities with respect to Telco 2.0 and Telco 2.0 University;
- Development of the LTE environment in the Open Innovation model;
- FT Group’s Leader in IMS Alcatel Lucent and MWAS Platforms;
- ROADM for UEFA 2012: development of a ROADM transmission network for the Euro 2012 tournament;
- Femtocells: implementation project in Poland; FUT (friendly user test) for Poland in collaboration with Huawei;
- Implementation of the Innovation Process 3.0;
- Development of FT Group’s first Handbook, which is a compendium of information in the field of development of environments for low-level testing of security of IT systems;
- Owing to Polish Orange Lab’s involvement in the work of standardisation organisations, such as ITU, ISO/IEC, IETF, ETSI, MEF, Broadband Forum, TeleManagement Forum and Home Gateway Initiative, and a number of contributions, TP could influence the content of telecommunication standards in such areas as cloud computing, people and environment protection against electromagnetic radiation, new generation networks (NGNs), IP, signalling protocols, etc. Orange Labs played a major role at ITU in the assessment of human exposure to electromagnetic radiation, managing the issue internationally and representing ITU on conferences and meetings (in Botswana, Switzerland, etc.);
- Over the last decade, the Polish Orange Lab has implemented and successfully settled seven international research grant projects under the sixth edition and nine projects under the seventh edition of the EU Framework Program. These projects included ALPHA (Architectures for fLexible Photonic Home and Access networks), aimed at developing a new generation access network (particularly all types of in-building networks); 4WARD: development of new requirements for network architecture; ONE LAB 2 (An Open Networking Laboratory Supporting Communication Network Research Across Heterogeneous Environments); and NAPA-WINE: research on P2P-TV systems; as well as continuation of TALOS, GEYSERS OCEAN, DEMONS and HEMOLIA projects till 2014.

7.2 R&D Cooperation with France Telecom

Key projects for FT (for which appropriate fee is charged):

Development

- Corporate responsibility over selected network solutions: Huawei Media Gateways, DSL and GPON Access, ZTE IN platforms, IP Routers and IMS Ericsson;
- VDSL2 and FTTH technologies: validation and pilot implementations;
- CDMA-based projects for Poland and AMEA countries;
- Femtocells;
- Mobile applications: Android, iPhone, Audio Games;
- New TV: platforms and services for Poland;
- Broadband Network Gateway;
- GreenBox ;
- Content Delivery Network.

Research

- Cloud computing;
- Rich Communications Suite Architecture and HD Voice on TP’s network;
- Android OS-based Set Top Box;
- Accessibility solutions.

Intended involvement in research

- Cloud for Media (C4M)
- Cognitive and Autonomic Network Management (CANM);
- Optimized Network Infrastructure (OPTINI);
- Multimodal Context-aware Interfaces (MCAI).

CHAPTER III.
ORGANISATION AND CORPORATE STRUCTURE

8 CHANGES IN TP S.A.'S STRUCTURE IN 2011

8.1 Changes in the TP S.A.'s Corporate Structure

In 2011, the Company did not implement any material changes in its corporate structure.

8.1.1 TP S.A.'s Management Board

As of 31 December 2011, the Management Board is composed of five Members, who have been assigned the direct supervision over the following Company's matters:

- President of the Management Board;
- Vice President of the Management Board in charge of Marketing and Strategy;
- Vice President of the Management Board in charge of Operations;
- Management Board Member in charge of Finance, and
- Management Board Member in charge of Human Resources

For detailed information about the Management Board and Supervisory Board of TP please see section 3 above.

8.1.2 TP S.A.'s Business Units

The total number of business units within TP's organisation slightly changed.

As a result of simplification of the names of structures and managerial positions, as of 31 December 2011, TP had 64 business units reporting directly to:

1) President of TP Management Board: 1 business unit;

2) Vice President of the Management Board in charge of Marketing and Strategy: 5 business units;

3) Vice President of the Management Board in charge of Operations: 12 business units;

4) Management Board Member in charge of Finance: 8 business units;

5) Management Board Member in charge of Human Resources: 11 business units;

6) TP Group Executive Officer in charge of Sales and Customer Service: 6 business units;

7) TP Group Executive Officer in charge of Corporate Matters: 12 business units;

8) TP Group Executive Officer in charge of Service Centre: 6 business units; and

9) TP Group Executive Officer in charge of Customer Relations Strategy: 3 business units.

8.1.3 Group's New Premises

On 22 December 2009, TP signed an agreement with Bouygues Immobilier Polska for the development and lease of new premises for the TP Group. The new location, a low rise and energy efficient complex of buildings in proximity of the city centre, will be able to comfortably host approximately 3,300 employees. The development is to be concluded by mid-2013, while the lease period will be ten years, with extension options secured. On 11 June 2010, Bouygues Immobilier Polska completed the negotiations and concluded a memorandum of understanding for the purchase of land for construction of TP Group's new premises. The 'Orange Campus' will be located in Aleje Jerozolimskie Street in Warsaw. In autumn 2010, the property developer obtained a final approval to commence building works and in February 2011 the building contractor was appointed, to whom the building site was handed over. At the moment construction works are taking place on the ground level of the buildings.

A procedure of selecting a financial investor for the 'Orange Campus' has been completed. The 'Orange Campus', which since the beginning has been implemented as a lease project, was initially owned by the French developer Bouygues Immobilier (BI). TP Group, which has hired the developer to erect the complex and signed an agreement for the lease thereof, has decided not to exercise its right of first purchase. Now, the whole project has been purchased by Qatar Holding LCC, a subsidiary of Qatar Investment Authority (Qatar investment fund). For the TP Group, the existing mutual obligations agreed upon with the developer remain binding.

8.2 Ownership Changes Effected by TP S.A. in 2011

8.2.1 Establishment of Bilbo sp. z o.o.

On 4 February 2011, TP executed the deed of establishment of Warsaw-based Bilbo sp. z o.o. The initial share capital of the new company amounted to PLN 5,000 and was divided into 100 shares of the nominal value of PLN 50 each. TP subscribed to 100 shares at nominal price, corresponding to 100% voting power at the General Assembly of Bilbo sp. z o.o., against a contribution in cash of PLN 5,000. On 16 March 2011, the District Court in Warsaw registered Bilbo sp. z o.o.

8.2.2 Establishment of Integrated Solutions sp. z o.o.

On 13 April 2011, TP executed the deed of establishment of Warsaw-based Integrated Solutions sp. z o.o. The initial share capital of the new company amounted to PLN 5,000 and was divided into 10 shares of the nominal value of PLN 500 each. TP subscribed to 10 shares at nominal price, corresponding to 100% voting power at the General Assembly of Integrated Solutions sp. z o.o., against a contribution in cash of PLN 5,000. On 29 April 2011, the District Court in Warsaw registered Integrated Solutions sp. z o.o.

The new company began its operations on 7 June 2011.

Integrated Solutions sp. z o.o. is to render IT and telecommunication system integration services and provide dedicated solutions for data centres.

The new company is a response to growing demand for services related to comprehensive management of the ICT infrastructure.

The company’s offer has been divided into four areas: LAN and WAN integration, unified communication, network and equipment security, as well as data centres and potentially cloud computing. It is addressed to medium to large companies from all sectors which want to entrust professionals with solving infrastructure-related problems. Such business collaboration may be particularly beneficial to multi-branch companies, which will be able to use the most unique part of the offer: integration of IT systems with high-capacity data lines.

8.2.3 Sale of a Minority Stake in Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. to Orange Customer Service sp. z o.o.

Following an agreement of 22 December 2010 between Orange Customer Service sp. z o.o. and TP S.A., on 23 May 2011 the Financial Supervision Commission approved the purchase of 125 shares of Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. (TP Employee Retirement Fund Company, “PTE”) by Orange Customer Service sp. z o.o. The shares sold by TP S.A. are a 25% stake in PTE, which corresponds to the same voting power at the General Assembly of the latter.

8.2.4 Transfer of Shares of TP Emitel sp. z o.o. to Bilbo sp. z o.o. and Sale of TP Emitel sp. z o.o. outside TP Group

On 24 March 2011, Bilbo sp. z o.o., a TP’s subsidiary, together with TP S.A. signed a preliminary sale agreement with Warsaw-based Kapiri Investments sp. z o.o., whose sole shareholder was Montagu IV (B) LP, for all shares held by TP Group in Kraków-based TP Emitel, each share of nominal value of PLN 500. The shares constituted 100% of the share capital of TP Emitel and corresponded to 100% voting power at the General Assembly of the latter.

On 6 June 2011, the District Court for Warsaw registered an increase in the share capital of Bilbo sp. z o.o. by PLN 1,725,000,000. All the new shares were taken up by TP S.A. against a non-cash contribution in the form of shares in TP Emitel sp. z o.o. Following the transaction, the share capital of Bilbo sp. z o.o. amounted to PLN 1,725,005,000 and was divided into 34,500,100 shares of the nominal value of PLN 50 each.

On 22 June 2011, Bilbo sp. z o.o. and EM Bidco sp. z o.o. (formerly Kapiri Investments) signed the promised sale agreement pursuant to which TP Group sold all shares held in TP Emitel sp. z o.o. The total sale price was PLN 1,725 million.

8.2.5 Changes of Equity in TP Group Companies

Otwarty Rynek Elektroniczny S.A.

On 13 April 2011, the Extraordinary General Assembly of Otwarty Rynek Elektroniczny S.A. adopted two resolutions: (i) on redemption of 15,666,680 registered ordinary A-series shares against remuneration of PLN 47,000,040 for the redeemed shares; and (ii) on a decrease in the share capital from PLN 35,000,000 to PLN 19,333,320, i.e. by PLN 15,666,680, through redemption of 15,666,680 shares.

On 13 December 2011, the District Court for Warsaw registered a decrease in the share capital of Otwarty Rynek Elektroniczny S.A. by PLN 15,666,680. Following the transaction, the share capital of Otwarty Rynek Elektroniczny S.A. amounts to PLN 19,333,320 and is divided into 19,333,320 shares of the nominal value of PLN 1 each.

TP Emitel sp. z o.o.

On 10 May 2011, the District Court for Kraków registered a decrease in the share capital of TP Emitel sp. z o.o. by PLN 163,500,000. Following the transaction, the share capital of TP Emitel sp. z o.o. amounted to PLN 430,150,000 and was divided into 860,300 shares of the nominal value of PLN 500 each.

Integrated Solutions sp. z o.o.

On 26 May 2011, the District Court for Warsaw registered an increase in the share capital of Integrated Solutions sp. z o.o. by PLN 7,495,000. All the new shares were taken up by TP S.A. against a contribution in cash. Following the transaction, the share capital of Integrated Solutions sp. z o.o. amounts to PLN 7,500,000 and is divided into 15,000 shares of the nominal value of PLN 500 each.

Bilbo sp. z o.o.

On 22 June 2011, the Management Board of TP S.A. adopted a resolution on decreasing the share capital of Bilbo sp. z o.o. from PLN 1,725,005,000 to PLN 5,000, i.e. by PLN 1,725,000,000, through redemption of 34,500,000 shares of the nominal value of PLN 50 each and the total nominal value of PLN 1,725,000,000.

On 14 December 2011, the District Court for Warsaw registered a decrease in the share capital of Bilbo sp. z o.o. by PLN 1,720,000,000,. Following the transaction, the share capital of Bilbo sp. z o.o. amounts to PLN 5,000 and is divided into 100 shares of the nominal value of PLN 50 each.

PayTel S.A.

On 29 November 2011, the Extraordinary General Assembly adopted a resolution on an increase in the share capital of PayTel S.A. from PLN 12,000,000 to PLN 12,720,000, i.e. by PLN 720,000, through an increase in the nominal value of 24,000 registered ordinary A-series shares from PLN 500 each to PLN 530 each, i.e. by PLN 30 each.

On 29 December 2011, the District Court for Warsaw registered an increase in the share capital of PayTel S.A. by PLN 720,000. Following the transaction, the share capital of of PayTel S.A. amounted to PLN 12,720,000 and was divided into 24,000 shares of the nominal value of PLN 530 each.

On 20 December 2011, the Extraordinary General Assembly adopted a resolution on an increase in the share capital of PayTel S.A. from PLN 12,720,000 to PLN 12,996,000, i.e. by PLN 276,000, through an increase in the nominal value of 24,000 registered ordinary A-series shares from PLN 530 each to PLN 541.50 each, i.e. by PLN 11.50 each.

On 13 January 2012, the District Court for Warsaw registered an increase in the share capital of PayTel S.A. by PLN 276,000. Following the transaction, the share capital of of PayTel S.A. amounted to PLN 12,996,000 and was divided into 24,000 shares of the nominal value of PLN 541.50 each.

TP Edukacja i Wypoczynek sp. z o.o.

On 6 December 2011, the Extraordinary General Assembly adopted a resolution on decreasing the share capital of TP Edukacja i Wypoczynek sp. z o.o. from PLN 98,754,000 to PLN 91,000,000, i.e. by PLN 7,754,000, through redemption of 15,508 shares of the nominal value of PLN 500 each and the total nominal value of PLN 7,754,000. The reduction in share capital was announced together with a summons on creditors to submit potential objections pursuant to article 264 of the Code of Commercial Companies. The share capital reduction will be registered upon completion of a procedure of notifying the creditors.

8.3 TP S.A.'s Shareholders

As of 31 December 2011, the share capital of TP S.A. amounted to PLN 4,007 million and was divided into 1,336 million fully paid ordinary bearer shares of nominal value of PLN 3 each.

The ownership structure of the share capital based on information available on 31 December 2011 was as follows:

(in PLN millions)	*% of votes*[2]	*% of shares*	*Nominal value*
France Telecom S.A.	50.21	49.79	1,995
Capital Group International, Inc.[1]	5.10	5.06	203
Other shareholders	44.69	44.30	1,775
Treasury shares	-	0.85	34
Total	100.00	100.00	4.007

(1) The number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

(2) As a result of buy-back of shares by the Company for the purpose of their redemption, the percentage of the total voting power held by Shareholders at the General Meeting increased as of 31 December 2011.

On 5 August 2010, the Ministry of Treasury informed that it had sold a 4.15% stake in TP on the Warsaw Stock Exchange, thus finally completing the privatisation of the Company.

As of 31 December 2011, France Telecom held a 49.79% stake in the Company. France Telecom has the power to appoint the majority of TP Supervisory Board members. The Supervisory Board appoints and dismisses members of the Management Board.

As of 31 December 2011, the Company has no information regarding valid agreements or other events that may result in changes in the proportions of shares held by the shareholders.

On 27 October 2011, the Company began the execution of a program of the buy back of the Company's own shares for the purpose of their redemption. In line with the authorisation granted by the Extraordinary General Meeting held on 13 October 2011, the Program will be carried out until the total amount of funds utilised for its execution achieves PLN 800,000,000, but not later than December 31, 2012. TP SA Management Board has been informed by France Telecom SA – the strategic shareholder of the Company – that France Telecom does not intend to participate in the Program.

TP did not issue any employee shares in 2011, but an Incentive Programme for the Key Managers was launched in 2007 (please see section 9.2.2 below for further details).

9 TP S.A.'S STRUCTURE AS OF 31 DECEMBER 2011

9.1 Corporate Governance Bodies of TP S.A.

For detailed information about the Management Board and Supervisory Board of TP please see section 3 above.

9.1.1 TP Shares Held by Persons Who Manage or Supervise TP S.A.

As of 31 December 2011, Maciej Witucki, President of the Management Board, held 4,000 shares in the Company.

Other members of the Management Board or Supervisory Board did not hold TP or related entities' shares as of 31 December 2011.

As part of the Company's incentive program, members of the Management Board of the Company acquired TP S.A. registered A-series first option bonds, giving the right to subscribe for the Company's shares with priority over existing shareholders.

The number of first option bonds held by members of the Management Board of the Company on 31 December 2011 was as follows:

Maciej Witucki	305,557
Piotr Muszyński	190,896
Jacek Kowalski	25,241

The members of the Supervisory Board of TP do not participate in the Company's incentive program and as at 31 December 2011 held no first option bonds.

9.1.2 Information on the Remuneration of Persons Who Manage or Supervise TP

For information on the remuneration (including profit sharing) paid or payable by the Company to the persons appointed to its management and supervisory bodies please see Note 29.1 to the Financial Statements enclosed.

9.1.3 Contracts of Persons Who Manage TP

Employment contracts of the Members of TP Management Board include provisions concerning severance pay payable in the case of the contract termination by the Company (and in some cases due to the resignation of a Board Member) and provisions concerning compensation payable for the ban on competing activity after the termination of employment. The severance pay related to the employment contract termination is equal to six monthly salaries. The compensation for restraining from any activity competitive to that of TP for a period of twelve months after the termination of employment is up to six monthly salaries, calculated as cash equivalent for unused leave (this applies to the Management Board Members who were in charge as of the date of the Financial Statements enclosed).

9.1.4 General Assembly

On 14 April 2011, the Annual General Assembly of TP approved a dividend of PLN 2,003 million (i.e. PLN 1.5 per share). The dividend, net of withholding tax, was paid on 7 July 2011.

On 13 October 2011, the Ordinary General Assembly of TP adopted a resolution on authorisation for the Management Board to buy back the Company's own shares for the purpose of their redemption.

9.2 Employment in TP S.A.

As of 31 December 2011, TP employed 14,854 people (in full-time equivalents), which is a decrease of 2.8% compared to the end of December 2010.

TP's workforce reduction was mainly a result of a voluntary departure programme, carried out in 2011 in accordance with the Social Agreement.

In 2011, severance pay was paid to 478 employees, out of which 431 (or 90.2%) left TP under the voluntary departure programme, and averaged PLN 58.1 thousand per employee.

The workforce restructuring provision at TP after discount and utilisation was PLN 151.8 million as of the end of December 2011 and accounted for the voluntary departure programme in the years 2012-2013 (the intended volume of departures are up to 2,300 people).

In 2011, external recruitment in TP totalled 535 positions (excluding temporary replacement agreements), up 8.3% year-on-year. External recruitment was mainly related to sale positions and customer service staff.

9.2.1 Social Agreement

On 24 October 2011, the Management Board of TP S.A. signed with trade unions the new Social Agreement for the years 2012-2013, effective from 1 January 2012. The Social Agreement regulates issues related to employment policy, including the role of internal mobility, recruitment and outsourcing, pay rises (not less than 4.5% in 2012 and 2013) and enabling employees who cannot adapt their professional profile to the changing market needs to leave TP with compensation.

In the years 2012–2013, up to 2,300 employees with seniority of over 6 years will be able to make use of the voluntary departure package. In addition, the Management Board of TP S.A. signed with trade unions a separate agreement which specifies that up to 1,150 employees may use the aforementioned package in 2012. The voluntary departure offer is addressed to TP's employees who are covered by the Intragroup Collective Labour Agreement.

The package offered to departing employees will depend on their seniority at TP and will range between 4 and 15 basic monthly salaries. This will be increased by additional compensation of PLN 8,000 in 2012 and PLN 6,000 in 2013. Employees with seniority of 20 years will receive extra compensation of up to PLN 20,000 per employee.

9.2.2 Incentive Program

On 28 April 2006, the General Assembly of TP approved an Incentive Program based on a "Stock Option Plan". On 12 December 2006, the Management Board of TP adopted the resolution No. 149/0/06 on adopting the Incentive Program Rules for the Members of the Management Board of TP and the Incentive Program Rules for the Key Managers of the TP Group.

The main purpose of the Program is to link the remuneration of key managers with their contribution into TP Group's development through enabling them to benefit from the planned growth of the Company's value; getting them more involved in the active management of the TP Group in order to increase its profitability.

First Option Bonds

The Program is carried out through issuing TP first option bonds. The issued bonds are registered bonds giving the right to subscribe, before the existing shareholders, for B-series shares issued by TP.

Pursuant to the resolution on the issue of bonds proposed by the Management Board the bonds have the nominal value of PLN 0.01 per piece and are to be issued at the issue price equal to the nominal value. Owing to the purpose of the Program, the bonds will not bear coupons. One bond will enable the subscription for one B-series share.

B-series shares carry the right to the dividend on the terms described in the information memorandum.

The issue of new B-series shares has an impact on reducing the percentage share of the existing shareholders in the share capital of TP. In the case that the bondholders exercise the rights under all the bonds, the percentage share in the share capital of all existing shareholders will be reduced by 0.508%.

Size of the Program

Initially in total, 7,113,000 of bonds enabling the subscription for 7,113,000 B series shares were planned to be issued in the Program..

Size of Individual Award

The number of bonds granted to particular Beneficiaries depends on the assessment of performance and operational involvement of each Beneficiary and the level of responsibility.

Exercise Period

The bondholders' right to subscribe for B-series shares might be exercised within seven years, i.e. from the third anniversary of the bonds issue date to the 10th anniversary of this date. The exercise of this right will be possible, in principle, only if the Beneficiary, on the day of its exercise, is the employee or member of the governing bodies of the Company or companies from the TP Group covered by the Program. As a general rule, if the Beneficiary stops being the employee or the member of TP governing bodies or those companies before the subscription date of B-series shares, all their bonds will be redeemed by way of payment of the nominal value of these bonds.

Issue Price of Shares

The issue price of B-series shares taken up by the bondholders was set by the Management Board of TP on the bonds issue day and was equal to the average market price of TP shares from 20 sessions on the Warsaw Stock Exchange immediately preceding the bonds issue day.

In September 2007, TP Management Board implemented the Program and the information memorandum was sent to potential Beneficiaries. Subscription letters were sent to 356 employees, out of which 339 managers subscribed for options (96% of potential Beneficiaries). The grant date was set up on 9 October 2007 and the option exercise price at PLN 21.57 (average TP close price of 20 sessions on Warsaw Stock Exchange proceeding the grant date). 6,047,710 A-series bonds were allotted to eligible managers and 154,698 bonds were taken by the trustee (KBC Securities). 0.9 million options out of 7.1 million were not issued. Cost of the Program of PLN 25 million has been booked over the vesting period.

By the end of 2011, a total of 2,459,032 options had been redeemed as a result of the termination of Beneficiaries' contracts of employment in the cases set out in the Program.

The Program is secured by a control system according to the resolution that implemented the Program in the TP Group. The Program is subject to a special procedure consistent with the reporting standards that is implemented across France Telecom Group. The controls will include the verification of the number of Program beneficiaries, Program revaluation and settlements with the employees leaving the Company.

CHAPTER IV.
KEY RISK FACTORS

10 RISK FACTORS AFFECTING THE ACTIVITIES OF TP S.A. AND TP GROUP

The risks mentioned in this report are not intended to constitute an exhaustive list of all possible risks, which may impact the Group's activities. The system of internal control and risk management in TP Group is designed and implemented by the Management. This approach allows to manage the risk of failure to achieve business objectives and provides reasonable assurance against material misstatement or loss (risk management does not mean the full elimination of risk, but provides for better risk identification and the implementation of adequate measures as needed) – (please see Note 28 to the IFRS Annual Financial Statements for additional information about major outstanding claims and litigations).

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TP Group has developed a risk management process which encompasses risk identification, analysis and assessment, implementation of risk mitigation measures and verification of action results. This provides the Management Board with information about the key risks within the Group, so preventive actions may be additionally supported. The Risk Management team provides structure, facilitates communication and reviews external risks faced by peers. The review and assessment of the identified risks, the identification of the main causes and the implementation of action plans involve the participation of Group's top management.

The major risks are subject to monitoring. For such risks, preventive measures aimed at reducing their vulnerability and limiting their potential impact on the Group's operations are implemented.

The most significant risks are updated and submitted to the Management Board and the Audit Committee of the Supervisory Board twice a year. The internal audit plan for each year is developed also taking account of a list of the major risks identified.

10.1 Implementation of TP Group's Medium-term Action Plan

The medium-term action plan for 2010–2012 focuses on stabilising the Group's leadership in Poland's telecommunication market, using the opportunities stemming from an agreement with UKE and re-balancing the organisation in order to achieve greater efficiency and ensure meeting the expectations of external and internal customers to the greatest possible extent.

Due to fierce competition and volatile regulatory environment, the Group's ability to achieve business objectives is under strong pressure, so TP carries out dedicated actions aimed at reducing the competitive pressure on its performance by constantly modernising its offers in the fixed-line and mobile segments and enhancing customer service. In line with its strategy, TP has been carrying out the previously announced actions, including sale of TP Emitel and establishment of a joint venture with PTC.

The competition in the core services of the TP Group, both in fixed and in mobile segment, could result in TP Group losing the market share or seeing its margins tighten significantly, and its revenue and profitability could then be adversely affected.

10.2 Timely Implementation of Regulatory Requirements

If TP Group companies are unable to satisfy the imposed regulatory requirements or fail to meet the indicated time limit, they may be at risk of initiation of administrative procedures and, consequently, imposition of administrative fines.

As provided in the Telecommunications Law, the President of UKE may impose a penalty of up to 3% of its prior calendar year's revenues on a telecommunications operator, if the operator does not fulfil certain requirements thereof.

As provided in the Law of 16 February 2007 on competition and consumer protection, in case of confirmed monopolistic practices or abuse of the collective interest of customers, the President of the Office for Competition and Consumer Protection (UOKiK) may impose a penalty of up to 10% of its prior financial year's revenues on a company , for failing to provide the information requested or a penalty of up to EUR 50 million for providing misleading information,.

According to article 13(11) of the Memorandum of Understanding between TP and UKE, in case of non-performance or improper performance of the MoU provisions by TP, including non-compliance with the auditor or President of UKE's recommendations regarding the IT audit, failure to meet the relevant deadlines or any actions inconsistent with the principles set out in MoU, the President of UKE may resume works on imposing a regulatory obligation of functional separation on TP. However, information related to the review of the implementation of the MoU provisions by TP indicates satisfactory assessment thereof by UKE. Under the current legal regime, no fines can be imposed on TP for non-performance or improper performance of MoU.

10.3 Launch of New Products and Services

Fierce competition in the market and technological developments of new services result in strong pressure on price reductions in the mobile and fixed segments. There is a risk that the effect of price reductions will not be offset by increased volume of traffic on the network.

TP Group faces competition from not only telecom companies but also players from outside the industry, such as television or internet providers. Despite its efforts, the Group is still at risk of erosion of its revenues and market shares.

To maintain its competitive position, TP Group launches innovative products and services. Integrated Solutions is a new company established within the TP Group which will render IT and telecommunication system integration services and provides solutions for Data Centres. The establishment of the new company is a response to growing demand of customers for services related to comprehensive management of the ICT infrastructure.

Although the Company performs extensive marketing tests and has considerable knowledge of customer needs, there is a risk that some products or services may not meet customers' expectations and have to be withdrawn from the market or do not bring the expected return on investment. Such potential negative marketing effect could also lead to increased marketing spending for unplanned marketing actions or failure to generate expected revenues.

In addition, new products and services require an adjustment of network and IT systems. This is a complex and frequently time-consuming process, which poses a potential risk of delays in the market introduction of products and services. The requirement to provide an equivalent offer to alternative operators and carry out consultations with UKE, which are often prolonged, poses an additional risk to timely implementation thereof. Delays in the launch of new products and services may result in lower than planned take-up, posing a risk of non-achievement of the Group's budgeted financial results.

The current and intended ownership changes in the media and telecommunication industries may affect the achievement of business objectives and contribute to an increase of competition in the market.

10.4 Potential Saturation of Networks

The current expansion in broadband usages, such as TV (as part of triple-play) or Internet streaming, fixed-line and mobile, has already on occasion resulted in the saturation of existing collection and transfer networks. As a result of growing use of sophisticated equipment (smartphones, tablets) and development of services which require high capacity, TP Group faces a challenge of undertaking significant capital expenditure programs.

10.5 Development of New Technologies and New Investments

TP Group has been constantly making new investments in order to provide modern services to customers and meet the requirements resulting from MoU with UKE. This contributes to Poland's perception among foreign investors as an attractive place for new investments and, owing to improvements in the telecommunication infrastructure, encourages Poles to undertake new activities using new types of services, such as e-business. The IT awareness is growing in Poland, which stimulates the development of a modern information society.

Due to new services, growing customer needs and competitive pressure, TP Group undertakes costly investments in the network infrastructure. To achieve synergies and assure more efficient use of the network infrastructure, TP has established a joint venture Networks! with Polska Telefonia Cyfrowa sp. z o.o. with the objective to build the best-in-class mobile network development by 2014. In 2011, the TP Group continued the development of HSPA+ DC and deployment of fixed and radio IP backhaul to handle increasing traffic. TP Group commenced also deployment of the VDSL technology. Should TP Group not manage to control the complexities of networks, technologies and processes necessary to meet the expectations of its customers with regards to quality and easy-of-use, it might lose or not gain market share or to be required to cut margins in its core market and its financial position and results could be adversely affected.

10.6 Non-availability or Failure of Technical Infrastructure

The technical infrastructure required to offer the Group's products and services is exposed to a risk of failure and interruption resulting from natural disasters or intentional human actions. Interruptions in technical infrastructure operations have a direct impact on provision of services and supply of products by the Group, which in turn translates into lower revenues from such products and services and a decline in customer satisfaction and the Company's image. This risk is mitigated by the proper network development planning, preventive maintenance, implementation of business continuity plans and insurance schemes. TP Group is covered by an insurance policy which protects it against loss of assets and profit if the Group's telecom infrastructure has been damaged. Aerial lines and submarine cables are excluded from the insurance policy and damage to these assets, and resulting losses, will be borne by TP Group.

In addition, any material failure in maintaining the security of technical infrastructure systems may significantly damage our reputation and may lead to disruptions in business processes, resulting in revenue losses. Therefore TP Group implements measures,as far as it is practicable, to protect the technical infrastructure from cyber-attacks and to detect the disclosure of sensitive data to unauthorised parties and to promptly react to security incidents.

10.7 Non-availability or Failure of IT Systems

As rapid implementation or modification of IT systems has become a necessity to meet customer demand for attractive offers, there may be a risk of errors resulting from insufficient testing of new services or lack of data integrity within connected systems. Potential failures and reduced availability of critical systems, resulting from frequent changes in the applications used, can lead to decreased quality of services and delayed response to changing customer needs. No major failure or non-availability of IT systems occurred in 2011.

10.8 Dependence on External Partners

TP Group concludes contracts with external partners, particularly for maintenance of its networks and telecommunication and IT infrastructure.

Although adequate safety clauses are included in the contracts, there is still a risk of non-performance by the Company’s partners, resulting in delays in network maintenance projects and a decrease in quality of services provided by TP Group. At the same time, the Group has partially outsourced operation and supervision of IT systems and processes to external suppliers of computer hardware and software.

In 2010, TP Group completed a process of consolidation of external suppliers. This enabled the Group to reduce the number of suppliers and negotiate better commercial terms, but on the other hand increased the risk related to dependence on key suppliers. This process has been monitored on a current basis in order to assure its optimum operation and taking effective corrective actions, if required.

10.9 Risk Related to Trade Agreements and Strategic Alliances

In order to attain its business objectives, TP Group attempts to extend its portfolio through trade agreements and strategic alliances that enable it to use products and services of external partners. It is assumed that such bilateral agreements will bring added value to both the company and its customers. However, there is a risk that the benefits resulting therefrom will fall short of the anticipated and planned levels.

At the same time, TP Group is at risk of losing a portion of its revenues due to migration of some of the existing customers who may sign beneficial trade agreements or arrangements with other telecom service providers which are competitive to TP. TP has undertaken a number of initiatives to reduce the exposure. In particular, it has signed a co-operation agreement with TVN Group: both companies have joined forces to satisfy growing demands of customers and provide them with as complete an offer as possible.

10.10 Availability of Skilled Employees

TP Group operates in a market which is affected by a constant risk related to attracting and retaining skilled employees in all business areas. This risk is particularly noticeable in customer service and sales, where personnel turnover is relatively high, and in the technology area, where highly qualified employees need to be attracted. Changes in Poland’s labour market increase the risk related to retaining work force, and understaffing of these functions may pose a threat to the timely performance and quality of TP Group’s core business processes and may hinder the achievement of the Group’s business objectives.

10.11 Human Resources Risk and Organisation Structure Adjustment

TP Group continues streamlining its organization and infrastructure in order to confront the competition and to take account of the new technologies, new and more efficient business models through the transformation program. If TP Group does not complete these transformations, its operating margins, financial position and results could be adversely impacted.

TP has continued a voluntary departure programme and a workforce restructuring process based on a competence assessment system. Furthermore, TP Management Board is negotiating with trade unions on a number of issues, such as working conditions, work organisation, professional development opportunities, mobility, wage level and potential further restructuring in the future. Although the Management Board believes that the on-going professional activity plans have been generating the expected benefits, in view of dynamically changing conditions in the TP Group’s business environment, some differences in opinion may appear between the Management Board and trade union representatives regarding the assessment of such factors, which may result in social tension that could slow down the restructuring process. TP's management constantly consults with trade unions on such matters and in case of reorganisations takes action to clarify the goals and expectations. Regular staff satisfaction surveys are conducted by an outside consultant.

10.12 Issues Related to the Incorporation of TP

TP was established as a result of the transformation of the former state-owned organisation PPTiT into two entities – Poczta Polska and TP. During the transformation process and transfer of ownership rights to the new entities, certain items of property and other assets that are currently under the Company'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 TP's rights to certain properties may be questioned.

A process of dissolution of co-ownership and regulation of limited rights in property (e.g. entering them in land and mortgage registers) is going on and will be continued for a few more years.

In addition, as the regulations concerning the transformation of PPTiT are unclear, the division of certain liabilities of PPTiT may be ineffective, which may result in joint liability in respect of TP's predecessor's obligations existing at the date of transformation.

10.13 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 causing considerable volatility of the tax system. 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 final tax payments were to be made. Consequently, the Group may be subject to additional tax liabilities, which may arise as a result of additional tax audits. Telekomunikacja Polska 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.

10.14 Compliance with Personal Data Protection Regulations and Breach of Licence Agreements or Infringement of Copyrights

TP Group possesses a vast customer base and constantly undertakes activities designed to prevent leakage of its customers' data. In that respect, the Company complies with the relevant regulations, implements adequate policies, adheres to rules and guidelines, and conducts any relevant training. However, it is not possible to fully exclude the risk of an unintended leak of data. There are further risks which arise from TP Group's operations as a broadcaster of Orange Sport and Orange Sport Info television channels. The risks include that of infringing copyrights, neighbouring rights or defaming persons or entities. In addition, the broadcasts are subject to regulations regarding the editor's responsibility for content of programmes comprising the service as well as a number of regulatory obligations imposed by the Polish Broadcasting Act. TP uses its best efforts to properly perform its obligations under Polish copyright law, press law, intellectual property law, Broadcasting Act and Act on Suppression of Unfair Competition. It applies to all content used in all media, including the internet. Some element of risk derives from a lack of effective control over broadcast content, in particular during broadcasting of live programmes. However, it should be noted that TP exercises due diligence in preparing programmes to prevent any unlawful materials from being broadcast.

10.15 Environmental Risks

TP Group believes that its activities do not pose a serious threat to the environment. The Group's activities generate waste for which recycling is closely controlled, such as electronic equipment waste, electronics at end-of-life, batteries and storage cells, cables and treated poles as well as other waste.

The Group has implemented procedures for monitoring and reporting environmental impact. These procedures are aimed at limiting the impact of the Group's activities on the environment and at maintaining compliance with Polish regulations on environment protection. The Group has been subject to environmental audits which have confirmed its compliance with Polish regulations and highlighted achievements in the field of limiting the impact on the environment. In addition, a dedicated team has been established to carry out ongoing supervision regarding regulatory compliance, emission levels, as well as to meet other legal requirements in the area of environmental protection.

10.16 Risk of Impairment in value of assets

Adverse market prospects or worsening forecast of TP Group' performance, in future periods, may result in the recoverable value of the Group' assets falling below their carrying value. In order to predict such situation and to reflect its impact on the financial statements, TP Group conducts yearly impairment reviews of its fixed assets and recorded goodwill at the level of cash generating units. The Group also conducts the procedures to review the economic useful lives of the assets on an annual basis. The assumptions used in these reviews regarding market conditions and future performance of the Group reflect the best judgment of the Management.

11 TELECOMMUNICATIONS SECTOR RISKS

This section describes potential risks in the telecommunications sector that may affect TP Group's operations except for the developments described in the section 5 above.

11.1 Regulatory Risks

Changes in the regulatory environment combined with increasing competition added to the pressure on the TP Group's top line in 2011.

TP continuously makes efforts in order to meet its regulatory obligations in the optimum way, including issues as Wholesale Line Rental (WLR), Bitstream Access (BSA) or Local Loop Unbundling (LLU).

TP Group has explored all possible legal means to protect its interest. TP intends to turn to relevant EU institutions whenever it believes that European law is being breached.

11.1.1 Single Reference Offer

On 29 September 2010, the President of UKE decided to approve the single reference offer ("SRO") for RIO, WLR, BSA and LLU services. The decision was made immediately enforceable. The approved offer differs from the draft submitted by TP for approval, as it covers the IP DSLAM-based access to BSA services and fails to provide a time schedule for the implementation of the new functionalities, a fee of PLN 1.95 for interconnect settlements, changes in the Interconnection Cooperation Model or changes in the WLR price list.

On 13 October 2010, TP applied to the President of UKE for the re-examination of the decision, objecting the solutions which differed from the ones proposed by TP in the draft submitted for approval. On 5 April 2011, the President of UKE, having reviewed applications of TP and the Polish Chamber of Electronics and Telecommunications for the re-examination of the case, modified some provisions of the Single Reference Offer. However, the decision did not introduce any substantial changes to SRO.

On 5 May 2011, TP filed a complaint with the Regional Administrative Court against the decision of 5 April 2011, petitioning for cancellation of the decision in part, particularly with respect to the provisions which have a negative financial effect on TP. The court proceedings are pending.

On 30 March 2011, TP applied for a change of SRO with respect to the LLU service. The requested change reflects an obligation imposed on TP on the market 4/2007, according to which TP is modify SRO by adding new regulated services (e.g. access to fibre optic loop). The procedure related to changes in SRO is pending.

On 28 July 2011, TP submitted a draft amendment to SRO with respect to the BSA service. The requested change reflects an obligation imposed on TP on the market 5/2007, according to which TP is modify SRO by adding new regulated services (e.g. access to FTTH technology and Ethernet network). The procedure is pending.

On 4 October 2011, the President of UKE amended SRO with respect to the VDSL service. The procedure had been opened upon TP's request following the TTM procedure. The key change in SRO is the introduction of new speed options of 40 Mb/s and 80 Mb/s for the managed IP level of service.

On 5 November 2011, TP submitted a draft amendment to SRO with respect to the call origination service in performance of an obligation imposed on TP on the market 2/2007. The procedure related to changes in SRO is pending.

On 22 November 2011, the President of UKE opened *ex officio* a procedure to amend SRO with respect to the call termination service. In an announcement on opening the procedure UKE did not indicate the rationale behind it or the detailed scope of changes to be introduced.

11.1.2 Bitstream Access

On 12 April 2010, the President of UKE decided to amend the BSA Reference Offer with respect to Section 8 (Price List). Owing to the fact that the decision differed from TP's application for amending the offer and the terms of the Memorandum of Understanding between TP and UKE, particularly with respect to Margin Squeeze and Price Squeeze tests, on 26 April 2010 TP filed an application for the re-examination of the case which ended with the decision amending the BSA Reference Offer. On 13 November 2010, TP filed a request for the discontinuation of the case in view of the President of UKE's decision of 29 October 2010 on approval of the Reference Offer (which, among other things, regulates the BSA service price list).

On 24 June 2010, the European Commission opened a case against Poland due to the President of UKE's failure to notify the draft amendment to the BSA Reference Offer (approved on 12 April 2010). The procedure was discontinued on 16 February 2011.

11.1.3 Leased Lines

On 18 October 2010, the President of UKE issued a decision with respect to the applications for the re-examination of the reference leased lines offer ("RLLO") for the markets 13 and 14, amending the RLLO approved on 31 December 2009. The new version of RLLO is more advantageous to TP than the former one, but it still includes some disadvantageous solutions. Consequently, on 19 November 2010 TP appealed against the new RLLO to the Regional Administrative Court. On 12 December 2011, the Regional Administrative Court rejected TP's appeal. Upon the receipt of a written statement of reasons, TP will consider filing a complaint with the Supreme Administrative Court.

Upon TP's request, on 15 July 2011, an administrative procedure was opened before UKE for approval of changes in the reference offer. On 15 December 2011, the President of UKE opened a consultation procedure with respect to draft RLLO. The draft offer being consulted provides for fees for ISI access and ISI training. The procedure is pending.

11.1.4 Cable Ducts (ROI)

On 16 July 2010, the President of UKE decided to approve ROI in a modified version compared to the draft offer submitted by TP. The approved offer generally accounts for the changes suggested by TP, but there are still some modifications which are disadvantageous to the Company. Consequently, on 30 July 2010, TP filed a request for the re-examination of the decision which implemented ROI. On 18 July 2011 the President of UKE modified ROI, due to TP's motion for re-examination of the decision implementing ROI in 2010. The Regular accepted the most essential aspects of the motion. In particular, ROI was supplemented by provisions on collaterals and updated in the area of technical standards.

TP also took other legal steps to modify ROI. On 13 July 2011 TP applied to President of UKE for approval of a modified version of ROI. The application comprises additional aspects compared with the request for the re-examination, for example concerning fees related to the IT system interface (ISI). On 7 October 2011, TP submitted draft ROI to the President of UKE. This contains additional changes, which have been mostly agreed upon at workshops with other operators. On 10 November 2011, UKE released the draft ROI decision for public consultation. A great majority of the provisions of the modified reference offer are as requested by TP.

11.1.5 Telecommunication Law Amendment

A bill of 15 April 2011 amending articles 39 and 40 of the Telecommunication Law came into force on 2 June 2011. The amendment resulted from the fact that the European Commission had sent a justified opinion to the Polish Government that articles 39 and 40 of the Telecommunication Law were inconsistent with EU law.

Pursuant to the amendment, the provisions enabling the regulator to set on its own the rates to be charged by an operator, regardless of the operator's regulatory obligation to calculate costs and of the positive outcome of the costing audit, have been deleted from the Telecommunication Law. In addition, the provisions according to which the decisions on setting telecommunication access rates could be issued in a dispute settlement procedure have been abandoned. Furthermore, the amendment obligates the President of UKE to indicate the methods which will be applied if the rates charged by an operator are incorrect.

A bill of 16 September 2011 amending the Telecommunication Law with respect to services provided for a higher fee came into force on 4 December 2011. The bill extends informational obligations with respect to users of such services and introduces some requirements regarding new functionalities related using such services (call blocking). The amendment necessitates some system implementations by TP and PTK Centertel.

Secondary Regulations

The following secondary regulations to the Telecommunication Law came into force in 2011:

Decree of the Minister of Infrastructure of 19 August 2011 amending the decree on radio transmitting and transmitting-receiving devices that can be used without a radio licence (Journal of Law of 2011, No. 188, item 1122);

Decree of the Minister of Infrastructure of 1 June 2011 on the national numbering plan for public telephone networks (JoL of 2011, No. 131, item 765); and

Decree of the Minister of Internal Affairs and Administration of 24 March 2011 on the central hub of emergency call centres and service central points (JoL of 2011, No. 75, item 404).

Analysis of Relevant Markets

Currently, the relevant market 1/2007 (access to a public telephone network at a fixed location for residential and non-residential customers) is being analysed. The procedure has reached the data collection stage. TP has not been notified about opening a procedure to designate it as an SMP operator on that market yet.

11.2 Competitive Risks

11.2.1 CATV Operators

CATV operators are one of the major risks to TP on the broadband market.

Holding an aggregate share of approximately 40% in the pay TV market and controlling almost one third of the broadband market, they have an ambition to provide not only primary services, such as internet or voice, but also entertainment. Hence, promotions offering game consoles, IPTV, HD channel portfolio, music-on-demand and 3D television. As usage of such services will generate growing demand for higher capacities, CATV operators modernise their own networks and, more and more frequently, lease third party’s fiber-optic lines.

CATV operators, which operate in Poland’s biggest cities, are perceived as technological leaders offering the highest internet access speeds. Their common practice is to offer higher speeds or increase the scope of services within a package (e.g. with mobile internet) without increasing the service price.

2011 saw the introduction of convergent services, combining fixed line and mobile products, as well as consolidation of the industry.

11.2.2 Fixed/Mobile Substitution

Fixed/mobile substitution is one of the major challenges for telecom operators. The process of F2M substitution has been particularly intensive in Central and Eastern Europe, where the fixed line penetration at the time of popularisation of mobile telephony was much lower than in West European countries.

The fixed/mobile substitution in Poland, like in other CEE countries, has a greater scale than in the majority of West European countries and the ratio of ‘only-mobile’ users is generally higher.

F2M substitution depends mainly on two factors:

- ratio of fixed line to mobile penetration; and
- the relation between mobile and fixed line prices.

Another important factor is habits of customers, who use fixed line phones to call fixed line numbers and mobile phones to call mobile numbers, which owing to high mobile penetration contributes to customer migration to mobile operators. Consequently, a great number of customers prefer to purchase a bundle of mobile/internet/convergent services rather than use fixed line services alone.

In the future, it is fixed line voice services that may become an added value to internet or mobile services. VoIP services are particularly popular in this context. They are activated over a broadband line as the equivalent of a traditional fixed line.

Finally, the aggressive pricing and communication policy of the PLAY network has also significantly added to the F2M substitution. This operator has been making use of the asymmetry of mobile termination rates on its network with respect to other mobile operators, thus adding to the F2M substitution.

Another factor contributing to the fixed/mobile substitution is growing popularity of bundled offers which combine the functionality and price terms of both mobile and fixed services, which are provided by mobile operators via their mobile networks. By offering attractive integrated offers, mobile operators win over customers from fixed-line operators with respect to the full range of telecommunication services.

11.2.3 WLR, BSA and LLU Wholesale Markets

In October 2009, TP and UKE concluded a Memorandum of Understanding, under which wholesale rates are to be frozen by UKE till the end of 2012 and new procedures in inter-operator relations are to be introduced.

In September 2010, the President of UKE approved a single reference offer (“SRO 1”), which in particular introduced the functionalities set forth in MoU. On 5 April 2011, the President of UKE issued another decision (“SRO 2”), partly amending the Single Reference Offer of 2010 (particularly with respect to operator relations and process handling). SRO was updated once again by the President of UKE on 5 October 2011. The last amendment resulted from the fact that on 1 June 2011 TP launched the BSA service based on the VDSL technology using IP DSLAM equipment.

WLR Service

The access to TP's network based on wholesale line rental (WLR) has been provided since 2006. By the end of 2011, TP had provided WLR services to 21 operators. As at 31 December 2011, TP handled about 1.6 million WLR lines.

BSA Service

The broadband access to a local subscriber loop (bitstream access – BSA) has been provided by TP since 2006.

By the end of 2011, the agreements for TP's BSA service had been signed by 25 operators. At the end of 2011, TP handled approximately 520,000 BSA lines.

On 28 April 2011, the President of UKE issued a decision imposing on TP an obligation to submit a draft offer to regulate the market 5 (broadband internet access). In particular, the decision effected the following:

- release of the regulatory obligations with respect to 11 local administrative units – gminas (Bielawa, Lublin, Zielona Góra, Nowy Dwór Mazowiecki, Płońsk, Warsaw, Białystok, Łomża, Braniewo, Elbląg and Olsztyn) excluded from the broadband market regulation; addition of a new Ethernet access level; and introduction of an obligation to provide services on fibre optic lines.

In performance of its obligation pursuant to the decision, TP submitted a draft reference offer to UKE on 28 July 2011. No decision specifying new regulatory obligations had been issued by the Regulator by the end of 2011.

LLU Service

The access to TP's local subscriber loop (LLU service) has been provided since 2005. By the end of 2011, 24 operators had made use of the LLU offer, and the number of LLU lines handled by TP had exceeded 180,000.

In December 2010, the President of UKE issued a regulatory decision for TP with respect to the market 4 (access to subscriber loop). In particular, the decision introduced an additional regulatory obligation to provide services via optic-fiber subscriber lines.

In performance of its obligation pursuant to the decision, TP submitted a draft reference offer to UKE on 30 March 2011. No decision specifying new regulatory obligations had been issued by the Regulator by the end of 2011.

11.2.4 Mobile Internet Access

In 2011, Poland's mobile internet segment saw rapid growth fuelled by growth of the market for portable computers. The mobile internet penetration of Poland's population was estimated at over 9% at the end of 2011.

Mobile internet access seems to be a substitution with respect to fixed internet access, which has significantly slowed down growth of the latter for the last two years. Nearly half of mobile internet users use it exclusively or almost exclusively at home.

Mobile broadband service providers have aimed at enhancing the coverage and technological capacity of their networks in order to offer higher data transmission rates. In the second half of the year, commercial services based on the LTE technology were launched by Cyfrowy Polsat and Polkomtel.

New players, including CATV operators, have been entering the market.

11.2.5 Leased Lines Market

TP's principal competitors in the wholesale leased lines market are Exatel, TK Telecom, GTS Energis and Netia. These companies have network resources that enable them to compete with TP's offer in terms of quality and price. A major part of the leased lines market is the retail segment with additional competition from smaller market players that develop their retail offer on the basis of lines leased from TP or other large players.

The current Reference Offer for telecommunication access with respect to leased line terminating segment, leased line trunk segment and leased end-to-end lines services (RLLO) provides access to this service for a broad group of customers. The companies that have used the retail leased lines services so far, may, upon registration in the register of telecom operators, use the preferential wholesale price list. The existing regulations, especially in terms of pricing, contribute to the market erosion by value. The offer is particularly attractive with respect to analog lines without an allocated frequency band.

At the same time, 2011 saw the continuation of an upward trend in the market for sophisticated data transmission services on managed networks. These solutions are increasingly popular in the business market, as they simplify corporate communications and enable easy incorporation of value-added services. They also enable companies to optimise their expenses and, as a result of telecom outsourcing, focus on their core activity. For this reason, in Poland, like in other European countries, customers have been migrating from traditional data transmission services (including leased lines) to managed solutions (IP VPN / MPLS). Both TP and alternative operators have been expanding their service portfolio in this direction.

11.2.6 Interconnect Market

In April 2011, the President of UKE launched a consultation procedure concerning SMP mobile operators (i.e. regarding MTRs). Following the consultations, the President of UKE issued MTR decisions for PTK Centertel, Polkomtel (PLK) and PTC, setting the following mobile termination rates:

- PLN 0.1520 / minute in the 1 July 2011 to 30 June 2012 period; and
- PLN 0.1223 / minute from 1 July 2012.

On 30 June 2011, the President of UKE issued an MTR decision for P4, setting MTRs on its network according to the following schedule:

- PLN 0.1520 / minute × 179% (July – December 2011);
- PLN 0.1520 / minute × 163% (January – June 2012); and
- PLN 0.1223 / minute × 147% (July – December 2012).

In addition, the President of UKE issued further decisions for alternative operators regarding symmetry of voice call termination rates on fixed networks. UKE’s decisions have introduced a flat rate model without differentiation to tariff periods. TP has appealed against such a methodology, as it actually results in an increase rather than a decrease in asymmetry.

On 5 August 2011, the President of UKE issued a regulatory decision for TP on the market 2 (call origination on a fixed public telephone network), slightly modifying the existing regulatory obligations of TP. In performance of its obligation pursuant to the decision, TP submitted a draft reference offer to UKE on 4 November 2011. No decision specifying new regulatory obligations had been issued by the Regulator by the end of 2011.

11.2.7 International Long Distance Inbound and Gateway Markets

The ILD inbound and gateway markets are highly competitive. The activity of operators in this market segment is a consequence of a slump in domestic interconnect rates and thus the need to search for additional sources of revenue. As a result, operators establish more and more direct interconnections with both incumbent operators and international operators that focus on voice traffic wholesale. At the same time, operators try to attract traffic to their own networks and win transit traffic to other domestic networks. The struggle is most dynamic in the market for mobile calls, which relatively generate the highest revenues.

TP has been an active player in the international inbound and gateway markets, particularly by:

- expanding its foreign interconnect base;
- maintaining its share in Poland’s inbound market;
- actively attracting new gateway traffic volumes by winning subsequent operators for its ILD service;
- concluding short-term bilateral agreements with operators, which assure stable traffic volumes, stable revenues and costs, the optimum network usage and business predictability; and
- having signed agreements with 41 domestic operators, under which it provides services of call termination on foreign operators’ networks via its own network, and applying the same cooperation model in business relations with 74 foreign operators.

These efforts increase TP’s bargaining power in its relations with foreign partners.

Another major trend in the ILD market is growing use of the IP technology. A number of operators is migrating or planning to migrate from the TDM technology to the IP technology both within their own networks and in the interconnect traffic.

In 2011, TP launched its first IP-based interconnect gateways. Such interconnections with a total of seven foreign operators are either being tested or have already been launched. In addition, TP has been working on attracting further international operators to cooperate on the IP interconnect basis.

As shown by the experience of TP’s foreign partners, such as Telecom Italia, British Telecom, Deutsche Telecom or France Telecom, the migration of complete service portfolio is a difficult and prolonged process. Therefore, operators are still using mixed technology and have not entirely given up TDM. TP has also adopted a similar model: it introduces a growing number of IP-based services into its portfolio, while not giving up the TDM technology.

11.2.8 International IP Transit Market

TP's principal competitors in this market are the biggest national operators, which develop or lease international lines to the main traffic exchange points. The presence of international operators in Poland further intensifies competition for access to the worldwide internet resources. The activity of the biggest domestic operators and the growing volume of IP traffic handled by international players (of Tier-1) have been gradually reducing TP’s position in this service market.

11.2.9 VoIP Segment

Constant growth in voice-over-Internet Protocol (VoIP) services in Poland is driven mostly by subscribers’ pursuit of lower voice rates. Owing to VoIP technology, some calls, namely between the users of the same VoIP internet application, are fully free of charge. This largely contributes to the popularity of this channel of communications, as reflected in the number of communicator users.

For many years the VoIP technology has been widely used in Poland also for providing fixed voice services in the form of fully functional equivalents of traditional fixed lines. In addition to following general market trends and meeting customer expectations, this enables reduction of service costs and frequently offers the easiest method for new market entries. The largest group of operators who have entered into the fixed line market in this way are CATV operators, which usually offer voice services bundled with broadband internet access to the existing subscribers of their TV services. TP Group has also been active in the market for VoIP services.

In May 2011, TP implemented the HD Phone service, which enables users to make calls of very high sound quality. Simultaneously, new plans meeting the demanding customers’ needs and expectations were introduced. The offer enables customers to use a pool of minutes available for the access fee not only for local and DLD calls, but also FTM and ILD calls. The new offer is based on geographical numbering.

The VoIP offer is developed by adding new services and functionalities.

12 RISK FACTORS RELATED TO MACROECONOMIC ENVIRONMENT AND FINANCIAL MARKETS

12.1 Macroeconomic Factors and Factors Related to Poland

12.1.1 Economic Growth

In 2011, Poland remained one of the fastest growing economies of the European Union. According to initial estimates of the Central Statistical Office, real GDP growth amounted to 4.3% (year-on-year). The GDP growth was fuelled mainly by continuously high private consumption (up 3.1% year-on-year) and an increase in investments (up 8.7%).

According to adjusted government assumptions, GDP growth in 2012 will slow down to 2.5%. Poland's economic outlook largely depends on the condition of other European economies and the economic climate in global markets. Owing to strong ties between the Polish economy and economies of other European countries, the current crisis in the Eurozone and a drop in confidence due to perturbations in Greece, Portugal, Spain or Italy will affect further economic growth in Poland. The pace of solving Eurozone problems and the effectiveness of the solutions applied will determine the economic outlook of the European Union, and, consequently, Poland. The Polish economy may be hit particularly hard by a feedback between slow-down in business activity, the risk of insolvency of the most heavily indebted countries and the risk of destabilisation of the financial sector, which may result in strong recession and rapid drop in demand for Polish exports, and, consequently, a drop production growth rate, employment and private investments in Poland.

An external factor affecting the economic growth rate in Poland will be the outcome of the structural reforms which the government wants to implement. The public finance consolidation is going to result in a decrease in direct contribution of public expenditure into growth of domestic demand and a reduction in the volume of public investments (compared to 2011).

12.1.2 Inflation

CPI accelerated to 4.3% (year-on-year) in 2011 (from 2.6% (year-on-year) in 2010). According to the guidance contained in the 2012 budget bill, the inflation rate will drop to 2.8%.

The higher inflation rate in 2011 resulted mainly from a strong increase in prices of fuels and agricultural goods in global markets. In 2012, the inflationary pressure should subside as a result of tightened monetary policy followed in 2011 and gradual stabilisation of prices of raw materials. Inflation will be further contained by economic slow-down and lower demand pressure. A risk factor for the achievement of the inflation rate target – apart from uncertainty of the economic growth rate – is potential further demand shocks in the global market for raw materials. In addition, a higher than expected inflation rate may also result from potential depreciation of the Polish zloty in case of a further significant increase in risk aversion in global financial markets.

12.1.3 Unemployment and Labour Costs

In 2011, unemployment rate stabilised at 12.5% (up 0.1 pp) by the end of the year. A relatively good macroeconomic climate, particularly relatively high growth in private investments and good financial standing of companies, had positive impact on employment growth in the business sector. However, this was not substantially reflected in wage growth. As a result, mean gross wage in the business sector grew 5% in 2011 (year-on-year).

12.1.4 Political and Economic Factors

Poland has undergone significant political, economic and social change in the last twenty years. Changes in political, economic, social and other conditions may have influence on the economy and the condition of enterprises, including the financial condition and performance of the Group. The parliamentary election in the second half of the year, as a result of which the Civic Platform and Polish Peasants' Party coalition was again entrusted with ruling the country, should not affect the business environment. A trend observed over the recent years shows that the activity of the telecommunication market regulator has much more meaningful effects on the Group and the telecommunication market as a whole than any political changes in Poland do.

12.1.5 Changes in Regulation

Changes in law or regulations (or in the interpretation of existing law or regulations), whether caused by change in the Polish government or implementation of European Community law as a result of Poland's membership in the EU, could materially adversely affect the Group's business, financial condition and operations. Competition, securities, telecommunication and other laws and regulations have been and continue to be subject to substantial changes in Poland.

12.1.6 Polish Tax System

Polish tax laws and regulations, in particular as regards value added tax and income tax provisions are complex and subject to frequent change, varying interpretations and inconsistent and selective enforcement by the Ministry of Finance and local authorities. Such and potentially other changes in Polish tax regulations may adversely affect the legal, business and financial situation of the Group in the future. The growing public debt and budget deficit influenced the decision to raise VAT by 1pp, to 23% and 8% as from 1 January 2011. Furthermore, the bill provides that should Poland's public debt exceed the cautionary threshold of 55% of GDP, there will be obligatory increases in VAT rates by 1pp in subsequent years until the maximum level of 25% and 10% is reached. On 1 February 2012, the disability insurance premium in Poland will increase from 6% to 8%. The increase is in a portion of the premium which is financed by the employer, which will automatically increase the costs of labour.

12.2 Factors Related to Financial Markets

12.2.1 General Risks Related to the Polish Market

Poland is still considered a less stable market, which is exposed to higher fluctuations in case of negative developments in global markets. Therefore, investors should exercise caution while assessing the risk of purchase of financial assets of Polish companies. In consideration of the above, investment decisions should be made by experienced investors who are able to fully assess all risks involved in such investments.

12.2.2 Interest Rates

In the first six months, the reference interest rate in Poland was raised by 100 basis points and then remained unchanged at 4.50% till the end of 2011. Due to continued inflationary pressure, related partly to weaker Polish zloty, no quick decisions about interest rates should be expected in the first half of 2012. Financial markets estimate the aggregate reference interest rate decrease in the second half of 2012 at 50 basis points.

A potential increase in interest rates should not have any major influence on TP Group's debt service costs, owing to high hedging ratio.

12.2.3 Foreign Exchange Rates

Foreign exchange rate fluctuations affect TP's obligations denominated in foreign currencies and settlements with foreign operators. However, this influence is greatly contained by a portfolio of hedging instruments held by TP.

In addition, the fluctuations of the exchange rate of the zloty against the euro may affect comparative analyses conducted by UKE, in which TP's price offer is referred to the offers of its European peers. The strong Polish Zloty may have an adverse effect, when the prices of new services are determined by UKE on the basis of the EUR-denominated benchmarks.

The external situation, especially European Union's debt problems, have been the main reasons behind the higher fluctuations and depreciation of the zloty. In 2011, the exchange rate of the zloty against the euro was in the 3.8403–4.5642 bracket, while its exchange rate against the US dollar oscillated between 2.6458 and 3.5066. NBP's mean exchange rates of PLN against the US dollar and the Euro in 2011 were 2.9636 and 4.1196, respectively.

12.2.4 Situation at the Warsaw Stock Exchange

2011 saw a decline in the indices on the Warsaw Stock Exchange (WSE). The WIG index, was down 20.8%. At the same time, TP shares gained 5.4% (or gained 14.6% including the effect of dividend paid), while the large-cap index, WIG20, lost 21.9%.

12.2.5 Other Factors That May Influence the Price of TP S.A. Shares

Other than major factors already mentioned earlier in this document, the following may also result in TP share price fluctuations:

- Change in TP Group’s ratings;
- Change in TP Group’s debt;
- Sale or purchase of assets by the TP Group;
- Significant changes in the shareholder structure; and
- Changes in the capital market analysts’ forecasts and recommendations concerning the TP Group, its competitors and partners, or business sectors in which the Group operates.

13 APPENDIX. PRODUCTS AND SERVICES

FIXED LINE VOICE

Business Customers

In 2011, in order to meet customer expectations and to improve its competitive position, TP introduced the following modifications in its business portfolio:

Price Reductions for Calls to Play

A price reduction for calls to Play was introduced on 1 January 2011. The price cut resulted from a reduction in MTRs for this operator. Currently, the price for calls to Play is PLN 0.43 per minute.

Tariff Solutions

In May, TP introduced new tariffs of innovative functionality, 'Corporate Plans', which are addressed mainly to SOHO and SME customers.

The 'Corporate Plans' offer comprises three tariff plans: 'Corporate Plan', 'Corporate Plan 250' and 'Corporate Plan 1000' with pools of cash embedded in the subscription fee which can be used for any types of calls.

The leading activation offer is still 'Connection for a Fair Price'. It has been extended until the end of January 2012. It concerns analog line activation. Depending on the term of agreement, either 12 or 24 months, the activation fee is PLN 1.01 or PLN 10.09 (incl. VAT), respectively.

For high-end customers, especially institutions purchasing telecommunication services through public procurement procedures, the Company offered 'tailored-to-measure' tariff solutions.

Dedicated tele-sales campaigns offering Business Plans and Corporate Plans were carried out in 2011 as part of customer retention efforts.

Value Added Services (VAS)

IN-based advanced services are a very important element of a service portfolio, providing special functionalities to customers that often constitute the basis for their business activity. VAS business portfolio includes mainly a broad range of corporate hotlines as well as TP Short Numbers and Teleconference services.

On 1 November 2011, TP introduced a major modification in its 'Short Numbers' offer. This involved a reduction in activation and subscription fees; a possibility to activate any available number chosen by a customer; and an option to migrate an AUS number to the 'TP Short Numbers' offer without any activation fees.

Residential Customers

Promotional Offers and Initiatives

- On 3 January 2011, the 'Home Plan at a Fair Price' promotional campaign started. It lasted till 28 February and offered a discount on a monthly access fee throughout the term of a loyalty agreement.
- On 2 May 2011, a campaign for fixed-time agreements for new tariff plans was launched. It lasted till 19 June. The campaign aimed at highlighting changes in the offer, namely a possibility to make F2M and ILD calls within the subscription fee.

New Services and Tariff Plans

TP launched the following promotions in 2011:

- In Q1 2011, five promotions which had been launched in 2010;
- In January 2011, the 'Home Plan at a Fair Price' promotion: a reduced subscription fee throughout the term of the agreement, provided that a loyalty agreement was signed for 12 or 24 months;
- In January 2011, the '120 Minutes with e-Invoice' offer to support activation of e-invoices by fixed line customers: extra 20 minutes for calls on domestic fixed networks, provided that e-invoice was activated;
- In February 2011, the 'Home Plan with Navigation' promotion: customers were offered a vehicle GPS navigation system, provided that a loyalty agreement was signed;
- In March 2011, a new price list for 'Home Plan' tariffs: Home Plans with fixed-time agreements, which offer much lower prices, were added to the permanent portfolio. In addition, the new offer includes a possibility to make ILD and F2M calls within the subscription fee;

- In September 2011, the ‘Free CLIP for 3 Months’ promotion was extended;
- In November 2011, the ‘Cheap Plan, Good Phone’ promotion: customers signing up for a ‘Home Plan’ with a fixed-term agreement could purchase a wireless telephone set for a price starting from PLN 1.

Connection Offers

With respect to the network connection service, in 2011 TP’s customers were offered the continuation of the ‘Connection for a Fair Price’ promotion on unchanged terms.

The promotion offers a discount on a one-off fee for connecting the first terminal to TP’s network via analog (POTS) lines. The offer includes two loyalty agreement options:

- POTS connection fee of PLN 10.09 (incl. VAT) in case of a 12-month agreement; or
- POTS connection fee of PLN 1.01 (incl. VAT) in case of a 24-month agreement.

DATA SEGMENT

Business Customers

Data Transmission for Business

Customers are increasingly interested in data transmission services, which enable them to reduce operating costs and streamline business processes. IP VPN, have been particularly popular.

IP VPN Service for the Most Demanding Customers

In 2011, customers eagerly invested in the IP VPN service, as it not only enables them to streamline company's operations but also reduce costs. It is a very good proposal for multi-site companies. The service is recommended not only for large corporations but also small to medium enterprises. IP VPN is based on the MPLS protocol. The service has been offered for several years and has already won a good reputation and recognition among customers. Customers choose TP offer because owing to a number of possible configurations it can be perfectly tailored to their needs.

IP VPN is a solution that involves high security and impressive speeds of data transmission, including multimedia transmission. The service offers high flexibility and enables companies to connect a number of branches in Poland and abroad into a corporate WAN intranet. In addition, employees may be provided with fast and safe access to the internet. IP VPN is an example of a service fully managed by the operator. TP's network engineers and specialists provide comprehensive management of the corporate network, so that virtually no additional expenses are required from the customer. As a result, customers can focus on their core business instead of dealing with equipment, set-up, repairs or fault removal.

The Business IP Telephony service still generated considerable interest among customers. It is based on the IP VPN solution (namely the Multimedia or Multimedia Plus options). It is also complementary to IP VPN, providing a network for voice and data transfer. The IP PABX service is also worth mentioning, as it is a solution offering the functionality of a central management system for communications both inside and outside a company. This solution is set-up, managed and maintained by TP.

City Ethernet

2011 saw an increase in sales of the City Ethernet service. City Ethernet offers safe data transmission and fixed access to the internet provided in the Ethernet technology at a rate of up to 1 Gb/s. The service is addressed to medium to large companies which need fast and reliable data transmission or safe access to the internet. Owing to high transmission parameters offered by the Ethernet technology, customers can carry out video- and teleconferences and use multimedia transmission and videophone services. The built-in mechanisms of the City Ethernet service facilitate management of IT units, which communicate with one another as if within single LAN. It enables customers to simplify the structure of their IT networks and reduce operating costs.

Quality Assurance (SLA) Services for Business

TP offers SLA (Service Level Agreement) Quality Certificate for data transmission services (Frame Relay/ATM data transmission, POLPAK-T network services, Frame Relay internet access), IP VPN, Ethernet VPN, digital leased lines and City Ethernet. The SLA Quality Certificate for the Business IP Telephony service was added to TP's service portfolio on 1 August 2011, and for the LAN Management service on 5 December 2011.

Customers receive credit if SLA parameters are not met by TP. It is calculated automatically by the operator and deducted from a net monthly fee for the service to which the quality certificate applies. SLA services are particularly important in business, where high quality parameters of data transmission services are required. SLA guarantees high quality of data transmission and fast removal of any faults, which assures the continuity and reliability of the underlying service. In addition to a standard customer service option, SLA is also offered at the Progress and Premium levels. TP has also extended the scope of its SLA – Service Package service, an additional sophisticated service offered to SLA customers.

Leased Lines

On 1 August 2011, TP reduced subscription fees (by up to 53%) for most types of digital lines in its Domestic Leased Lines service portfolio. In order to further encourage customers to use digital lines, the 'Line for Less' offer was introduced, in which the installation fee for a digital line may be reduced even to PLN 1 net of VAT (or PLN 1.23 incl. VAT).

Internet Access Portfolio

DSL Internet Access

Promotional offers: 'DSL Sprinter', 'DSL Sprinter for Loyal Customers' and 'DSL Sprinter for NEO' were particularly popular in 2011. These promotions offered attractive access fees during an initial period, reduced subscription fees for value-added services and an installation fee of PLN 1. Owing to high popularity among customers, the 'DSL Sprinter' promotion has been extended to 30 June 2012. In addition, TP launched attractive 'Rally' promotions ('DSL Rally' and 'DSL Rally for NEO'). Customers could sign up for an attractive promotional offer of a reduced installation fee (for a modem with enhanced functionality) and a reduced access fee. Active sales of the 'DSL Rally' promotional offers continued throughout 2011.

In September 2011, a new version of the Webmail application for the DSL Internet Access service, which is more clear and user-friendly, was introduced. This is a web application which enables users to access e-mail services using a web browser. The Webmail application is available free of charge to all users of the DSL Internet Access service who use DSL Internet mail as part of hosting (free for all options of the service). TP promotes the development of information society particularly through enabling telework, that is work performed outside traditional work establishments. Employees of TP's corporate customers can use the DSL Internet Access service at home, whereas the service fee can be paid by their employers.

Advanced Business SDSL Internet

On 1 August 2010, TP launched the Advanced Business SDSL Internet service on a commercial basis. The service offers a fixed symmetric internet link with no time or transfer limits. It is addressed to large corporations which seek more advanced yet uncomplicated internet access solutions, e.g. for the purpose of e-banking, on-line stores, web servers, etc. The new offer generated high interest. Owing to high quality of transmission, the symmetric access may be used also for the purpose of video monitoring or tele- and video-conferences.

Development of the ICT Service Portfolio

The Information and Communication Technology (ICT) comprises a number of solutions for business customers, including telecommunication and IT products and services, as well as consulting, outsourcing and other auxiliary services that support such solutions. TP has actively followed this market trend, offering a growing number of such services. As a result of combining different products and services, the Company offers integrated solutions that can meet the increasingly complex and varied customer needs.

IT for Business

A major development in 2011 was the introduction of a new offer, IT For Business, in November. Customers are offered hardware, software and IT support within a single package.

A major development was the introduction of a new offer, IT For Business, in November. Customers are offered hardware, software and IT support within a single package. It is a market-unique comprehensive IT solution, through which TP offers hardware, software and IT support within a single package. Customers can choose from among four service packages tailored to their needs. The 'basic' package offers a desktop, while the other three, 'optimal', 'prestigious' and 'mobile', offer a laptop; this is combined with pre-installed software and IT support.

IT for Business offers a number of benefits from a single service provider. Customers are offered ready-to-use packages, which are delivered with pre-installed software directly to their office. This is a transparent and flexible modular offer which can be customised to customer's specific needs. In addition, TP guarantees professional and reliable IT support, which is provided by a team of top-class IT specialists. Signing up for this offer brings efficiency gains, as any defective pieces of equipment are immediately replaced or repaired, which adds to the efficiency of employees. In the IT for Business service, customers pay only an affordable monthly fee with no hidden costs and bear no capital expenditure. The offer provides for computer replacement with an option to purchase the equipment. When the term of an agreement ends, TP replaces the computers with new ones and the customer has an option to purchase the equipment. High SLA level (repairs on site not later than on the following business day) add to the attractiveness of the offer. TP ensures business continuity, as in case of failure substitute equipment is provided for the time of repairs. In addition, IT for Business guarantees a high level of security, as it prevents leakage of confidential information.

LAN Management

TP provides the LAN Management service, which offers outsourcing of corporate LAN/WAN management to the operator. Customers can also entrust TP with the whole LAN development. Network equipment (routers and switches) offered to customers as part of the service is set-up according to their requirements and then delivered and installed on site. As a result, all pieces of equipment, such as desktop or laptop computers, servers, mass storage devices, printers, IP phones, etc., are connected into single corporate LAN. The service is offered in two options: Advanced LAN Management and Basic LAN Management. On 15 October 2011, in a process of development of the LAN management service, its portfolio was extended to include equipment which enables development of wireless WLAN networks. In addition, a new option was introduced in the basic version of the service, which offers service activation together with set-up and installation. LAN audit on customer’s site was also added to the service portfolio.

Cisco Iron Port Email Security

TP has been actively supporting the secure data transfer policy in business, particularly by offering Cisco Iron Port Email Security. This service significantly increases the security of corporate email systems. In the new service, customers are offered a Cisco device which assures very high protection of their corporate email against hackers and spam. This is a much more sophisticated means of protection than standard antivirus software packages usually used by companies for this purpose. Customers do not need to update software any more, as this is done automatically by the device.

Managed UTM: Higher Security in Business

In October 2011, TP introduced a new service for business, ‘Managed UTM’, which provides additional security while using the Internet. Internet users are offered multi-tier protection, as a single UTM unit combines several functional modules, such as antivirus, firewall, IPS/IDS intrusion detection/prevention system (IPS/IDS) and website filtering. Customers can choose between a basic and advanced option of the service.

Cabling: New Solution in the ICT Service Portfolio

A cabling offer involves the development or expansion of a cable network in a customer’s location. The service includes installation of cubicles, cables and logical (network) and electrical sockets of various manufacturers. In addition, if a network is terminated with logical and electrical sockets, fuses and protective devices are installed. The service involves design and is prepared on a case-by-case basis according to individual needs.

Content Servers

TP fits perfectly well in the program of development of an information society, particularly with its ‘Content Servers’ offer. The offer is addressed mainly to web content providers, such as portals or web media. The service enables faster access to key news reports and information for the audience of internet portals and on-line news services.

The ‘Content Servers’ offer was enhanced in September, particularly by adding a new functionality of live distribution of on-line content (e.g. concerts, sports events or important state celebrations) and offering a more advantageous model of settlements.

Business Package: Service Bundle for SME

Business Package offers fast internet access at up to 4 Mb/s, an attractive tariff plan for voice calls, a separated virtual private network (VPN) as well as a number of additional services useful in company’s everyday operations. Small to medium companies are particularly interested in simple and integrated solutions. The ‘Package for Everyone’ promotion was extended to the end of January 2012. It offers a reduced monthly fee for selected business packages throughout the term of the 24-month loyalty agreement.

INTERNET SOLUTIONS

Residential Customers

Broadband Internet Access

In terms of the broadband portfolio, the most important development in 2011 was the introduction of new speed options of *Neostrada* based on the VDSL technology:

- 'Internet of Your Dreams': 12-month or 24-month agreements for 2 to 20 Mb/s options. For a 24-month agreement, the prices are PLN 54.40 for 2 Mb/s, PLN 59.48 for 6 Mb/s, PLN 64.53 for 10 Mb/s and PLN 69.57 for 20 Mb/s, as well as PLN 79.9 for *Neostrada Fiber* 40 Mb/s and PLN 99.9 for *Neostrada Fiber* 80 Mb/s, respectively.

VoIP Services

In 2011, TP introduced a number of changes was introduced in its portfolio of VoIP services. In the second quarter of 2011, the sales of the 'TP Internet Telephony' service were discontinued and a new service called 'HD Telephone' was introduced with a number of attractive tariff plans and cost-saving value-added services. The new service is available to *Neostrada* users and enables them to use VoIP services via a standard analog terminal connected to a Livebox modem (in the same way as with a traditional fixed line phone). HD Phone users, like PSTN subscribers, can make emergency calls.

In addition, the range of calls which can be made by users of the HD Phone and TP Softphone services has been extended to include e.g. calls to short numbers. In the fourth quarter, TP enabled HD Phone users to make voice calls not only with a traditional telephone set but also with a dedicated software application. As a result, VoIP subscribers can now make and receive voice calls under their home tariff plan not only at home but at any place in the world where they have access to the Internet.

In the fourth quarter of 2011, TP also substantially changed its sales strategy, shifting from sales of individual services to sales of bundled offers, in which voice service is provided in the VoIP technology. Hence, since the end of 2011, the VoIP service has been offered by TP as a full substitute of a traditional analog phone.

Multimedia Services

In terms of the multimedia portfolio, key developments in 2010 included the launch of the Fun Pack offer (broadband + TV + voice) and the introduction of *n Television* packages for subscribers of TP's television services.

- *Fun Pack*:
  - 80 Mb/s broadband service;
  - TV service based on DTH or IPTV technology (49 or 56 channels, respectively);
  - Telephone service: unlimited F2F calls in Poland for no extra fee, cheap F2M and ILD calls, crystal-clear HD quality sound.

  For a 24-month agreement, the prices are PLN 104.91 for 2 Mb/s, PLN 109.90 for 6 Mb/s, PLN 114.91 for 10 Mb/s, PLN 119.90 for 20 Mb/s, PLN 129.90 for 40 Mb/s and PLN 149.90 for 80 Mb/s, respectively.

- *n Television* packages: *Welcome to HD* (78 channels on IPTV/74 on DTH, including 14 HD channels), *HD World* (110 channels on IPTV/116 on DTH, including 23 HD channels), *HD Movies* (118 channels on IPTV/124 on DTH, including 29 HD channels), and *Full HD* (120 channels on IPTV/126 on DTH, including 31 HD channels).

Business Customers

Orange Internet For Business/Internet For Business Pro

The fixed-line broadband service, Internet For Business, which is based on the BSA model, is addressed mainly to the SOHO segment. In 2011, TP's efforts focused mainly on bundled sales with other Orange services: Fixed Orange For Business (WLR) or Orange mobile offers.

The CDMA-based Internet For Business Pro offer provides for internet access speeds of up to 1 Mb/s in 'white zones', that is areas where no broadband services were available prior to the introduction of such a solution. An option of activating a permanent IP address was introduced in July 2011 and the new 'Platinum' option of the service was launched in November. The latter offers a higher data transfer limit (25 GB) for a higher price and is expected to generate a higher margin.

Both Internet For Business and Internet For Business Pro offer a pool of minutes for calls to Orange or fixed-line numbers from an Orange mobile phone. This aims at increasing the loyalty of Orange mobile customers and promoting cross-sales of mobile services to Orange fixed broadband customers who have not signed a mobile service agreement.

Orange Fixed For Business (Fixed Line Voice)

The Orange Fixed For Business service enables voice calls via a fixed analog line (POTS) or an ISDN BRA digital line and is based on TP's wholesale line rental (WLR) offer. Both options offer a predefined pool for F2F calls and F2M calls to Orange, which is embedded in the subscription fee.

Orange Business Everywhere

In 2011, PTK Centertel further developed its mobile internet offer, Business Everywhere. Owing to modifications and new options introduced towards the end of 2010, sales remained stable in 2011, despite growing competitive pressure.

At the end of January and beginning of February, new technology HSPA+DC (offering transfer at up to 42Mb/s) with dedicated modem Huawei E372 was introduced. By the end of 2011, as part of pilot implementation, all PTK Centertel customers could use the technology free of charge, provided they had the right modem.

In January, new solutions were introduced to reduce prices of tablets; at present, the tablet portfolio includes iPad, Samsung Galaxy Tab and Orange Tablet at prices starting from PLN 1. In addition, the portfolio of terminals, modems and notebooks has been constantly modified (at the end of May, Samsung NC110 netbook was added to the portfolio). Towards the end of September, the iPad 2 tablet was presented within this offer in the Polish market. The new offer has featured access to a greater number of value-added services and an increased price flexibility.

In addition, the service software has been systematically modified and drivers for new equipment in the portfolio have been provided for both Windows and MAC operating systems.

Another initiative aimed at making the Business Everywhere portfolio even more attractive and adapting it to the rapidly growing market for mobile internet services was the introduction of the Business Everywhere Day-by-day offer at the end of May. It is the first offer in the business market in which there is low or no monthly access fee and customers are charged only for the days when they actually use the data transfer service.

At the end of November, a new mobile broadband offer of Orange For Business was introduced. The new Business Everywhere offer, which is oriented on customer needs, has three main options: with a modem, without a modem or with a computer. Each option features six tariff plans tailored to specific needs of customers. This solution will constitute the basis for further development of the Business Everywhere offer in 2012.

Orange Telemetry

In the first quarter of 2011, M2M users were offered new, flexible packages for data transmission in roaming: No Frontiers Package and MB Packages for Europe or the world. The packages may be tailored to requirements of individual customers.

In the second half of the year, a new telemetric offer was introduced to enable the use of CDMA technology ('CDMA Telemetric Tariff'). This is the first such offer in the Polish market. In connection with the new offer, a CDMA module dedicated to M2M services was added to the portfolio. At present, the CDMA technology covers 88% of Poland's territory and the data transmission rate is up to 1 Mb/s.

The development of products for M2M users was crowned in December 2011 with the introduction of soldered SIM cards of the MFF2 standard. They provide for high reliability of telemetric equipment operating in difficult environment, which could not be achieved with traditional SIM cards, and guarantee security against misuse by third parties (e.g. SIM theft).

Orange Navigation

Various marketing efforts in this product included pre-installation of the navigation application in a majority of handsets with a GPS receiver offered by Orange; launch of a new version of the application featuring enhanced functionality and ergonomics; service communication in professional journals; sending promotional leaflets with invoices; and positioning of a website with information about the service on the internet. Moreover, the service was promoted on TV in the Orange Weekends promotional campaign (twice).

Navigator

2011 was marked by the modernisation of the Navigator service. The service refurbishment involves development of a new version of the management application with an intuitive and ergonomic interface as well as replacement of maps into up-to-date and much more detailed ones. In addition, the marketing offer is being thoroughly modernised. Three price lists, two dedicated to monitoring and mobile staff management and one dedicated mainly to mobile staff supervision, are being developed. New offers will be more flexible and will better match the needs of customers, which will reduce churn and attract new users.

Orange Email Solutions

In 2011, the portfolio of communication solutions for business customers was expanded to include new products developed together with business partners.

As a result of cooperation with home.pl, since 28 February 2011 Orange business customers have been able to use a special offer which enables unlimited access to an email account handled by home.pl. A monthly fee for the service is PLN 7.90 (net of VAT).

On 14 April, as a result of cooperation with Wirtualna Polska, a similar service was launched for Orange business customers who use email accounts handled by wp.pl servers.

In addition, in December 2011, data packets in the Email for Business, MSE Mail and Nokia Mail services were significantly increased. The changes applied to both new and existing customers. The data packet increase did not change the service price and was introduced in response to the existing upward trend in data volumes sent within the service.

Orange Additional Voice Solutions

2011 saw an increase in the customer base of two services with fixed line numbers: Extra Business Zone and Orange Virtual Exchange. Both services were implemented in 2010 and owing to regular informational initiatives have steadily gained popularity since then. The Extra Business Zone service enables customers to use an additional fixed-line number on their SIM card. Orange Virtual Exchange is a revolutionary solution in the area of enterprise-wide telecommunication management. In addition to traditional features of a corporate PABX, it offers a number of new functionalities, including extensive IVR, Text-To-Speech message recording, integration with an external server through Web Services, fax reception and consultant group management (the consultant selection algorithm is chosen by the administrator).

The popularity of both services grew particularly strongly towards the end of the year, increasing their customer base. Moreover, customers purchasing the Orange Virtual Exchange usually increased their fleet of mobile phones, thus generating additional revenue. Further development of the Orange Virtual Exchange service is planned in 2012.

Orange Teleconferences

2011 brought modification of teleconference service tariffs. Before, Orange Teleconference users used to pay for each minute of teleconference calls like for standard calls on the Orange network, accounting for pools and rate-reducing services. In June, a dedicated tariff was introduced. Now, conference calls are payable at a fixed rate of PLN 0.18 per minute and this charge is neither reduced by any services nor included in pools. This solution has facilitated communication of the service costs and at the same time increased revenue from the service.

In November, a mobile application was implemented to enable teleconference booking and set-up ad hoc (users are called by the organiser). Now, it is possible to start a conference at the moment chosen by the organiser, without remembering the teleconference room data and waiting for all participants to call in.

GLOSSARY OF TELECOM TERMS

Access Fee – revenues from monthly fee from New Tariff Plans (incl. Free minutes)

ARPL – Average Revenues per Line

ARPU – Average Revenues per User

AUPU – Average Usage per User

BSA – Bitstream Access Offer

CDMA (Code Division Multiple Access) – second generation wireless mobile network used also as a wireless local loop for locations where cable Access Is not economically justified

DLD – Domestic Long Distance Calls

DSLAM - Digital Subscriber Line Access Multiplexer

F2M – Fixed to Mobile Calls

FVNO – Fixed Virtual Network Operator

ILD – International Calls

IP TV – TV over Internet Protocol

LC – Local Calls

LLU – Local Loop Unbundling

MAN – Metropolitan Area Network

MPLS – MultiProtocol Label Switching

MTR – Mobile Termination Rates

MVNO – Mobile Virtual Network Operator

Net FCF – Net Free Cash Flow = Net cash provided by Operating Activities – (CAPEX + CAPEX payables)

POTS – Plain Old Telephone Service

RIO – Reference Interconnection Offer

SAC – Subscriber Acquisition Costs

SDI – Permanent (Rapid) Access to Internet

SMP – Significant Market Power

USO – Universal Service Obligation

VoIP – Voice over Internet Protocol

WLL – Wireless Local Loop

WLR – Wholesale Line Rental