REPORT
of the Supervisory Board on results of the assessment
of the financial statements of BGŻ S.A. and the activity report of the Management Board of the Bank for the year ended 31 December 2013, and the recommendation of the Bank's Management Board on the allocation of profit for the year ended 31 December 2013 together with the assessment of adequacy and effectiveness of the internal control system at the Bank

In accordance with Article 382 § 3 of the Code of Commercial Companies, the Supervisory Board of Bank Gospodarki Żywnościowej S.A. assessed the financial statements of the Bank for the year ended 31 December 2013, the Management Board Report on the activities of BGŻ S.A., and the recommendation of the Management Board on the allocation of the profit for the year ended 31 December 2013.

The aforementioned assessment has been made based on:

1. the financial statements comprising:
    - profit and loss account for the period from 1 January 2013 to 31 December 2013, showing a net profit of PLN 162 403 thousand,
    - statement of total income for the period from 1 January 2013 to 31 December 2013, showing a total income of PLN 38 515 thousand,
    - statement of financial position prepared as at 31 December 2013 showing total assets of PLN 35 763 492 thousand,
    - the statement of changes in total equity for the period from 1 January 2013 to 31 December 2013, disclosing an increase in equity by PLN 38 515 thousand,
    - cash flow statement for the period from 1 January 2013 to 31 December 2013, disclosing a negative net cash in the amount of PLN 322 657 thousand; and
    - accounting principles (policy) and additional explanatory notes,
2. Management Board Report on the activities of BGŻ S.A. in 2013,
3. Motion of the Management Board on the allocation of the profit for the year ended 31 December 2013,
4. opinion and report of the independent auditor – KPMG Audyt Spółka z ograniczoną odpowiedzialnością Sp.k. – appointed to audit the financial statements based on the resolution of the Supervisory Board No 1/2013 of 28 January 2013.

The Supervisory Board has stated as follows:

Ad. 1) Financial statements

Based on the assessment of the financial statements of BGŻ S.A. for the year ended 31 December 2013, the Supervisory Board has concluded that these financial statements, have been prepared:

- in accordance with the International Financial Reporting Standards approved by the European Union;
- based on properly maintained accounting records;

- in accordance with the provisions of the law governing preparation of the financial statements and provisions of the Bank's Statute influencing the form and content of the financial statements;

and give a fair and clear view of all information material for the evaluation of the financial result of business activities for the period from 1 January 2013 to 31 December 2013, as well as the economic and financial position of BGŻ S.A. as at 31 December 2013.

Selected financial data and ratios

PLN'000	31.12.2013	31.12.2012	Change	
Profit (loss) before tax	204 437	178 467	25 970	14.6%
Net profit (loss)	162 403	134 343	28 060	20.9%
Total equity	3 505 062	3 466 547	38 515	1.1%
Balance sheet total	35 763 492	37 230 693	(1 467 201)	(3.9)%

	31.12.2013	31.12 2012	Change	
Return on equity (ROE)[(1)]	4.7%	4.5%	0.2	percentage points
Return on assets (ROA)[(2)]	0.4%	0.4%	-	percentage points
Net interest margin (NIM)[(3)]	2.7%	2.9%	(0.2)	percentage points
Costs / Income (C/I)[(4)]	68.2%	69.5%	(1.3)	percentage points
Loans / Deposits[(5)]	104.0%	101.8%	2.2	percentage points
Solvency ratio	13.2%	11.7%	1.5	percentage points

(1) Net profit to average equity calculated based on balances as at the end of the years.
(2) Net profit to average assets calculated based on balances as at the end of the years.
(3) Result on interest to average assets calculated based on balances as at the end of the years.
(4) Total administrative costs and depreciation/amortisation to total result on banking activities and other operating income and costs excluding depreciation/amortisation.
(5) Carrying amount of loans and advances granted to clients to liabilities to clients. Balances as at the end of the year.

Assets

As at the end of 2013 total assets value of the Bank was PLN 35.76 billion and was by 3.9% lower than in 2012.

The main factor of the decrease in assets in 2013 was reduction of excess liquidity stored in debt securities recognized as financial assets available for sale. These assets have been reduced by PLN 2 041 484 thousand, by what part of the released funds was moved into debt securities recorded as held for trading (an increase of PLN 799 650 thousand y/y).

Optimization of the liquidity structure of assets in 2013 was linked to the reduction of funding in the form of commitments to customers, banks and due to issued debt securities and have a positive impact on net interest income of the Bank.

Overall in 2013, loans and advances to customers decreased by PLN 27 162 thousand, i.e. 0.1%. This was due to low demand for loans for enterprises, caused by more conservative planning for investment spending in the situation of economic downturn and also by prudent Bank's policy for crediting sectors with higher risk.

The second significant factor of assets' decline was balance of cash on hand and with Central Bank (a decrease of PLN 488 944 thousand y/y). In the reporting period, the cash balance decreased by PLN 152 228 thousand, i.e. 17.6%, as a result of activities to optimize the maintenance of the Bank's cash in this form. The balance account in the Central Bank decreased by PLN 336 716 thousand PLN, i.e. 27.1%, whereas they are naturally under huge volatility because they are created by the current needs of the Bank to settle the obligatory reserve requirements.

Liabilities and equity

As at 2013 end Bank's total liabilities amounted PLN 32.26 billion and was by 4.5% lower than in previous year. Main factor contributing to this drop was liabilities due to banks and from issuance of debt securities.

The decrease in liabilities due to banks by PLN 823 022 thousand, i.e. 20.1%, was mainly due to the early repayment of part of the loan in CHF from Rabobank (repaid CHF 90 million), while lending this amount to the Bank by Rabobank in the form of a subordinated loan. Its value at 31.12.2013 amounted to PLN 304 817 thousand.

The amounts due to customers decreased by PLN 449 255 thousand, i.e. 1.7% mainly as result of lower funding obtained from non-banking financial institutions in form of high balance deposits.

Liabilities from debt securities issuance has been reduced by PLN 661 619 thousand, i.e. 35.7%, as a result of non-renewal of expiring portion of securities in a situation of reduced Bank's demand for funding.

By the end of 2013, the Bank's equity amounted to PLN 3 505 062 thousand and was by PLN 38 515 thousand higher than at the end of 2012. The change in equity during this period was the result of:

- decrease in other reserves of PLN 123 888 thousand, i.e. 37.5%, due to lower valuation of financial assets (mainly debt securities classified as available for sale);
- retention of the financial results from 2012 in the amount of PLN 134 343 thousand (charged to other supplementary capital);
- higher result for the current period (by PLN 28 060 thousand y/y).

Profit and loss account

In 2013, the Bank has generated net profit of PLN 162 403 thousand i.e. more by PLN 28 060 thousand than in 2012 (20.9%). The main causes for the increase were: limitation of general administrative costs, decrease of net impairment losses on financial assets, higher other operating income and lower other operating expenses.

In 2013, net interest income decreased by PLN 2 314 thousand, i.e. 0.2%. The relative stability of the annual net interest income was achieved by reducing interest expense by PLN 239 532 thousand, i.e. 21.1% y/y, almost fully compensating decrease in interest income, which amounted to PLN 241 846 thousand, i.e. 11.2% y/y. The dynamics of income and expenses in 2013 was influenced by external factors, and the rate of growth of loans and deposits.

Among the external factors, the most important were the NBP interest rate cuts. In the period from November 2012 to July 2013 there were eight reductions, a total of 2.25 percentage point.

Another important external factor was the entry into force on 24 October 2012, the regulation on payment services in the part concerning information obligations imposed on the service provider in relation to the customer.

The above-mentioned factors - especially in the first half of 2013 - had put pressure on interest margins realized on deposit products. Positive for net interest income impact of deposit's price adjustments to the low level of interest rates has highlighted fully in the second half of 2013.

The size of the loan portfolio remained stable during 2013, what was the result of the prevailing economic conditions and the credit policy of the Bank.

Net fee and commission income in 2013 was lower by PLN 21 247 thousand, i.e. 7.1% y/y, compared with 2012, due to decrease in income from fees and commissions by PLN 12 402 thousand, i.e. 3.6% y/y and an increase in commission expenses by PLN 8 845 thousand, i.e. 18.3%.

Decrease in net fee and commission income was a result of lower income from:

- loans and advances – as a result of slowdown of loans on current account and loan commitment growths. In case of loan commitments, an additional factor, which limited income in the statement of profit or loss, was commencement of settling them over time.
- clearing operations - as a result of a slower rate of turnover of transaction in the economy,
- sale of insurance products - as a result of the introduction of settlement in time of net commissions for the sale of insurance products related to the creation of financial assets or liabilities (mainly regarding cash loans insurance). Starting from the 1 January 2013, these fees have become an integral part of the effective interest rate method and are recognized in the statement of profit or loss as interest income.

Despite reduced interchange rates, fee and commission income on payment cards increased by PLN 8 135 thousand, i.e. 11.0%, mainly due to higher income from cards organizations for increased number of underlying transactions.

Better stock exchange and the investment fund market situation, as well as the renegotiation of distribution agreements with selected TFI enabled the Bank to increase income from commissions from brokerage operations PLN 3 734 thousand, i.e. 33.7%.

The increase in costs from fees and commissions was mainly caused by the higher cost of payment cards (by PLN 8 997 thousand, i.e. 37.0% y/y), paid to operators of card due to a larger number of transactions executed by the Bank's customers.

Dividend income in 2013 decreased by PLN 568 thousand, i.e. 16.6%.

Net trading income in 2013 was by PLN 18 143 thousand, i.e. 18.4% y/y, lower than in 2012. The level and volatility of this result is shaped mainly by the valuation of the Bank's position in the instruments of interest rate swaps (IRS) as a hedge against interest rate risk, and trading activity on debt securities whose profitability is dependent on the accuracy of predicted changes in the market.

Result on investment activity fell by PLN 11 427 thousand, i.e. 26.4%, compared with 2012, mainly due to impairment loss provision established on shares of associated entity BGŻ Leasing sp. z o.o. in the amount of PLN 7 321 thousand – due to net loss incurred by this entity in 2013.

Other operating income in 2013 increased by PLN 12 596 thousand, i.e. 34% compared with the previous year, mainly due to the increase in other operating income from recovery of overdue, amortized and uncollectable debts, and repayment of debts excluded from statement of financial position, which recognized significant income from the repayment of debts written off from the balance sheet of a corporate client from agro food sector.

In addition, in the fourth quarter of 2013, the Bank made a partial (PLN 7 788 thousand) release of provisions for fine imposed in 2006 on the Bank by the President of the Office of Competition and Consumer Protection on charges of payment cards – because of the court's decision of reducing the penalty.

General administrative expenses and depreciation/amortization in 2013 decreased by PLN 47 334 thousand, i.e. 5.1%, compared to 2012, which was primarily due to decrease in employee, marketing, external services, other non-personnel and IT costs.

Other operating expenses for 2013 were lower by PLN 9 332 thousand, i.e. 30.6% compared to 2012, what was related to the fact that in 2012, in other operating expenses due to write-downs of other receivables the Bank demonstrated PLN 5 909 thousand provisions for operating losses in two branches.

Loan portfolio quality

As at 31.12.2013 the share of receivables that lost their value, in the portfolio of loans and advances granted to customers was 8.1% in comparison to 7.2% to the end of 2012.

Growth rate for the total portfolio was a consequence of the increase of receivable share that have lost value in the mortgage loan portfolio, respectively to 5.2% from 4.9%, and in the portfolio of loans to corporate customers excluding farmers, respectively, to 12.6% from 9.4%.

However, the quality of cash loans to retail customers has improved (decrease of respectively from 17.8% to 13.0%), what was caused by the dynamic growth of this portfolio and a number of sale transactions of overdue receivables.

The participation rate of impaired loans in the agriculture portfolio was low and during 2013 it further improved (from 3.6% to 3.5%). The agricultural sector showed good resistance to the economic downturn.

Equity and solvency ratio

The capital adequacy ratio increased from 11.75% at the end of 2012 to 13.22% at the end of 2013.

Own funds increased by PLN 369 899 thousand, which was the result of the following factors:

- inclusion to supplementary funds of subordinated liability in the amount of CHF 90 000 thousand CHF (304 344 thousand PLN as at 31/12/2013) to a strategic shareholder, with the consent of the Financial Supervision Authority issued in August 2013;
- retention of net profit for 2012 in the amount of PLN 134 343 thousand, which increased the capital reserve;
- higher by PLN 44 556 thousand profit in the course of approval, which is the net profit for the first half of the year after a review of interim financial statements by an auditor;
- increase in unrealized losses/decrease in unrealized profits on debt securities classified as available for sale and recognized respectively in basic /supplementary funds of the Bank – in total by PLN 115 651 thousand.

The decrease of the capital requirement for credit risk by PLN 44 617 thousand y/y corresponded to the inhibition of lending. The increase in the capital requirement for operational risk corresponded to the increase in the result being a basis for the calculation of this requirement in accordance with BIA method used by the Bank (the requirement is calculated as 15% of the average result for the previous three years).

Assessment made by the Supervisory Board

After reviewing the financial statements of BGŻ S.A. for the year ended 31 December 2013 prepared by the Management Board and the independent registered auditor’s opinion and report, the Supervisory Board decides to issue a positive opinion on the financial statements of BGŻ S.A. for the year ended 31 December 2013 and to recommend the Ordinary General Meeting to approve these financial statements.

Ad. 2) Management Board Report on the activities of BGŻ S.A. in 2013

The Supervisory Board concludes that the Management Board Report on activities of Bank Gospodarki Żywnościowej S.A. for 2013 contains information consistent with the information included in the financial statements for the year ended 31 December 2013. The Supervisory Board recommends the Ordinary General Meeting of BGŻ S.A. to approve the Management Board Report on activities of BGŻ S.A. in 2013 and to grant a vote of acceptance to the members of the Management Board in respect of their duties.

Ad. 3) Recommendation of the Management Board on the allocation of the profit for 2013

The Supervisory Board would like to express a positive opinion on the recommendation of the Management Board to allocate net profit for the period from 1 January 2013 to 31 December 2013 in the amount of PLN 162 402 821.90 to the supplementary capital of BGŻ S.A. After the General Meeting of BGŻ S.A.'s approval of the proposed allocation of net profit for 2012, the Bank's supplementary capital would equal PLN 3 247 462 897.85.

Assessment of adequacy and effectiveness of the internal control system at the Bank

The organisation of the internal control system is in line with the banking law requirements and resolution of the Polish Financial Supervision Authority No. 258/2011 and it encompasses the risk control mechanisms (including functional control), checking the compliance of the Bank's activities with the provisions of law and internal regulations, as well as the internal audit. The internal control system is adjusted to the specifics of the conducted activity and takes into consideration the Bank's resources. The Bank performs periodic verification of the risk control mechanisms functioning in the Bank. Besides, the effectiveness of key control mechanisms is tested in selected areas.

The Management Board of the Bank is responsible for the effectiveness of the risk management system, internal control system, internal capital assessment and reviews, the internal capital assessment and maintenance process, and for the supervision over the efficiency of these processes, making necessary adjustments and improvements in case of a change of the risk level in the Bank's activity, economic environment factors, and irregularities in systems and processes functioning. Moreover, the Management Board determines the principles of functioning of the organizational units which participate in the Bank management, and is responsible for the preparation, introduction, and update of the written policies, strategies, and procedures in this respect.

The Supervisory Board performs supervision over the internal control system and evaluates its adequacy and effectiveness via the Bank's Internal Audit Committee. The Committee performs assessment, among others, on the basis of the results of audits conducted by the internal audit unit, about which it is informed in quarterly reports on audits and recommendations issued after them. Audit reports with qualified or inadequate opinion are provided to the Chairman of the Committee. Beside this the Committee becomes familiar with the progress in the realization of the recommendations issued by the internal audit unit, external auditor and the Polish Financial Supervision Authority.

The Committee approved of the Audit Plan for 2013 and was informed about the changes in the Plan and the level of its realization. The Internal Audit Department monitors the situation in the Bank on the current basis, including the realization of the key undertakings and changes in its environment and – if needed – makes necessary adjustments in the Audit Plan.

The Internal Audit Department supports the Bank in achieving its targets by the checking and assessing, in an independent and objective manner, the compliance as well as adequacy and effectiveness of the internal control system, the correctness and effectiveness of the systems and internal procedures in the Bank, and by providing opinions on the Bank's management system, including the effectiveness of management of the risk essential for the Bank's activity.

In 2013 the external auditor KPMG Advisory made an independent assessment of the activity of the Bank's internal audit unit. No occurrences of non-compliance with PFSA Recommendation H concerning internal control systems in banks was found. Independent review confirmed positive aspects of the internal audit's activities, including model solution with regard to the positioning of the audit function in the Bank's organisational structure, and adequate competences of the employees as well. Identified areas requiring improvement have been properly addressed.

Compliance is, in addition to the Internal Audit, a significant element of the internal control system.

The term 'compliance embraces employee behaviours, systems and processes taking place in the Bank, and means compliance with the requirements arising out of commonly applicable regulations, as well as standards of conduct, with a special emphasis on market behaviours, developed by the Bank and Rabobank International Holding B.V.

The responsibilities of the compliance function encompass assessment of the Bank's compliance with external and internal regulations.

Such assessment is made based on the results of risk analysis, recorded in the system RCMIS (Risk & Control Management Information System) implemented in Rabo Group and on the results of monitoring of the Bank's organisational units.

Results of such assessment are presented to the Management Board and, further, to the members of the Supervisory Board by delivering reports of the activities of the Compliance Department to the Internal Audit Committee.

The Compliance unit supports the decision making process in the Bank ensuring that proper aid is given to the Bank's Management and Supervisory Boards with regard to identification and assessment of compliance risk, and acting as an advisory function, points to potential dangers, and also presents proposed solutions concerning effective management of compliance risk.

The Operational Risk Management Department supervises and coordinates the process of implementation of functional control in the Bank, carried out semi-annually, as well as the process of verification of the mechanisms and procedures of internal control in the Bank, realised annually.

Functional control is realised semi-annually by managers of all units of the Bank (network and Head Office units), or by persons appointed by them. Periodical functional control covers verification of correctness of operation of individual areas, and risk self-assessment. The Operational Risk Management Department prepares semi-annual reports including the results of functional control, indicating the areas with biggest irregularities identified, and in consultation with the competent units actions are determined, aiming at elimination of irregularities in the future. The reports are presented to the Management Board for approval.

The process of verification of mechanisms and procedures of internal control is realized every year through self-assessment of risk and control environment by managers supervising individual areas of the Bank’s activity (owners of control processes and mechanisms). The purpose of the review is identification of possible gaps in the control environment, including potential ineffectiveness of some controls. The review results in a report indicating which control mechanisms and procedures are effective and no gaps in the control process are identified, or, if the analysis shows gaps and irregularities, such report will indicate actions to be taken to eliminate such gaps / irregularities. The report is presented to the Management and Supervisory Board for approval.

Assessment of adequacy and effectiveness of risk management with regard to risks essential for the Bank.

The system of risk management in the Bank is a formal system governed, i.a., by the policy of managing capital adequacy of the bank (ICAAP), policy of managing retail exposures risk, strategy of managing risk, specifying the Bank’s apetite for key risks associated with the Bank’s activity, approved by the Supervisory Board. The Bank has a list of essential risks, approved by the Management Board, and the system of their measuring, limiting and reporting. The limits and thresholds for the major risks are specified once a year and reflected in the risk apetite statement of Bank BGŻ. The Bank regularly monitors and reports compliance with the limits, and if a limit is exceeded, the Bank takes actions to restore the situation where the risks are held within the limits specified by the Management and Supervisory Boards of the Bank. Regular monitoring and reporting cover also the size and type of deviations from the principles and policies applicable in the Bank.

The Management Board of the Bank and the relevant Committees approve detailed policies and principles of risk management and perform daily supervision over the risk management system. The Bank has a Balance Sheet and Risk Management Committee (BRMC) which is responsible for managing all kinds of risk important in the Bank’s activity, including also through dedicated committees:

a) Liquidity Sub-committee,

b) Operational and Compliance Risk and Fraud Preventing Sub-committee,

c) Product Sub-committee,

d) Credit Policy, Monitoring and Control Sub-committee,

e) Ethics Sub-committee.

The Supervisory Board of the Bank receives quarterly information on essential risks in the activity of the Bank, in the form of report „Risk Dashboard”. The scope of information reported covers assessment of the Bank’s exposure to credit risk (including stress tests and concentration risks) operational risk (including compliance and HR risks), market, interest rate and liquidity risks. The Management Board receives, via BRMC and dedicated subcommittees, regular complex monthly information on the Bank's exposure to credit, operational, financial liquidity and market risks and the banking book interest rate risk. The reports and information are presented at meetings of the committees which decide on the actions to be taken if the Bank's takes excessive risk.

In 2013 the Bank continued to enhance its risk management system. The major actions in this respect were associated with the extension of the product and client scope covered by the monitoring of overdue payments, as part of the in-house soft vindication.The improvement included the process of granting loans, monitoring clients, credit ability and creditwirthiness criteria, both with regard to retail and institutional clients. A number of changes were initiated and implemented regarding the limiting of the level of operational risk the Bank was taking. As a result of those actions the level of losses associated with operational risk events dropped significantly. Financial liquidity risk remained under effective, strict control. The Bank acted in compliance with the external regulatory liquidity standards, optimising at the same time the level and structure of liquidity in the context of credit business, lower than planned. Market risk was held within the strict internal limit grid and, as to the principle, remained at a low level. In 2013 the Bank more actively managed its banking book interest rate risk which allowed it to earn additional incomes in the portfolio of securties for sale while at the same time maintaining the level of risk taken under the limits set.

Conclusion:

In the opinion of the Supervisory Board the system of internal control is adequate for the level of activity and complexity of the activities of the Bank. The Supervisory Board also expresses a positive opinion on the functioning of the system of managing risks essential for the Bank.