



# Alior Bank S.A.

**Independent Auditor's Report**

**Financial Year ended**

**31 December 2017**



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## **INDEPENDENT AUDITOR'S REPORT**

*To the General Shareholders' Meeting of Alior Bank S.A.*

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

We have audited the accompanying annual separate financial statements of Alior Bank S.A., with its registered office in Warszawa, Łopuszańska 38D (the "Bank"), which comprise the statement of financial position as at 31 December 2017, the income statement, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended and notes comprising a summary of significant accounting policies and other explanatory information (the "separate financial statements").

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

The Management Board of the Bank is responsible for the preparation, on the basis of properly maintained accounting records, of separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards, as adopted by the European Union ("IFRS EU") and other applicable laws. The Management Board of the Bank is also responsible for such internal control necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

In accordance with the accounting act dated 29 September 1994 (Official Journal from 2017, item 2342 with amendments) ("the Accounting Act"), the Management Board of the Bank and members of the Supervisory Board are required to ensure that the separate financial statements are in compliance with the requirements set forth in the Accounting Act.

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

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with:

- the act on certified auditors, audit firms and public oversight dated 11 May 2017 (Official Journal from 2017, item 1089) (the „Act on certified auditors”);
- International Standards on Auditing as adopted by the resolution dated 10 February 2015 of the National Council of Certified Auditors as National Standards on Assurance;

- Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-listed entities and repealing Commission Decision 2005/909/EC (Official Journal of the European Union L 158 from 27.05.2014, page 77 and Official Journal of the European Union L 170 from 11.06.2014, page 66) (the "EU Regulation"); and
- other applicable laws.

Those regulations require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the regulations mentioned above will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve collusion, forgery, deliberate omission, intentional misrepresentations or override of internal controls.

The scope of audit does not include assurance on the future viability of the Bank or on the efficiency or effectiveness with which the Management Board has conducted or will conduct the affairs of the Bank.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation of the separate financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of the Bank, as well as evaluating the overall presentation of the separate financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *The most significant assessed risks of material misstatements*

During our audit we identified the most significant assessed risks of material misstatements (the "key audit matters"), including those due to fraud, described below and we performed appropriate audit procedures to address these matters. Key audit matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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**Impairment of loans and advances to customers and provision for off-balance sheet liabilities**

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The carrying value of loans and advances to customers amounted to PLN 51 244 million as at 31 December 2017 and PLN 46 249 million as at 31 December 2016. The value of off-balance sheet liabilities amounted to PLN 12 747 million as at 31 December 2017 and PLN 14 615 million as at 31 December 2016. Impairment allowance for losses on loans and advances to customers amounted to PLN 3 395 million as at 31 December 2017 and PLN 3 057 million as at 31 December 2016. Provision for off-balance sheet liabilities amounted to PLN 24 million comparing to PLN 18 million as at 31 December 2016.

Net impairment losses and provisions for off-balance sheet liabilities amounted PLN 920 million for 2017 comparing to PLN 795 million for 2016.

Reference to disclosures in financial statements: note 12 "Net impairment losses and provisions for off-balance sheet liabilities", note 20 "Loans and receivables to customers", note 26 "Provisions" and note 38 "Credit risk"

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**Key audit matters**

Loans and advances to customers are measured at amortized cost less impairment allowance for losses.

The impairment allowance for losses represents the Management's best estimate of incurred credit risk losses on loans and advances to customers at the reporting date.

We assessed this area as a key audit matter due to its significance for the financial statements given the size of credit portfolio and impairment allowance for losses and provisions for off-balance sheet liabilities, as well as, the fact that it involves making significant estimates with a high degree of estimation uncertainty and requires a significant judgement by the Management. In particular:

- For the non-impaired loans assessed individually, there is a risk of not identifying impairment triggers on a timely basis, and therefore incorrect valuation of loans and advances to customers in the financial statements, in particular in relation to the impairment triggers that occurred before loan delinquency.
- For the impaired loans assessed individually, there is a risk of using inappropriate assumptions in the valuation relating to recovery scenarios, expected future cash flows and their timing.
- For the loans assessed collectively, there is a risk of using inappropriate statistical models, data inputs and key assumptions to estimate credit risk parameters, which may not reflect the actual level of incurred losses as at the reporting date. There is also a risk

**Our procedures**

Our audit encompassed procedures aimed at critical evaluation of the process and the accounting policies for impairment allowances estimation, along with critical evaluation of internal control environment, including application level controls in Bank's IT systems.

Our audit procedures performed with support of our internal IT specialists, included among others:

- Critical evaluation of design and implementation of key internal controls in the process of identification of impairment triggers (individual and group assessment) and estimation of impairment allowances, as well as, testing of operating effectiveness of these internal controls;
- Analytical procedures encompassing the structure and dynamics of changes of loan portfolio and risk parameters including the quality of loan portfolio, and the level of impairment allowances for losses, in particular with aim to identify portfolios with underestimated impairment allowances;
- Critical analysis of the Bank's impairment methodology for estimation of risk parameters and impairment allowances for both collective portfolios and individual loans in terms of compliance with relevant international financial reporting standards, as well as, the best market practice;

Specific procedures for loans assessed individually for impairment:

- Independent assessment, for the selected credit files sample, of impairment triggers identification based on the financial standing of a customer, evaluation of the Bank's internal documentation and analysis of compliance with terms and conditions of a loan agreement and any changes to them since origination;
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of an error during the impairment allowance calculation process.

Portfolio of loans to alternative energy producers (wind farms) has been identified as a portfolio, for which the impairment loss calculation involved significantly higher estimation risk. Increased estimation risk arises from high price volatility of green certificates (publicly traded subsidy instrument), which constitute a significant portion of income for entities in this portfolio.

- For the selected credit files sample, for which impairment triggers have been identified and impairment allowance calculated – recalculation of impairment allowance for losses and critical evaluation of key assumptions applied by the Bank, including in particular actual financial standing of the customer, the Bank's strategy towards the given customer and other components of impairment allowance for losses calculation, such as assessment of recovery scenarios applied by the Bank, including probability of each scenario and expected future cash flows (e.g. from the sale of collaterals) and their timing.
- For selected customers from the alternative energy producers sector – critical evaluation of Bank's projections regarding energy prices, green certificates prices, sponsor's financial support, as well as, other key assumptions for impairment allowance calculation in line with the Bank's strategy regarding the specific customer and the sector.

Specific audit procedures for loans assessed collectively for impairment:

- Critical evaluation, taking into account the results of validation of impairment models performed by the Bank, assumptions and data inputs applied in the estimation of key credit risk parameters, such as probability of default (PD), loss given default (LGD), loss identification period (LIP);
- Evaluation of the adequacy of incurred but not reported allowances (IBNR) by comparison to prior years actual incurred losses observed on particular homogenous portfolios;
- Verification of the appropriateness of application of risk parameters in statistical models based on the credit risk characteristics for homogenous portfolios, i.e. past due status;
- Independent recalculation, of the impairment allowances (IBNR and collective) based on credit risk parameters estimated by the Bank.

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### Revenue recognition of interest income and fee and commission income

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Interest income for the period ended 31 December 2017 amounted to PLN 3 591 million, compared to PLN 2 639 million for the period 31 December 2016. Fee and commission income for the period ended 31 December 2017 amounted to PLN 802 million, compared to PLN 592 million for the period ended 31 December 2016.

Reference to disclosures in financial statements for Interest income and fee and commission income: note 6: „Net interest income” and note 7: „Net fee and commission income”

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**Key audit matters**

Recognition of interest income as well as fee and commission income requires judgement regarding the classification:

- fees that are an integral part of an effective interest rate (recognized as interest income);
- fees recognized as the services are provided (recognized over time, recognised in fee and commission income);
- fees earned on the execution of a significant act (recognised upfront in fee and commission income).

In particular, for the loans and advances to customers, classification of fees related to the origination of financial asset that should be included as an integral part of an effective interest rate requires judgment.

We assessed this area as a key audit matter due to the significance of interest income and fee and commission income in the financial statements, as well as the fact that they are key element of the Banks' profitability assessment on the core banking activity and require the Management's judgement regarding the classification of fees.

Inappropriate classification and allocation of fees, could result in incorrect recognition of income in terms of amount and timing, in particular if fee is recognized upfront whereas it should be recognized as an integral part of effective interest rate of the asset or there is service condition in next period.

**Our procedures**

Our audit procedures included critical evaluation of internal control environment regarding the classification, recognition and presentation of interest income and fee and commission income. We also critically assessed key application level controls for revenue recognition in the Bank's IT systems.

Audit procedures performed aimed at the appropriate revenue recognition of interest income and fee and commission income included among others:

- Critical evaluation of the Bank's accounting policies for revenue recognition in terms of compliance with the requirements of appropriate international financial reporting standards for classification, recognition and the effective interest rate calculation;
- Critical evaluation of the process and design and implementation of key internal controls for calculation of interest income and effective interest rate, as well as, products parametrization;
- Verification of particular categories of fee and commission income in terms of appropriateness of recognition in line with appropriate international financial reporting standards and the Bank's accounting policy;
- Critical analysis, on a sample basis, of appropriateness of classification and recognition of selected individual components of fee and commission income by contract analysis, as well as, vouching to other source documents that specify the Bank's remuneration;
- Critical analysis of key assumptions and data inputs in the relative fair value model applied by the Bank for bancassurance income recognition;
- Analytical procedures in terms of rationalization of the amount of interest income level by performing a recalculation based on loan balances and effective interest rates by the main categories of interest income;

### *Opinion*

In our opinion, the accompanying separate financial statements of Alior Bank S.A.:

- give a true and fair view of the unconsolidated financial position of the Bank as at 31 December 2017 and of its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with IFRS EU and the adopted accounting policies;
- have been prepared, in all material respects, on the basis of properly maintained accounting records; and
- comply, in all material respects, with regard to form and content, with applicable laws and the provisions of the Bank's articles of association.

### *Other Matters*

The separate financial statements of the Bank as at and for the year ended 31 December 2016 were audited by another audit firm who expressed an unmodified opinion on those financial statements dated 9 March 2017.

### *Report on other legal and regulatory requirements*

#### *Report on the Capital Group activities*

Our opinion on the separate financial statements does not cover the report on the Capital Group activities (the "report on activities").

The Management Board of the Bank is responsible for the preparation of the report on activities in accordance with the requirements of the Accounting Act and other applicable laws. Furthermore, the Management Board of the Bank and members of the Supervisory Board, are also required to ensure that the report on activities is in compliance with the requirements set forth in the Accounting Act. Our responsibility was also to state, if based on our knowledge about the Bank and its environment obtained in the audit, we have identified material misstatements in the report on the activities and describe the nature of each material misstatement.

In accordance with Act on certified auditors our responsibility was to determine if the report on activities, excluding the content of the chapter "*Statement on non-financial information*" was prepared in accordance with applicable laws and the information given in the report on activities is consistent with the separate financial statements.

In accordance with Art. 111a paragraph 3 of the Banking Act dated 29 August 1997 (Official Journal from 2017, item 1876 with amendments) (the "Banking Act") our responsibility was to audit financial information, described in Art. 111a paragraph 2 of the Banking Act presented in the report on the Capital Group activities. We conducted our audit in this respect in accordance with the paragraph "Auditor's responsibility".

Based on the work undertaken in the course of the audit of the separate financial statements, in our opinion the accompanying report on activities, excluding the chapter titled "*Statement on non-financial information*", in all material respects:

- was prepared in accordance with applicable laws, and

- is consistent with the separate financial statements.

Furthermore, based on our knowledge about the Bank and its environment obtained in the audit, we have not identified material misstatements in the report on activities.

#### *Opinion on corporate governance statement*

The Management Board of the Bank and members of the Supervisory are responsible for preparation of the corporate governance statement in accordance with the applicable laws.

In connection with the audit of the separate financial statements, our responsibility in accordance with the requirements of the Act on certified auditors was to report whether the issuer of securities obliged to file a corporate governance statement, constituting a separate part of the report on activities, included information required by the applicable laws and regulations, and in relation to specific information indicated in these laws or regulations, to determine whether it complies with the applicable laws and whether it is consistent with the separate financial statements.

In our opinion the statement of corporate governance, which is a separate part of the report on the Bank's activities, includes the information required by paragraph 91 subparagraph 5 point 4 letter a, b, g, j, k of the Decree of the Ministry of Finance dated 19 February 2009 on current and periodic information provided by issuers of securities and the conditions for recognition as equivalent of information required by the laws of a non-member state (Official Journal from 2014, item 133 with amendments) (the "decree"). Furthermore, in our opinion the information identified in paragraph 91 subparagraph 5 point 4 letter c-f, h and letter i of the decree, included in the corporate governance statement, in all material respects:

- has been prepared in accordance with the applicable laws; and
- is consistent with the separate financial statements.

#### *Information about non-financial statement*

In accordance with the requirements of the Act on certified auditors, we report that the Bank has prepared a statement on non-financial information referred to in art. 49b paragraph 1 of the Accounting act as a separate part of the report on activities.

We have not performed any assurance procedures in relation to the statement on non-financial information of the Bank and, accordingly, we do not express any assurance thereon.

#### *Independence and the appointment of the audit firm*

Our opinion on the audit of separate financial statements is consistent with our report to the audit committee.

During our audit the key certified auditor and the audit firm remained independent of the Bank in accordance with requirements of the Act on certified auditors, the EU Regulation and the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants' (IFAC) as adopted by the resolutions of National Council of Certified Auditors.

We declare that, to the best of our knowledge and belief, we did not provide prohibited non-audit services referred to in art. 5 paragraph 1 second subparagraph of the EU Regulation and art. 136 including transitional provisions in art. 285 of the act on certified auditors.

We had been appointed to audit the separate financial statements of the Bank based on resolution of Supervisory Board dated 22 May 2017.

Our total uninterrupted period of engagement is one year, beginning from the year ended 31 December 2017.

*Information required by the Act on certified auditors on compliance with applicable prudential regulations*

The Management Board is responsible for the Bank's compliance with the applicable prudential regulations, in particular for the appropriate determination of the capital ratios. The audit objective was not to express an opinion on the Bank's compliance with the applicable prudential regulations, in particular whether the Bank appropriately determined the capital ratios and therefore we do not express such an opinion.

Our audit of the Bank's separate financial statements included audit procedures designed to identify instances of the Bank's non-compliance with the applicable prudential regulations, defined in separate laws, in particular with respect to the determination of the capital ratios by the Bank, that could have a material impact on the separate financial statements.

Based on our audit of the separate financial statements of the Bank, we have not identified any instances of noncompliance in the period from 1 January 2017 to 31 December 2017 of the Bank with the applicable prudential regulations, defined in separate laws, in particular with respect to the determination of the capital ratios as at 31 December 2017, that could have a material impact on the separate financial statements of the Bank.

On behalf of audit firm  
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*Signed on the Polish original*

.....  
Ewa Józwik  
Key Certified Auditor  
Registration No. 11154  
Limited Liability Partner  
with power of attorney

*Signed on the Polish original*

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Stacy Ligas  
Member of the Management Board  
of KPMG Audyt Sp. z o.o., entity  
which is the General Partner of  
KPMG Audyt spółka z ograniczoną  
odpowiedzialnością sp. k.

7 March 2018