



Consolidated annual report of
TAURON Polska Energia S.A.
Capital Group
for the year 2011

19 March 2012

Letter of the President of the Management Board of TAURON Polska Energia S.A.

Ladies and Gentlemen,

For the second time, as the President of the Management Board of a public company, I have the pleasure to present to you the Annual Report of TAURON Polska Energia Capital Group. The summary of activities refers to the year 2011 – the first full year of operations of our business as the company listed at the stock exchange. It was certainly a very interesting year for business, but it was also a period of intensive work in many areas of operations of the Group. It was a difficult year at capital markets – problems of Greece, vision of recession in countries of the European Union, or the announced economic slowdown in Poland – this is only some pessimistic information that has dominated the public debate in Poland and in Europe. Thus, I am even more satisfied to state that the TAURON Group may consider this year as successful.

Referring to our presence at the capital market, assessment of our Group performed by analysts of brokerage houses and investment banks is worth attention. In 2011 they issued, in total, 24 recommendations for TAURON shares, most of which were the “buy” recommendations. For the first time, as a listed company, we shared the generated profit with shareholders. For payment of the dividend for 2010 we allocated almost PLN 263 million. Shares of TAURON are currently included in all key stock exchange indices, i.e., among others, WIG, WIG20, WIG-Poland, WIG-Energia, MSCI Poland Standard Index or CECE Index – the index of the Vienna Stock Exchange covering the biggest companies of Central and Eastern Europe.

Due to the necessity to adjust the corporate strategy binding so far to the changing market conditions and the new business model of the Group, in April 2011 the Management Board and the Supervisory Board of TAURON Polska Energia adopted its updated version. In the document, we focus more on mitigation of risks connected with exposure to carbon dioxide emission as well as on enhancement of discipline within implementation of investment projects. Under the updated strategy, until 2020 we want to build generating units in various technologies, of the total power of about 2400 MW, with substantial share of low emission technologies. One of important elements of the updated strategy is to take advantage of market opportunities to take over attractive assets. And this has already started. In December we completed the process of acquisition of 99.98% of shares of Górnośląski Zakład Elektroenergetyczny from Vattenfall AB. We have gained the assets which perfectly fit into our business, not only geographically but also in terms of operations. We have already started integration of these assets, by including all the Vattenfall companies taken over in the TAURON Group.

In the discussed period we continued reorganisation of the Group thanks to which our key competence is allocated to companies responsible for individual business areas. Simultaneously, we conducted many processes, including consolidation of companies and disposal of irrelevant assets. Owing to such actions, currently, almost 100% of consolidated net profit falls to shareholders of TAURON Polska Energia S.A. Let me remind you that one year ago this share amounted to 87%.

In 2011 we continued the construction of new and modernisation of existing generating units. Within the investment programme, we implement projects for construction of energy generating units based on hard coal, natural gas and renewable energy sources. Activities are advanced in relation to selection of the contractor for the 400 MW_e/240 MW_t gas and steam unit at Stalowa Wola, executed together with PGNiG. At ZEC Bielsko-Biała, the 50 MW_e/182 MW_t heat generating unit is under development. What is important, this investment – like the construction of the 50 MW_e/45 MW_t biomass burning boiler at Elektrownia Jaworzno III – is co-financed from resources acquired from the European Investment Bank. The Bank has granted us two preferential loans of the total value of PLN 510 million. In the Group, investment projects are implemented within construction and reconstruction of biomass boilers as well as numerous modernization tasks. We have selected the constructor for the 82 MW wind farm in Marszewo, whose works have already commenced. In addition – due to the implemented acquisitions – we have also gained new assets in the area of green energy. We have purchased the 30.75 MW wind farm in Lipniki and, owing to GZE acquisition, we have acquired the 30 MW wind farm in Zagórze near Wolin.

In 2011 we recorded growth in core business areas of the Group. In the previous year, power plants and cogeneration plants of the Group generated 21.38 TWh of net electric energy. In 2011, distribution of electric energy was higher by 1.9% than in 2010 and it amounted to 38.24 TWh. In the discussed period, the Group supplied 35.52 TWh of electric energy to retail clients, which means growth of 3.4% in relation to 2010.

Higher quantities of generated, distributed and supplied electric energy significantly contributed to achievement of better financial results than in 2010. In 2011 TAURON Group gained revenue on sales at the level of PLN 20,755.2 million, which means growth by about 34.5%, as compared to the previous year. The rapid increase in sales can be attributed to sales of almost all volume of energy generated in the Group through the exchange. However, the increased sales also results from the higher volume of electric energy sold on the market as well as increase in revenue in the majority of operating segments. The result on operating activity reached PLN 1,611.5 million (growth by 15.2%), while the net profit amounted to PLN 1,239.4 million (growth by 25%). The margin on operational profit of the Group reached 7.8%, and net profit – 6%.

For the second consecutive year we were implementing the programme of operational costs reduction aimed at reducing operational costs within the Group in the years 2010–2012 by PLN 1 billion. Observing the development of the programme, it is visible that the assumed level of savings will be achieved.

In 2011 we were taking advantage of the centralized financing model implemented to finance investments executed by the Group's companies. Thanks to this solution we decrease the costs of external financing and we increase financing opportunities, which consequently results in higher evaluation of the financial standing of the Group issued by rating agencies. In December 2011 under the bond issue programme, the Company issued bonds of the total value of PLN 3.3 billion. The aim of the issue was to acquire funds for financing of GZE acquisition from Vattenfall AB.

A significant event of the year 2011 was, unquestionably, the establishment and registration of the Capital Tax Group. The agreement between the companies of the TAURON Group shall be effective from 1 January 2011 until the end of 2014. Such solution allows for tax optimisation within the TAURON Group.

At the end, it is worth mentioning that the Fitch rating agency still evaluates us at the unchanged, high level. In 2011 Fitch sustained the rating for the company in foreign and local currency at the BBB level with stable outlooks.

On behalf of the Management Board of TAURON Polska Energia I would like to extend my gratefulness to our shareholders, clients and employees for their involvement in development of TAURON Group. I am convinced that the challenges we are facing shall mobilise us to continue working on systematic increase of the company and the TAURON Group value.

Your faithfully,

A handwritten signature in black ink, appearing to read 'Dariusz Lubera', with a stylized flourish extending to the right.

Dariusz Lubera

President of the Management Board

Selected consolidated financial information of TAURON Polska Energia S.A. Capital Group

SELECTED FINANCIAL INFORMATION	in thousands PLN		in thousands EUR	
	2011 period from 1 January 2011 to 31 December 2011	2010 period from 1 January 2010 to 31 December 2010	2011 period from 1 January 2011 to 31 December 2011	2010 period from 1 January 2010 to 31 December 2010
Sales revenue	20 755 222	15 428 879	5 013 218	3 852 981
Operating profit	1 611 489	1 399 259	389 239	349 430
Profit before taxation	1 565 936	1 257 314	378 236	313 983
Net profit	1 239 360	991 383	299 356	247 573
Net profit for shareholders of the parent company	1 220 011	858 656	294 682	214 428
Net profit for non-controlling interest	19 349	132 727	4 674	33 145
Other comprehensive income	358	630	86	157
Total comprehensive income	1 239 718	992 013	299 442	247 731
Total comprehensive income for shareholders of the parent company	1 220 369	859 151	294 768	214 552
Total comprehensive income for non-controlling interest	19 349	132 862	4 674	33 179
Earnings per share (in PLN/EUR) (basic and diluted)	0.70	0.54	0.17	0.13
Weighted average number of shares (in items) (basic and diluted)	1 752 549 394	1 600 730 480	1 752 549 394	1 600 730 480
Net cash flows from operations	2 213 651	2 520 345	534 685	629 394
Net cash flows from investments	(5 689 534)	(1 508 476)	(1 374 250)	(376 705)
Net cash flows from financial activity	2 510 039	(512 864)	606 275	(128 075)
Net change of cash and cash equivalents	(965 844)	499 005	(233 290)	124 614
	As at 31 December 2011	As at 31 December 2010	As at 31 December 2011	As at 31 December 2010
Non-current assets	23 248 498	18 334 911	5 263 652	4 629 677
Current assets	5 156 082	5 090 976	1 167 380	1 285 503
Non-current assets qualified for sale	8 951	4 397	2 026	1 110
Total assets	28 413 531	23 430 284	6 433 058	5 916 290
Primary capital	8 762 747	15 772 945	1 983 958	3 982 765
Equity for shareholders of the parent company	15 677 721	14 704 825	3 549 565	3 713 058
Equity for non-controlling interest	461 347	507 246	104 453	128 083
Total equity	16 139 068	15 212 071	3 654 018	3 841 141
Long-term liabilities	7 431 923	4 070 063	1 682 649	1 027 716
Short-term liabilities	4 842 540	4 148 150	1 096 391	1 047 433
Total liabilities	12 274 463	8 218 213	2 779 040	2 075 149

The aforementioned financial information for 2011 and 2010 has been calculated into EUR in accordance with the following rules:

- particular items of the statement of financial situation – in accordance with the average NBP exchange rate announced as of 30 December 2011 – 4.4168 PLN/EUR (as of 31 December 2010 – 3.9603 PLN/EUR),
- particular items of the statement of comprehensive income and statement of cash flows – in accordance with the exchange rate which constitutes an arithmetic mean of average NBP exchange rates announced on the last day of each month of the financial period from 1 January 2011 to 31 December 2011 – 4.1401 PLN/EUR (for the period from 1 January 2010 to 31 December 2010 – 4.0044 PLN/EUR).

**INDEPENDENT AUDITOR'S OPINION
ON THE CONSOLIDATED FINANCIAL STATEMENTS OF
TAURON POLSKA ENERGIA S.A.
CAPITAL GROUP
FOR THE YEAR 2011**

INDEPENDENT AUDITORS' OPINION

To the General Shareholders' Meeting and the Supervisory Board of TAURON Polska Energia S.A.

1. We have audited the attached consolidated financial statements of TAURON Polska Energia S.A. Group ('the Group'), for which the holding company is TAURON Polska Energia S.A. ('the Company') located in Katowice at ks. Piotra Ściegiennego Street 3, for the year ended 31 December 2011, containing the consolidated statement of financial position as at 31 December 2011, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flow for the period from 1 January 2011 to 31 December 2011 and the summary of significant accounting policies and other explanatory notes ('the attached consolidated financial statements').
2. The truth and fairness¹ of the attached consolidated financial statements, the preparation of the attached consolidated financial statements in accordance with the required applicable accounting policies and the proper maintenance of the consolidation documentation are the responsibility of the Company's Management Board. In addition, the Company's Management Board and Members of the Supervisory Board are required to ensure that the attached consolidated financial statements and the Directors' Report meet the requirements of the Accounting Act dated 29 September 1994 (2009 Journal of Laws No. 152 item 1223 with subsequent amendments – 'the Accounting Act'). Our responsibility was to audit the attached consolidated financial statements and to express an opinion on whether, based on our audit, these financial statements comply, in all material respects, with the required applicable accounting policies and whether they truly and fairly² reflect, in all material respects, the financial position and results of the operations of the Group.
3. We conducted our audit of the attached consolidated financial statements in accordance with:
 - chapter 7 of the Accounting Act,
 - national auditing standards issued by the National Council of Statutory Auditors,in order to obtain reasonable assurance whether these financial statements are free of material misstatement. In particular, the audit included examining, to a large extent on a test basis, documentation supporting the amounts and disclosures in the attached consolidated financial statements. The audit also included assessing the accounting principles adopted and used and significant estimates made by the Management Board, as well as evaluating the overall presentation of the attached consolidated financial statements. We believe our audit has provided a reasonable basis to express our opinion on the attached consolidated financial statements treated as a whole.

¹ Translation of the following expression in Polish: 'rzetelność i jasność'

² Translation of the following expression in Polish: 'rzetelne i jasne'

4. The consolidated financial statements for the year ended 31 December 2010 were subject to our audit and we issued an opinion including an emphasis of matter on these consolidated financial statements, dated 1 March 2011. The emphasis of matter concerned the decision of the Energy Regulatory Office (*Urząd Regulacji Energetyki*) on the reimbursement of the received advance in relation to termination of the long-term electricity and power purchase agreements. The actual status of this issue is presented in point 6 of this opinion.
5. In our opinion, the attached consolidated financial statements, in all material respects:
 - present truly and fairly all information material for the assessment of the results of the Group's operations for the period from 1 January 2011 to 31 December 2011, as well as its financial position³ as at 31 December 2011;
 - have been prepared in accordance with International Financial Reporting Standards as adopted by the EU;
 - are in respect of the form and content, in accordance with the legal regulations governing the preparation of financial statements.
6. Without qualifying our opinion, we draw attention to the fact that as it was described in more details in note 34 of the explanatory notes to the attached consolidated financial statements, a subsidiary of the Company, TAURON Wytwarzanie S.A. (formerly Południowy Koncern Energetyczny S.A.), is entitled to receive a compensation to cover the stranded costs incurred by the producers in relation to termination of long-term electricity and power purchase agreements that is based on the act dated 29 June 2007 (Journal of Law from 2007, no. 130, item 905, 'PPA Act'). Based on accounting policy on compensations resulting from the provisions of the PPA Act as well as its own estimates and assumptions, the Group recognizes revenue from the compensations since the year ended 31 December 2008. As described in mentioned above note, on 31 July 2009 the President of the Energy Regulatory Office (*Urząd Regulacji Energetyki*) issued a decision ordering to reimburse part of received advance for the year 2008 in the amount of 160 million zlotys ('the Decision'). The Management of TAURON Wytwarzanie S.A. did not agree with the Decision and lodged an appeal against it to the Court of Competition and Customer Protection (*Sąd Ochrony Konkurencji i Konsumentów*) in Warsaw ('the Court'). On 26 May 2010 the Court passed a judgment confirming the Company's position in this respect. The President of the Energy Regulatory Office lodged an appeal against the above judgment, which has not been considered by the appropriate court yet. The Company's Management is convinced that the proceedings will result positively for the Group. As at the date of this opinion the appeal proceedings are underway.

³ Translation of the following expression in Polish: '*sytuacja majątkowa i finansowa*'

The Polish original should be referred to in matters of interpretation.
Translation of auditors' report originally issued in Polish.

7. We have read the 'Directors' Report for the period from 1 January 2011 to 31 December 2011 and the rules of preparation of annual statements' ('the Directors' Report') and concluded that the information derived from the attached consolidated financial statements reconciles with these financial statements. The information included in the Directors' Report corresponds with the relevant regulations of the Decree of the Minister of Finance dated 19 February 2009 on current and periodic information published by issuers of securities and conditions for recognition as equivalent the information required by laws of non-EU member states (Journal of Laws No. 33, item 259).

on behalf of:
Ernst & Young Audit sp. z o.o.
Rondo ONZ 1
00-124 Warsaw
Reg. No. 130

Key certified auditor

Artur Żwak
Certified auditor No. 9894

Warsaw, 6 March 2012

**CAPITAL GROUP
TAURON POLSKA ENERGIA S.A.**

**LONG-FORM AUDITORS' REPORT
ON THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011**

CAPITAL GROUP

TAURON POLSKA ENERGIA S.A.

**LONG-FORM AUDITORS' REPORT
ON THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011**

I. GENERAL NOTES

1. Background

The holding company of the Capital Group (hereinafter 'the Group' or 'the Capital Group') is TAURON Polska Energia S.A. ('the holding company', 'the Company').

The holding company was incorporated on the basis of a Notarial Deed dated 6 December 2006 under the name Energetyka Południe S.A. Change of the name into TAURON Polska Energia S.A. was registered by the District Court on 16 November 2007. The Company's registered office is located in Katowice at ks. Piotra Ściegiennego Street 3.

The holding company is an issuer of securities as referred to in art. 4 of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of the European Union of 19 July 2002 on the application of international accounting standards (EC Official Journal L243 dated 11 September 2002, page 1, polish special edition chapter 13, title 29 page 609) and, based on the article 55.5 of the Accounting Act dated 29 September 1994 (2009 Journal of Laws No. 152 item 1223 with subsequent amendments – 'the Accounting Act'), prepares consolidated financial statements of the Group in accordance with International Financial Reporting Standards as adopted by the EU.

The holding company was entered in the Register of Entrepreneurs of the National Court Register under no. KRS 0000271562 on 8 January 2007.

The Company was issued with tax identification number (NIP) 9542583988 on 13 March 2007 and statistical number (REGON) 240524697 on 11 December 2006.

The principal activities of the holding company are as follows:

- activities of head offices and holdings,
- electricity trade.

The operations of the Group's subsidiaries, jointly controlled entities and associates include the following activities:

- hard coal mining,
- generation of electricity and heat energy using conventional sources,
- generation of electricity using renewable sources,
- distribution of electricity,
- sale of energy and other energy market products,
- rendering other services related to the items mentioned above.

As at 31 December 2011 the holding company's issued share capital amounted to 8,762,747 thousand zlotys. Equity as at that date amounted to 16,139,068 thousand zlotys.

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 (in thousand zlotys)

In accordance with the information included in Note 31 of the other explanatory notes ("additional notes") to the accompanying consolidated financial statements and point 4 of directors' report the ownership structure of the holding company's issued share capital was as follows:

	Number of shares	Number of votes	Par value of shares	% of issued share capital
State Treasury	526,883,897	526,883,897	2,634,419	30.06%
KGHM Polska Miedź S.A.	182,110,566	182,110,566	910,553	10.39%
ING Otwarty Fundusz Emerytalny	88,742,929	88,742,929	443,715	5.06%
Other shareholders	954,812,002	954,812,002	4,774,060	54.49%
	-----	-----	-----	-----
Total	1,752,549,394	1,752,549,394	8,762,747	100%
	=====	=====	=====	=====

According to information received from the holding company the following changes took place in the holding company's ownership structure of the Company's issued share capital during the financial year:

- the State Treasury's percentage of issued share capital decreased from 41.96% in the year 2010 to 30.06% in the year 2011,
- the percentage of issued share capital of KGHM Polska Miedź S.A. increased from 4.67% in the year 2010 to 10.39% in the year 2011,
- the percentage of issued share capital of ING Otwarty Fundusz Emerytalny in the year 2010 was insignificant and increased in the year 2011 to 5.06%.

Movements in the issued share capital of the holding company in the financial year were as follows:

	Number of shares	Par value of shares
Opening balance	1,752,549,394	15,772,945
Decrease in share capital	-	7,010,198
	-----	-----
Closing balance	1,752,549,394	8,762,747
	=====	=====

On 25 March 2011 the holding company registered a decrease of the share capital to the amount of 8,762,747 thousand zlotys. According to the resolution No. 4 of the Extraordinary General Shareholders' Meeting dated 10 November 2010, the share capital was reduced by way of decreasing the nominal value of each share from PLN 9 to PLN 5. In the result, the holding company's share capital was decreased by 7,010,198 thousand zlotys. According to the resolution mentioned above the resulting amount was allocated to the reserve capital.

As at 6 March 2012, the holding company's Management Board was composed of:

Dariusz Lubera	- President
Joanna Schmid	- Vice President
Dariusz Stolarczyk	- Vice President
Krzysztof Zamasz	- Vice President
Krzysztof Zawadzki	- Vice President

There were no changes in the holding company's Management Board composition during the reporting period as well as from the balance sheet date to the date of the opinion

2. Group Structure

As at the 31 December 2011 TAURON Polska Energia S.A. Capital Group consisted of the following subsidiaries (direct or indirect):

Entity name	Consolidation method	Type of opinion about the financial statements	Name of authorised entity that audited financial statements
TAURON Wytwarzanie S.A.	Purchase accounting	unqualified with an emphasis of matter	Ernst & Young Audit sp. z o.o.
TAURON Dystrybucja S.A.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Sprzedaż Sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Obsługa Klienta Sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Ekonergia sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Elektrociepłownia Tychy S.A.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Kopalnia Wapienia „Czatkowice” sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Południowy Koncern Węglowy S.A.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Polska Energia- Pierwsza Kompania Handlowa sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Ciepło S.A.	Purchase accounting	qualified	Ernst & Young Audit sp. z o.o.
Elektrociepłownia EC Nowa sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Czech Energy s.r.o.	Purchase accounting	not issued t	COTAX AUDIT s.r.o.
BELS INVESTMENT sp. z o.o.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.
MEGAWAT MARSZEWO sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Lipniki Sp. z o.o.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.

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(in thousand zlotys)

Entity name	Consolidation method	Type of opinion about the financial statements	Name of authorised entity that audited financial statements
Górnślaski Zakład Elektroenergetyczny S.A.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.
TAURON Dystrybucja – GZE S.A.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
Vattenfall Sales Poland Sp. z o.o.	Purchase accounting	unqualified	Ernst & Young Audit sp. z o.o.
TAURON Serwis GZE Sp. Z o.o.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.
Vattenfall Wolin-North Sp. z o.o.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.
Vattenfall Business Services Poland Sp. z o.o.	Purchase accounting	not issued	Ernst & Young Audit sp. z o.o.

As at 31 December 2011 shares in Elektrociepłownia Stalowa Wola S.A. were accounted for in the consolidated financial statements using equity method.

Details of the type and impact of changes in entities included in the consolidation as compared to the prior year may be found in Note 30 of the summary of significant accounting policies and other explanatory notes (additional notes) to the audited consolidated financial statements of the Group for the year ended 31 December 2011.

3. Consolidated Financial Statements

3.1 Auditors' opinion and audit of consolidated financial statements

Ernst & Young Audit sp. z o.o. with its registered office in Warsaw, at Rondo ONZ 1, is registered on the list of entities authorised to audit financial statements under no. 130.

Ernst & Young Audit sp. z o.o. was appointed by the holding company's Supervisory Board on 29 October 2010 to audit the Group's financial statements.

Ernst & Young Audit sp. z o.o. and the key certified auditor in charge of the audit meet the conditions required to express an impartial and independent opinion on the consolidated financial statements, as defined in Art. 56.3 and 56.4 of the Act on statutory auditors and their self-governance, audit firms authorized to audit financial statements and public oversight, dated 7 May 2009 (Journal of Laws 2009, No. 77, item 649 with subsequent amendments).

Under the contract executed on 19 November 2010 with the holding company's Management Board, we have audited the consolidated financial statements for the year ended 31 December 2011.

Our responsibility was to express an opinion on the consolidated financial statements based on our audit. The auditing procedures applied to the consolidated financial statements were designed to enable us to express an opinion on the consolidated financial statements taken as a whole. Our procedures did not extend to supplementary information that does not have an impact on the consolidated financial statements taken as a whole.

Based on our audit, we issued an unqualified auditors' opinion with an emphasis of matter dated 6 March 2012, stating the following:

“To the General Shareholders' Meeting and the Supervisory Board of TAURON Polska Energia S.A.

1. We have audited the attached consolidated financial statements of TAURON Polska Energia S.A. Group ('the Group'), for which the holding company is TAURON Polska Energia S.A. ('the Company') located in Katowice at ks. Piotra Ściegiennego Street 3, for the year ended 31 December 2011, containing the consolidated statement of financial position as at 31 December 2011, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flow for the period from 1 January 2011 to 31 December 2011 and the summary of significant accounting policies and other explanatory notes ('the attached consolidated financial statements').

2. The truth and fairness¹ of the attached consolidated financial statements, the preparation of the attached consolidated financial statements in accordance with the required applicable accounting policies and the proper maintenance of the consolidation documentation are the responsibility of the Company's Management Board. In addition, the Company's Management Board and Members of the Supervisory Board are required to ensure that the attached consolidated financial statements and the Directors' Report meet the requirements of the Accounting Act dated 29 September 1994 (2009 Journal of Laws No. 152 item 1223 with subsequent amendments – 'the Accounting Act'). Our responsibility was to audit the attached consolidated financial statements and to express an opinion on whether, based on our audit, these financial statements comply, in all material respects, with the required applicable accounting policies and whether they truly and fairly² reflect, in all material respects, the financial position and results of the operations of the Group.
3. We conducted our audit of the attached consolidated financial statements in accordance with:
- chapter 7 of the Accounting Act,
 - national auditing standards issued by the National Council of Statutory Auditors,
- in order to obtain reasonable assurance whether these financial statements are free of material misstatement. In particular, the audit included examining, to a large extent on a test basis, documentation supporting the amounts and disclosures in the attached consolidated financial statements. The audit also included assessing the accounting principles adopted and used and significant estimates made by the Management Board, as well as evaluating the overall presentation of the attached consolidated financial statements. We believe our audit has provided a reasonable basis to express our opinion on the attached consolidated financial statements treated as a whole.
4. The consolidated financial statements for the year ended 31 December 2010 were subject to our audit and we issued an opinion including an emphasis of matter on these consolidated financial statements, dated 1 March 2011. The emphasis of matter concerned the decision of the Energy Regulatory Office (*Urząd Regulacji Energetyki*) on the reimbursement of the received advance in relation to termination of the long-term electricity and power purchase agreements. The actual status of this issue is presented in point 6 of this opinion.
5. In our opinion, the attached consolidated financial statements, in all material respects:
- present truly and fairly all information material for the assessment of the results of the Group's operations for the period from 1 January 2011 to 31 December 2011, as well as its financial position³ as at 31 December 2011;
 - have been prepared in accordance with International Financial Reporting Standards as adopted by the EU;
 - are in respect of the form and content, in accordance with the legal regulations governing the preparation of financial statements.

¹ Translation of the following expression in Polish: 'rzetelność i jasność'

² Translation of the following expression in Polish: 'rzetelne i jasne'

³ Translation of the following expression in Polish: 'sytuacja majątkowa i finansowa'

6. Without qualifying our opinion, we draw attention to the fact that as it was described in more details in note 34 of the explanatory notes to the attached consolidated financial statements, a subsidiary of the Company, TAURON Wytwarzanie S.A. (formerly Południowy Koncern Energetyczny S.A.), is entitled to receive a compensation to cover the stranded costs incurred by the producers in relation to termination of long-term electricity and power purchase agreements that is based on the act dated 29 June 2007 (Journal of Law from 2007, no. 130, item 905, 'PPA Act'). Based on accounting policy on compensations resulting from the provisions of the PPA Act as well as its own estimates and assumptions, the Group recognizes revenue from the compensations since the year ended 31 December 2008. As described in mentioned above note, on 31 July 2009 the President of the Energy Regulatory Office (*Urząd Regulacji Energetyki*) issued a decision ordering to reimburse part of received advance for the year 2008 in the amount of 160 million zlotys ('the Decision'). The Management of TAURON Wytwarzanie S.A. did not agree with the Decision and lodged an appeal against it to the Court of Competition and Customer Protection (*Sąd Ochrony Konkurencji i Konsumentów*) in Warsaw ('the Court'). On 26 May 2010 the Court passed a judgment confirming the Company's position in this respect. The President of the Energy Regulatory Office lodged an appeal against the above judgment, which has not been considered by the appropriate court yet. The Company's Management is convinced that the proceedings will result positively for the Group. As at the date of this opinion the appeal proceedings are underway.
7. We have read the 'Directors' Report for the period from 1 January 2011 to 31 December 2011 and the rules of preparation of annual statements' ('the Directors' Report') and concluded that the information derived from the attached consolidated financial statements reconciles with these financial statements. The information included in the Directors' Report corresponds with the relevant regulations of the Decree of the Minister of Finance dated 19 February 2009 on current and periodic information published by issuers of securities and conditions for recognition as equivalent the information required by laws of non-EU member states (Journal of Laws No. 33, item 259)."

We conducted the audit of the consolidated financial statements during the period from 21 November 2011 to 6 March 2012. We were present at the holding company's head office from 29 November to 3 December 2011 and from 31 January to 3 February 2012.

3.2 Representations provided and data availability

The Management Board of the holding company confirmed its responsibility for the truth and fairness⁴ of the consolidated financial statements and the preparation of the financial statements in accordance with the required applicable accounting policies, and the correctness of consolidation documentation. The Board stated that it provided us with all financial statements of the Group companies included in the consolidated statements, consolidation documentation and other required documents as well as all necessary explanations. We also obtained a written representation dated 6 March 2012, from the Management Board of the holding company confirming that:

- the information included in the consolidation documentation was complete,
- all contingent liabilities had been disclosed in the consolidated financial statements, and
- all material events from the balance sheet date to the date of the representation letter had been disclosed in the consolidated financial statements.

In the representation letter there was confirmed that the information provided to us was true and fair to the best of the holding company Management Board's knowledge and belief, and included all events that could have had an effect on the consolidated financial statements.

3.3 Consolidated financial statements for prior financial year

The consolidated financial statements of the Group for the year ended 31 December 2010 were audited by Artur Żwak, key certified auditor no. 9894, acting on behalf of Ernst & Young Audit sp. z o.o. with its seats in Warsaw, Rondo ONZ 1, registered on the list of entities authorized to audit financial statements under no. 130. The key certified auditor acting on behalf of authorized entity issued an unqualified opinion on the consolidated financial statements for the year ended 31 December 2010 with an emphasis of matter concerned the decision of the Energy Regulatory Office (*Urząd Regulacji Energetyki*) on the reimbursement of the received advance in relation to termination of the long-term electricity and power purchase agreements. The actual status of this issue is presented in point 6 of the opinion to consolidated financial statements for the year ended 31 December 2011. The consolidated financial statements of the Group for the year ended 31 December 2010 were approved by the Shareholders at General Shareholders' Meeting on 6 May 2011.

The consolidated financial statements of the Group for the financial year ended 31 December 2010, together with the auditors' opinion, a copy of the resolution approving the consolidated financial statements and the Directors' Report, were filed on 11 May 2011 with the National Court Register.

The consolidated statement of financial position as at 31 December 2010, the statement of comprehensive income, the statement of changes in equity, the statement of cash flow for the year ended 31 December 2010, together with the auditors' opinion, a copy of the resolution approving the financial statements and a copy of the resolution on the appropriation of profit were published in Monitor Polski B No. 1810 on 3 October 2011.

⁴ Translation of the following expression in Polish: "rzetelność i jasność"

4. Analytical Review

4.1 Basic data and financial ratios

Presented below are selected financial ratios indicating the financial situation of the Group for the years 2009 – 2011. The ratios were calculated on the basis of financial data included in the financial statements for the years ended 31 December 2011 and 31 December 2010.

	2011	2010 (restated)	2009 (restated)
Total assets	28,413,531	23,430,284	22,155,493
Total equity	16,139,068	15,212,071	14,233,666
Net profit/ loss	1,239,360	991,383	948,163
Return on assets (%)	4.4%	4.2%	4.3%
$\frac{\text{Net profit} \times 100}{\text{Total assets}}$			
Return on equity (%)	7.7%	6.5%	6.7%
$\frac{\text{Net profit} \times 100}{\text{Total equity}}$			
Profit margin (%)	6.0%	6.4%	6.9%
$\frac{\text{Net profit} \times 100}{\text{Sales revenues}}$			
Liquidity I	1.1	1.2	1.1
$\frac{\text{Current assets}}{\text{Current liabilities}}$			
Liquidity III	0.1	0.4	0.3
$\frac{\text{Cash and cash equivalents}}{\text{Current liabilities}}$			
Debtors days	33 days	37 days	32 days
$\frac{\text{Trade debtors} \times 365}{\text{Sales revenues}}$			

	2011	2010 (restated)	2009 (restated)
Creditors days	30 days	26 days	31 days
$\frac{\text{Trade creditors} \times 365}{\text{Costs of sales}}$			
Inventory day	12 days	11 days	17 days
$\frac{\text{Inventories} \times 365}{\text{Costs of sales}}$			
Stability of financing (%)	83.0%	82.3%	82.4%
$\frac{(\text{Equity} + \text{non-current liabilities}) \times 100}{\text{Total liabilities and equity}}$			
Debt ratio (%)	43.2%	35.1%	35.8%
$\frac{\text{Total liabilities} \times 100}{\text{Total assets}}$			
Rate of inflation:			
yearly average	4.30%	2.60%	3.50%
December to December	4.60%	3.10%	3.50%

4.2 Comments

The following trends may be observed based on the above financial ratios:

- The return on assets ratio in 2011 was 4.4% and was higher in comparison to 4.2% in 2010 and 4.3% in 2009.
- The return on equity ratio in 2011 was 7.7% and was higher in comparison to the years 2010 and 2009, when it reached 6.5% and 6.7%.
- Profit margin ratio in the year 2011 was 6.0% and was lower in comparison to 6.4% in 2010 and 6.9% in 2009.
- The liquidity I ratio decreased as at 31 December 2011 to the level of 1.1 in comparison to 1.2 as at 31 December 2010 and it was at the same level as at 31 December 2009.
- The liquidity ratio III decreased as at 31 December 2011 to the level of 0.1 in comparison to 0.4 as at 31 December 2010 and 0.3 as at 31 December 2009.
- Debtors days' ratio in 2011 was 33 days and decreased in comparison to 37 days in 2010 and increased in comparison to 32 days in 2009.
- Creditors days' ratio in 2011 reached 30 days and was higher in comparison to 26 days in 2010 and was lower in comparison to 31 days in 2009.
- Inventory days ratio in 2011 reached 12 days and was higher in comparison to 11 days in 2010 and was lower in comparison to 17 days in 2009.

- In the analyzed period, the Company has preserved a high level of stability of financing ratio.
- The debt ratio in 2011 was 43.2% and was higher in comparison to 35.1% in 2010 and 35.8% in 2009.

4.3 Going concern

Nothing came to our attention during the audit that caused us to believe that the holding company is unable to continue as a going concern for at least twelve months subsequent to 31 December 2011 as a result of an intended or compulsory withdrawal from or a substantial limitation in its current operations.

In Note 5 of the additional notes to the Group's audited consolidated financial statements for the year ended 31 December 2011, the Management Board of the holding company has stated that the financial statements of the entities included in the consolidated financial statements were prepared on the assumption that these entities will continue as a going concern in a foreseeable future and that there are no circumstances that would indicate a threat to its continued activity.

II. DETAILED REPORT

1. Completeness and accuracy of consolidation documentation

During the audit no material irregularities were noted in the consolidation documentation which could have a material effect on the audited consolidated financial statements, and which were not subsequently adjusted. These would include matters related to the requirements applicable to the consolidation documentation (and in particular eliminations relating to consolidation adjustments).

2. Accounting policies for the valuation of assets and liabilities

The Group's accounting policies and rules for the presentation of data are detailed in note 11 of the additional notes and explanations to the audited Group's consolidated financial statements for the year ended 31 December 2011.

3. Structure of assets, liabilities and equity

The structure of the Group's assets and equity and liabilities is presented in the audited consolidated financial statements for the year ended 31 December 2011.

The data disclosed in the consolidated financial statements reconcile with the consolidation documentation.

3.1 Goodwill on consolidation and amortisation

The method of determining goodwill on consolidation, the method on determining impairment of goodwill, the impairment charged in the financial year and up to the balance sheet date were presented in note 11 of the additional notes and explanations to the audited consolidated financial statements.

3.2 Shareholders' funds including non-controlling interest

The amount of shareholders' funds is consistent with the amount stated in the consolidation documentation and appropriate legal documentation. Non-controlling interest amounted to 461,347 thousand zlotys as at 31 December 2011. It was correctly calculated and is consistent with the consolidation documentation.

Information on shareholders' funds has been presented in note 31 of the additional notes and explanations to the consolidated financial statements.

3.3 Financial year

The financial statements of all Group companies forming the basis for the preparation of the consolidated financial statements were prepared as at 31 December 2011 and include the financial data for the period from 1 January 2011 to 31 December 2011.

4. Consolidation adjustments

4.1 Elimination of inter-company balances (receivables and liabilities) and inter-company transactions (revenues and expenses) of consolidated entities.

All eliminations of inter-company balances (receivables and liabilities) and inter-company transactions (revenues and expenses) of the consolidated companies reconcile with the consolidation documentation.

4.2 Elimination of unrealised gains/losses of the consolidated companies, included in the value of assets, as well as relating to dividends

All eliminations of unrealised gains/losses of the consolidated companies, included in the value of assets, as well as relating to dividends reconcile with the consolidation documentation.

5. Disposal of all or part of shares in a subordinated entity

During the financial year the Group did not sell any shares in subordinated entities.

6. Items which have an impact on the group's result for the year

Details of the items which have an impact on the Group's result for the year have been included in the audited consolidated financial statements for the year ended 31 December 2011.

The auditor's opinion includes the emphasis of matter concerning the uncertainty of questioning by the President of Energy Regulatory Office the compensation amounts, that the Group is entitled to receive due to premature termination of long-term electricity and power purchase agreements – paragraph I.3.1 of this report.

7. The appropriateness of the departures from the consolidation methods and application of the equity accounting as defined in International Financial Reporting Standards as adopted by the EU

During the process of preparation of the consolidated financial statements there were no departures from the consolidation methods or application of the equity accounting

8. Additional Notes

The additional notes and explanations to the consolidated financial statements for the year ended 31 December 2011 were prepared, in all material respects, in accordance with International Financial Reporting Standards as adopted by the EU.

9. Directors' Report

We have read the 'Directors' Report for the period from 1 January 2011 to 31 December 2011 and the rules of preparation of annual statements' ('the Directors' Report') and concluded that the information derived from the attached consolidated financial statements reconciles with these financial statements. The information included in the Directors' Report corresponds with the relevant regulations of the Decree of the Minister of Finance dated 19 February 2009 on current and periodic information published by issuers of securities and conditions for recognition as equivalent the information required by laws of non-EU member states (Journal of Laws No. 33, item 259 with subsequent amendments).

10. Conformity with Law and Regulations

We have obtained a letter of representations from the Management Board of the holding company confirming that no laws, regulations or provisions of the Group entities' Articles of Association were breached during the financial year.

on behalf of:
Ernst & Young Audit sp. z o.o.
Rondo ONZ 1
00-124 Warsaw
Reg. No. 130

Key certified auditor

Artur Żwak
Certified auditor No. 9894

Warsaw, 6 March 2012



TAURON POLSKA ENERGIA S.A. CAPITAL GROUP

**CONSOLIDATED FINANCIAL STATEMENTS
PREPARED ACCORDING TO THE INTERNATIONAL FINANCIAL
REPORTING STANDARDS
FOR THE YEAR ENDED 31 DECEMBER 2011**

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Note	Year ended 31 December 2011	Year ended 31 December 2010
Continuing operations			
Sale of goods for resale, finished goods and materials without elimination of excise		16 282 481	11 108 492
Excise		(393 757)	(418 178)
Sale of goods for resale, finished goods and materials		15 888 724	10 690 314
Rendering of services		4 825 806	4 698 111
Other income		40 692	40 454
Sales revenue	13.1	20 755 222	15 428 879
Cost of sales	13.6	(18 184 818)	(13 089 128)
Gross profit		2 570 404	2 339 751
Other operating income	13.2	106 162	105 186
Selling and distribution expenses	13.6	(283 684)	(231 252)
Administrative expenses	13.6	(664 350)	(670 308)
Other operating expenses	13.3	(117 043)	(144 118)
Operating profit		1 611 489	1 399 259
Finance income	13.4	115 767	92 284
Finance costs	13.5	(160 274)	(233 993)
Share in profit/(loss) of associate and joint venture recognised using the equity method	2	(1 046)	(236)
Profit before tax		1 565 936	1 257 314
Income tax expense	14.1	(326 576)	(265 931)
Net profit from continuing operations		1 239 360	991 383
Net profit for the year		1 239 360	991 383
Other comprehensive income:			
Change in the value of hedging instruments		–	1 112
Foreign exchange differences from translation of foreign entities		358	(271)
Income tax relating to other comprehensive income items	14.1	–	(211)
Other comprehensive income for the year, net of tax		358	630
Total comprehensive income for the year		1 239 718	992 013
Net profit for the year:			
Attributable to equity holders of the parent		1 220 011	858 656
Attributable to non-controlling interests	31.5	19 349	132 727
Total comprehensive income:			
Attributable to equity holders of the parent		1 220 369	859 151
Attributable to non-controlling interests	31.5	19 349	132 862
Earnings per share (in PLN):			
– basic, for profit for the period attributable to equity holders of the parent	28	0.70	0.54
– basic, for profit for the period from continuing operations attributable to equity holders of the parent	28	0.70	0.54
– diluted, for profit for the period attributable to equity holders of the parent	28	0.70	0.54
– diluted, for profit for the period from continuing operations attributable to equity holders of the parent	28	0.70	0.54

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note	As at 31 December 2011	As at 31 December 2010 <i>(adjusted figures)</i>	As at 1 January 2010 <i>(adjusted figures)</i>
ASSETS				
Non-current assets				
Property, plant and equipment	16	21 911 047	17 524 936	17 260 573
Intangible assets	19, 8	988 950	346 340	342 866
Investments in associates and joint ventures recognised using the equity method	2, 37.1	22 717	764	–
Other long-term financial assets	23.1, 37.1, 38.4	197 470	177 452	179 746
Other long-term non-financial assets	23.2	96 349	123 613	58 547
Deferred tax asset	14.3	31 965	161 806	152 221
		23 248 498	18 334 911	17 993 953
Current assets				
Current intangible assets	19, 8	870 954	624 190	481 885
Inventories	20	574 790	408 560	536 201
Corporate income tax receivable		64 266	74 749	52 926
Trade and other receivables	21, 37.1, 38.4	2 743 344	2 273 145	1 874 996
Other current financial assets	23.1, 37.1, 38.4	108 024	28 193	18 753
Other current non-financial assets	23.3	289 034	208 158	158 725
Cash and cash equivalents	22, 37.1	505 670	1 473 981	1 032 103
		5 156 082	5 090 976	4 155 589
Non-current assets classified as held for sale	17	8 951	4 397	5 951
TOTAL ASSETS		28 413 531	23 430 284	22 155 493

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)

	Note	As at 31 December 2011	As at 31 December 2010 (adjusted figures)	As at 1 January 2010 (adjusted figures)
EQUITY AND LIABILITIES				
Equity attributable to equity holders of the parent				
Issued capital	31.1	8 762 747	15 772 945	13 986 284
Reserve capital	31.3	7 412 882	475 088	64 050
Revaluation reserve on valuation of hedging instruments		–	–	(766)
Foreign exchange differences from translation of foreign entities		87	(271)	–
Retained earnings/Accumulated losses	31.4	(497 995)	(1 542 937)	(2 191 002)
		15 677 721	14 704 825	11 858 566
Non-controlling interests	31.5	461 347	507 246	2 375 100
Total equity		16 139 068	15 212 071	14 233 666
Non-current liabilities				
Interest-bearing loans and borrowings	37.1, 37.3	4 251 944	1 076 178	1 179 406
Finance lease and hire purchase commitments	18.2, 37.1	56 232	67 810	88 291
Long-term provisions and employee benefits	27, 32	1 202 840	1 059 028	978 807
Long-term accruals and government grants	25	642 549	644 522	624 567
Trade payables and other financial long-term liabilities	37.1	7 968	6 910	5 683
Deferred tax liability	14.3	1 270 390	1 215 615	1 150 695
		7 431 923	4 070 063	4 027 449
Current liabilities				
Trade and other payables	37.1	2 349 201	1 629 723	1 490 726
Current portion of interest-bearing loans and borrowings	37.1, 37.3	214 169	325 027	596 315
Current portion of finance lease and hire purchase commitments	18.2, 37.1	14 761	23 452	35 377
Other current liabilities	24.2	644 910	752 819	556 669
Accruals and government grants	25	279 058	189 712	210 267
Income tax payable		163 437	68 672	67 034
Short-term provisions and employee benefits	27, 32	1 177 004	1 158 745	937 990
		4 842 540	4 148 150	3 894 378
Total liabilities		12 274 463	8 218 213	7 921 827
TOTAL EQUITY AND LIABILITIES		28 413 531	23 430 284	22 155 493

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

		Equity attributable to the equity holders of the parent							
Note	Issued capital	Reserve capital	Revaluation reserve on valuation of hedging instruments	Foreign exchange differences from translation of foreign entities	Retained earnings/Accumulated losses	Total	Non-controlling interests	Total equity	
	15 772 945	475 088	-	(271)	(1 542 937)	14 704 825	507 246	15 212 071	
As at 1 January 2011									
	-	-	-	-	1 220 011	1 220 011	19 349	1 239 360	
Profit for the period									
	-	-	-	358	-	358	-	358	
Other comprehensive income									
Total comprehensive income for the period				358	1 220 011	1 220 369	19 349	1 239 718	
Appropriation of prior year profits									
	-	-	-	-	-	-	-	-	
Reduction of issued capital through reduced nominal value of shares	31.1	(7 010 198)	7 010 198	-	-	-	-	-	
Acquisition of non-controlling interests	30	-	-	-	192	192	(1 104)	(912)	
Change in non-controlling interests due to mergers	30	-	-	-	25	25	(62)	(37)	
Payment from profit to the State Treasury					-	-	-	-	
Dividends	29	-	(72 404)	-	(190 478)	(262 882)	(14 278)	(277 160)	
Acquisition of subsidiaries of GZE Group	30	-	-	-	-	-	778	778	
Mandatory squeeze-out	30	-	-	-	15 192	15 192	(50 582)	(35 390)	
As at 31 December 2011	8 762 747	7 412 882	-	87	(497 995)	15 677 721	461 347	16 139 068	

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Note	Equity attributable to the equity holders of the parent							Non-controlling interests	Total equity
		Issued capital	Reserve capital	Revaluation reserve on valuation of hedging instruments	Foreign exchange differences from translation of foreign entities	Retained earnings/ Accumulated losses	Total			
As at 1 January 2010		13 986 284	64 050	(766)	-	(2 191 002)	11 858 566	2 375 100	14 233 666	
Profit for the period		-	-	-	-	858 656	858 656	132 727	991 383	
Other comprehensive income		-	-	766	(271)	-	495	135	630	
Total comprehensive income for the period		-	-	766	(271)	858 656	859 151	132 862	992 013	
Appropriation of prior year profits		-	176 159	-	-	(176 159)	-	-	-	
Issue of merger shares and accounting for the acquisition of non-controlling interests		318 665	-	-	-	(145 651)	173 014	(169 364)	3 650	
Acquisition of non-controlling interests for cash and share capital issued		1 467 996	234 879	-	-	110 204	1 813 079	(1 813 788)	(709)	
Payment from profit to the State Treasury		-	-	-	-	32	32	-	32	
Dividends		-	-	-	-	-	-	(6 027)	(6 027)	
Mandatory squeeze-out		-	-	-	-	983	983	(11 537)	(10 554)	
As at 31 December 2010		15 772 945	475 088	-	(271)	(1 542 937)	14 704 825	507 246	15 212 071	

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	Year ended 31 December 2011	Year ended 31 December 2010
Cash flows from operating activities			
Profit/(loss) before taxation		1 565 936	1 257 314
Adjustments for:			
Share in profit/(loss) of associate and joint venture recognised using the equity method		1 046	236
Depreciation and amortization		1 411 097	1 358 778
(Gain)/loss on foreign exchange differences		2 819	43
Interest and dividends, net		58 294	132 331
(Gain)/loss on investing activities		(16 568)	13 153
(Increase)/decrease in receivables		(147 945)	(395 393)
(Increase)/decrease in inventories		(184 588)	117 372
Increase/(decrease) in payables excluding loans and borrowings		(76 220)	215 558
Change in other non-current and current assets		(78 266)	(111 089)
Change in deferred income, government grants and accruals		(35 276)	(31 098)
Change in provisions		(174 358)	201 130
Income tax paid		(111 929)	(238 400)
Other		(391)	410
Net cash from operating activities		2 213 651	2 520 345
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment and intangible assets		39 957	11 731
Purchase of property, plant and equipment and intangible assets		(2 302 270)	(1 518 088)
Proceeds from sale of financial assets	23.1	114 304	56 189
Purchase of financial assets	23.1	(147 989)	(69 570)
Acquisition of shares in associates and joint ventures accounted for using the equity method		(23 000)	(1 000)
Acquisition of a subsidiary, after deducting cash acquired	30	(3 379 615)	23
Dividends received		8 173	4 349
Interest received		666	1 377
Repayment of loans granted		240	1 475
Loans granted		-	(1 400)
Other		-	6 438
Net cash used in investing activities		(5 689 534)	(1 508 476)

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Note	Year ended 31 December 2011	Year ended 31 December 2010
Cash flows from financing activities			
Payment of finance lease liabilities		(25 603)	(35 842)
Proceeds from loans		87 254	167 115
Repayment of loans		(467 183)	(744 020)
Issue of debt securities		3 300 000	848 200
Redemption of debt securities		–	(608 692)
Dividends paid to equity holders of the parent		(262 882)	–
Dividends paid to non-controlling interests		(13 676)	(5 573)
Interest paid		(52 292)	(115 820)
Acquisition of non-controlling interests	31.5	(37 800)	(9 863)
Other		(17 779)	(8 369)
Net cash from (used in) financing activities		2 510 039	(512 864)
Net increase/(decrease) in cash and cash equivalents		(965 844)	499 005
Net foreign exchange difference		(3)	(134)
Cash and cash equivalents at the beginning of the period		1 471 660	972 655
Cash and cash equivalents at the end of the period, of which:	22	505 816	1 471 660
restricted cash		176 241	165 862

Summary of significant accounting policies and other explanatory notes are an integral part of these consolidated financial statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND OTHER EXPLANATORY NOTES

1. General Information

The TAURON Polska Energia S.A. Capital Group (“the Group”, “the Capital Group”, “the TAURON Group”) is composed of TAURON Polska Energia S.A. (“parent”, “Company”, “Parent Company”) and its subsidiaries. TAURON Polska Energia S.A. operates as a joint-stock company incorporated on the basis of the notarial deed dated 6 December 2006. Until 16 November 2007 the Company operated under the name Energetyka Południe S.A. The consolidated financial statements of the Group cover the year ended 31 December 2011 and contain comparative data for the year ended 31 December 2010.

The parent is entered in the Register of Entrepreneurs of the National Court Register kept by the Katowice–Wschód District Court, Economic Department of the National Court Register, Entry No. KRS 0000271562.

The parent was granted a statistical number REGON 240524697.

The parent and the other Group entities have an unlimited period of operation.

The Group’s principal business activities include:

1. Hard coal mining.
2. Generation of electricity and heat energy using conventional sources.
3. Generation of electricity using renewable sources.
4. Distribution of electricity.
5. Sale of energy and other energy market products.
6. Rendering other services related to the items mentioned above.

Operations are conducted based on relevant concessions granted to the individual companies in the Group.

2. Composition of the Group

As at 31 December 2011, the TAURON Polska Energia S.A. Capital Group was composed of the following direct or indirect subsidiaries that have been included in consolidation.

No.	Name of the entity	Address	Principal business activities	% held by TAURON in the entity's share capital	Holder of shares as at 30 December 2011	% held by TAURON in the entity's governing body	Holder of shares as at 30 December 2011
1.	TAURON Wytwarzanie S.A. (formerly: Południowy Koncern Energetyczny S.A.) ¹	40-389 Katowice; ul. Lwowska 23	Generation, transmission and distribution of electricity and heat	99.72%	TAURON Polska Energia S.A. - 99.72%	99.72%	TAURON Polska Energia S.A. - 99.72%
2.	TAURON Dystrybucja S.A. (formerly: EnergiaPro S.A.) ¹	30-390 Kraków; ul. Zawila 65 L	Distribution of electricity	99.38%	TAURON Polska Energia S.A. - 99.38%	99.51%	TAURON Polska Energia S.A. - 99.51%
3.	TAURON Sprzedaż Sp. z o.o.	30-417 Kraków; ul. Łagiewnicka 60	Sale of electricity	100.00%	TAURON Polska Energia S.A. - 100.00%	100.00%	TAURON Polska Energia S.A. - 100.00%
4.	TAURON Obsługa Klienta Sp. z o.o.	53-128 Wrocław; ul. Sudecka 95-97	Customer service	100.00%	TAURON Polska Energia S.A. - 100.00%	100.00%	TAURON Polska Energia S.A. - 100.00%
5.	TAURON Ekoenergia Sp. z o.o.	58-500 Jelenia Góra; ul. Obrońców Pokoju 2B	Generation of electricity, trading in electricity	100.00%	TAURON Polska Energia S.A. - 100.00%	100.00%	TAURON Polska Energia S.A. - 100.00%
6.	Elektrociepłownia Tychy S.A.	43-100 Tychy; ul. Przemysłowa 47	Generation of electricity, production and distribution of heat	95.47%	TAURON Polska Energia S.A. - 99.47%	99.05%	TAURON Polska Energia S.A. - 99.05%
7.	Kopalnia Wapienia Czatkowice Sp. z o.o. ²	32-063 Krzeszowice 3; os. Czatkowice 248	Quarrying, crushing and breaking of limestone, quarrying of stone for construction industry	99.72%	TAURON Wytwarzanie S.A. - 100.00%	99.72%	TAURON Wytwarzanie S.A. - 100.00%
8.	Południowy Koncern Węglowy S.A. ²	43-600 Jaworzno; ul. Grunwaldzka 37	Hard coal mining	52.33%	TAURON Wytwarzanie S.A. - 52.48%	67.82%	TAURON Wytwarzanie S.A. - 68.01%
9.	Polska Energia Pierwsza Kompania Handlowa Sp. z o.o.	40-389 Katowice; ul. Lwowska 23	Trading in electricity	100.00%	TAURON Polska Energia S.A. - 100.00%	100.00%	TAURON Polska Energia S.A. - 100.00%
10.	TAURON Ciepło S.A. (formerly: Przedsiębiorstwo Energetyki Ciepłej Katowice S.A.) ¹	40-126 Katowice; ul. Grażyńskiego 49	Heat production and distribution	90.06%	TAURON Polska Energia S.A. - 90.06%	91.76%	TAURON Polska Energia S.A. - 91.76%
11.	Elektrociepłownia EC Nowa Sp. z o.o.	41-308 Dąbrowa Górnicza; al. J. Piłsudskiego 92	Generation of electricity, production of heat and technical gases	84.00%	TAURON Polska Energia S.A. - 84.00%;	84.00%	TAURON Polska Energia S.A. - 84.00%;
12.	TAURON Czech Energy s.r.o.	720 00 Ostrava, Na Rovince 879/C Czech Republic	Trading in electricity	100.00%	TAURON Polska Energia S.A. - 100.00%	100.00%	TAURON Polska Energia S.A. - 100.00%
13.	BELS INVESTMENT Sp. z o.o.	58-500 Jelenia Góra, ul. Obrońców Pokoju 2B	Generation of electricity	100.00%	TAURON Ekoenergia Sp. z o.o. - 100.00%	100.00%	TAURON Ekoenergia Sp. z o.o. - 100.00%

No.	Name of the entity	Address	Principal business activities	% held by TAURON in the entity's share capital	Holder of shares as at 30 December 2011	% held by TAURON in the entity's governing body	Holder of shares as at 30 December 2011
14.	MEGAWAT MARSZEWO Sp. z o.o.	58-500 Jelenia Góra, ul. Obrońców Pokoju 2B	Generation of electricity	100.00%	TAURON Ekoenergia Sp. z o.o. – 100.00%	100.00%	TAURON Ekoenergia Sp. z o.o. – 100.00%
15.	Lipniki Sp. z o.o.	52-420 Wrocław; ul. Tadeusza Mikulskiego 5	Generation of electricity	100.00%	TAURON Ekoenergia Sp. z o.o. – 100.00%	100.00%	TAURON Ekoenergia Sp. z o.o. – 100.00%
16.	Górnośląski Zakład Elektroenergetyczny S.A.	44-100 Gliwice; ul. Barlickiego 2	Financial holding activities	99.98%	TAURON Polska Energia S.A. – 99.98%	99.98%	TAURON Polska Energia S.A. – 99.98%
17.	Vattenfall Distribution Poland S.A. ³	44-100 Gliwice; ul. Portowa 14a	Distribution of electricity	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%
18.	Vattenfall Sales Poland Sp. z o.o. ⁴	44-100 Gliwice; ul. Barlickiego 2a	Trading in electricity	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 99.998%, Vattenfall Network Services Poland Sp. z o.o. – 0.002%	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 99.998%, Vattenfall Network Services Poland Sp. z o.o. – 0.002%
19.	Vattenfall Network Services Poland Sp. z o.o. ⁵	44-100 Gliwice; ul. Mysliwska 6	Repair and maintenance of machinery and electrical equipment, electrical installations, construction of power lines	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 99.8%, Vattenfall Sales Poland Sp. z o.o. – 0.2%	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 99.8%, Vattenfall Sales Poland Sp. z o.o. – 0.2%
20.	Vattenfall Wolin-North Sp. z o.o. ⁶	44-100 Gliwice; ul. Barlickiego 2	Generation of electricity	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%
21.	Vattenfall Business Services Poland Sp. z o.o. ⁷	44-100 Gliwice; ul. Wybrzeże Armii Krajowej 19b	Services	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%	99.98%	Górnośląski Zakład Elektroenergetyczny S.A. – 100%

¹ In the third quarter of 2011, mergers of certain subsidiaries took place, as described below. Poludniowy Koncern Energetyczny S.A. acquired Elektrownia Stalowa Wola S.A. and changed its name to TAURON Wytwarzanie S.A., EnergiaPro S.A. acquired ENION S.A. and changed its name to TAURON Dystrybucja S.A., Przedsiębiorstwo Energetyki Ciepłej Katowice S.A. acquired Przedsiębiorstwo Energetyki Ciepłej w Dąbrowie Górniczej S.A. and changed its name to TAURON Ciepło S.A.

² TAURON Polska Energia S.A. is the usufructuary of shares owned by TAURON Wytwarzanie S.A. As a result of signing agreements for the usufruct of shares, TAURON Polska Energia S.A. holds 100% interests in the share capital and in the governing body of Kopalnia Wapienia Czatkowice Sp. z o.o. and a 52.48% interest in the share capital of Poludniowy Koncern Węglowy S.A., giving it 68.01% of votes at the company's General Shareholders' Meeting.

³ On 20 February 2012, the District Court entered the change of the company's name from Vattenfall Distribution Poland S.A. to TAURON Dystrybucja GZE S.A. in the National Court Register.

⁴ On 21 February 2012, the company's Shareholders' Meeting resolved to change the company's name from Vattenfall Sales Poland Sp. z o.o. to TAURON Sprzedaż GZE Sp. z o.o.

⁵ On 15 February 2012, the District Court entered the change of the company's name from Vattenfall Network Services Poland Sp. z o.o. to TAURON Serwis GZE Sp. z o.o. in the National Court Register.

⁶ On 27 February 2012, the District Court entered the change of the company's name from Vattenfall Wolin-North Sp. z o.o. to TAURON Ekoenergia GZE Sp. z o.o. in the National Court Register.

⁷ On 24 January 2012, the company's Shareholders' Meeting resolved to change the company's name from Vattenfall Business Services Poland Sp. z o.o. to TAURON Obsługa Klienta GZE Sp. z o.o.

Joint venture

Elektrociepłownia Stalowa Wola S.A. was set up in 2010 on the initiative of TAURON Polska Energia S.A. and PGNiG S.A. with a share capital of PLN 2,000 thousand. In the year ended 31 December 2011 the company's share capital was increased by the total of PLN 26,200 thousand, up to PLN 28,200 thousand. The District Court in Tarnobrzeg registered two increases of capital: the first one on 20 April 2011 and the second one on 9 September 2011. The new shares were taken up by the existing shareholders i.e. Elektrownia Stalowa Wola S.A. (acquired by TAURON Wytwarzanie S.A. in August 2011) and PGNiG Energia S.A., each of them holding a 50% stake in the share capital and in the governing body of Elektrociepłownia Stalowa Wola S.A. (the indirect share of TAURON Polska Energia S.A. amounts to 49.86%).

Elektrociepłownia Stalowa Wola S.A. is a special purpose entity which is intended to carry out an investment involving construction of a gas and steam unit fired with natural gas in Stalowa Wola, with a gross electric power of 400 MWe and net thermal power of 240 MWt. The project is to be completed in 2015. The partners intend to carry out the project sharing the rights and obligations on an equal basis.

Elektrociepłownia Stalowa Wola S.A. as a joint venture has been accounted for using the equity method in the consolidated financial statements.

The equity-accounted investment in the joint venture as at 31 December 2011 and 31 December 2010 is presented in the table below:

	As at 31 December 2011	As at 31 December 2010
Non-current assets	40 423	1 563
Current assets	7 796	1 080
Non-current liabilities (-)	(255)	(57)
Current liabilities (-)	(2 403)	(1 060)
Share in net assets	22 717	764
Goodwill	-	-
Investment in joint venture	22 717	764
Share in sales revenue of joint venture	146	5
Share in profit/(loss) of joint venture	(1 046)	(236)

3. Composition of the parent's Board of Directors

As at 31 December 2010, the Board of Directors consisted of:

- Dariusz Lubera – President,
- Joanna Schmid – Vice President,
- Dariusz Stolarczyk – Vice President,
- Krzysztof Zamasz – Vice President,
- Krzysztof Zawadzki – Vice President.

On 24 February 2011, the Supervisory Board elected the existing Board of Directors for the next term of office and the composition of this Board of Directors did not change in 2011.

As at 31 December 2011, the Board of Directors consisted of:

- Dariusz Lubera – President,
- Joanna Schmid – Vice President,
- Dariusz Stolarczyk – Vice President,
- Krzysztof Zamasz – Vice President,
- Krzysztof Zawadzki – Vice President.

In the period from the balance sheet date to the date of these financial statements there were no changes in the parent's Board of Directors.

4. Authorization of financial statements

These consolidated financial statements were authorized for issue by the Board of Directors on 6 March 2012.

5. Going concern

These consolidated financial statements have been prepared on the assumption that the Group companies will continue as going concerns in the foreseeable future. As at the date of authorization of these financial statements, the directors are not aware of any facts or circumstances that would indicate a threat to the continued activity of the Group companies.

6. Basis of preparation of consolidated financial statements

6.1. Statement of compliance

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRSs endorsed by the European Union ("EU").

At the date of authorization of these financial statements, considering the pending process of IFRS endorsement in the EU and the nature of the Group's activities, within the scope of the accounting principles applied by the Company there is no difference between the IFRSs that came into effect and the IFRSs endorsed by the EU. IFRSs comprise standards and interpretations accepted by the International Accounting Standards Board ("IASB") and the IFRS Interpretations Committee.

TAURON Dystrybucja S.A., Elektrociepłownia EC Nowa Sp. z o.o., Kopalnia Wapienia Czatkowice Sp. z o.o., Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. and the companies acquired as a result of the purchase of shares in Górnośląski Zakład Elektroenergetyczny S.A. keep their books of account in accordance with International Financial Reporting Standards ("IFRS"). The parent and TAURON Dystrybucja S.A. prepare their financial statements in accordance with IFRS starting from the financial statements for periods beginning on 1 January 2010. Elektrociepłownia EC Nowa Sp. z o.o., Kopalnia Wapienia Czatkowice Sp. z o.o., Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. prepare financial statements in accordance with IFRS starting from the financial statements for periods beginning on 1 January 2011.

TAURON Czech Energy s.r.o. keeps its books of account and prepares financial statements in accordance with the accounting standards accepted in the Czech Republic.

The other Group entities keep their books of account and prepare financial statements in accordance with the accounting policies specified in the Accounting Act dated 29 September 1994 ("the Accounting Act") with subsequent amendments and the regulations issued based on that Act ("Polish Accounting Standards", "PAS").

The consolidated financial statements include a number of adjustments not included in the books of account of the Group entities, which were made in order to bring these consolidated financial statements to conformity with IFRS.

6.2. Functional currency and presentation currency

Polish zloty is the functional currency of the parent and other entities included in these consolidated financial statements, except for TAURON Czech Energy s.r.o., as well as the presentation currency of these consolidated financial statements. The functional currency of TAURON Czech Energy s.r.o. is the Czech Koruna ("CZK"). The items included in the financial statements of TAURON Czech Energy s.r.o. are translated into the presentation currency of the TAURON Group using appropriate exchange rates.

These consolidated financial statements are presented in Polish zloty ("PLN") and all amounts are stated in PLN thousands unless otherwise indicated.

7. Significant judgments and estimates

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the consolidated financial statements, including explanatory notes. The assumptions underlying these estimates are based on management's best knowledge of current and future activities and events in the particular areas. The details of the assumptions adopted are presented in the relevant notes to these consolidated financial statements.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of assets

As a result of the analyses conducted as at 31 December 2011, the Group identified an existence of an external factor that could indicate a potential impairment of assets, which consists in the carrying amount of the Company's net assets exceeding their market capitalization. As a result, the Company analyzed cash flows generated by the particular operating segments of the Group. However, these cash flows were not found to be lower than the carrying amounts of the particular segments. The Company believes that the results of the above-mentioned analysis show that low market capitalization is not a sufficient basis for conducting impairment tests for all of the Group's assets. For this reason, the Company did not conduct such tests at the balance sheet date. In accordance with IAS 36, the Company carried out impairment tests for the operating segments that include goodwill as well as impairment tests of non-current assets attributable to the Other – Distribution

and Sales of Heat Segment. Those tests required estimating the value in use of the segments based on future cash flows generated by them, which were subsequently amortized to present value using the discount rate. The details of the adopted assumptions and significant details of the tests and analyses performed are included in Notes 16 and 19.

Depreciation and amortization rates

Depreciation and amortization rates and charges are determined based on the anticipated economic useful lives of property, plant and equipment or intangible assets and the estimated residual values of property, plant and equipment. Capitalized overhaul expenses are depreciated over the periods remaining up to the anticipated date of commencing the next overhaul of a given item. The economic useful lives are reviewed annually by the Group based on current estimates.

Estimation of revenue from sale of electricity

The readings of the meters concerning the amount of electricity sold on the retail market are in most cases taken and the invoices issued in periods other than the reporting periods. Therefore, the Group companies trading in energy make an estimate of the sales at each balance sheet date for the period not covered by the reading.

Compensations for termination of long-term contracts

The Group receives compensations for stranded costs in accordance with the Act of 29 June 2007 on the principles for covering costs incurred by electricity generating companies due to early termination of long-term contracts for the sale of power and electricity (Power Purchase Agreements). Revenue from such compensations is recognized in line with the compensation earned until the end of the period covered by the compensation scheme. In order to estimate the amount of the revenue attributable to the given period the Group makes estimates to determine the index of the estimated stranded costs to the sum total of the discounted yearly advances received, returned and expected (including the yearly advances received to date), the annual adjustments and the anticipated final adjustment. The details of compensation for termination of long-term contracts are discussed in Note 34.

Valuation of provisions for employee benefits

Provisions for employee benefits (provision for retirement, disability and similar benefits, coal allowances, provision for transfers to the Social Fund for present and future pensioners, provision for special electricity rates and charges granted to employees) were determined using actuarial valuations. In addition, provisions were recognized for benefits paid under the early retirement scheme, redundancy payment scheme and pre-retirement benefit scheme. The details of the above-mentioned provisions and the adopted assumptions are presented in Note 27.

Valuation of provision for decommissioning liabilities and for dismantling and removal of fixed assets

This provision is recognized with respect to the mining enterprises being part of the Group based on the estimate of the anticipated decommissioning costs related to the dismantling and removal of facilities and the restoration of land to its original condition. The amount of the provision is estimated based on studies prepared on the basis of deposit exploitation projections (for mining facilities) and technological and economic analyses. In addition, provisions for the dismantling and removal of fixed assets are recognized when such obligations arise or are undertaken by the Group.

Deferred tax assets

Deferred tax assets are measured using the tax rates that are expected to apply in the period when the asset is expected to be realized, based on tax laws that have been enacted at the balance sheet date. The Group recognizes deferred tax assets based on the assumption that taxable profits will be available against which the deferred tax asset can be utilized. Deterioration of future taxable profits might render this assumption unreasonable.

Classification of financial instruments

In accordance with the guidelines to IAS 39 regarding classification of non-derivative financial instruments with fixed payment dates or determinable maturity dates, such assets are classified as financial assets held to maturity. In making such a judgment an assessment is made of the intention and ability to hold such investments to maturity.

Fair value of financial instruments

The fair value of financial instruments for which no active market exists is assessed by means of appropriate valuation techniques. The Group applies professional judgment in selecting appropriate methods and assumptions. The methods used for measuring the fair value of financial instruments are presented in Note 37.

Allowances for doubtful debts

At the balance sheet date the Group makes an assessment of whether there is any objective evidence of impairment of an individual receivable or a group of receivables. Where the recoverable amount of the asset is less than its carrying amount, the entity recognizes an allowance to bring down the carrying amount to the present value of the expected cash flows.

Valuation of obligations under compulsory buy-out of shares (squeeze-out) by subsidiaries

In the TAURON Group, the process of compulsory buy-out of shares from minority shareholders by the following subsidiaries: TAURON Wytwarzanie S.A., TAURON Dystrybucja S.A., TAURON Ciepło S.A. and Elektrociepłownia Tychy S.A. is pending, based on Article 4181 of the Code of Commercial Companies. As at 31 December 2011, the potential unrecognized financial liability to the shareholders eligible for the compulsory buy-out of shares, which would result in the decrease of equity, is immaterial for the consolidated financial statements.

8. Changes in presentation and estimates

8.1. Changes in presentation

To date, property rights arising from energy generated using renewable sources (renewable energy certificates) and certificates of electricity generated using cogeneration or sources fuelled with natural gas which were acquired by the Company for the purpose of cancellation due to sale of electricity to final users as well as greenhouse gas emission allowances acquired for the purpose of cancellation have been recognized under non-current assets as intangibles. The Group decided to change the presentation of such assets in the statement of financial position as, in the opinion of the Company's management, an intangible asset which is acquired for cancellation in the year immediately following the end of a given financial year meets the definition of a current asset due to the expected timing of its realization through cancellation. Management believe that this change better reflects the Company's intentions and the nature of its assets. As a result, as at 31 December 2011 the Group presents energy certificates and greenhouse gas emission allowances acquired for the purpose of their cancellation in the next year under current assets, as current intangible assets.

The impact of these changes on the statement of financial position as at 31 December 2010 and 1 January 2010 is presented in the tables below:

	As at 31 December 2010 (approved figures)	Presentation change relating to energy certificates	Presentation change relating to greenhouse gas emission allowances	As at 31 December 2010 (restated figures)
Non-current assets	18 959 101	(523 017)	(101 173)	18 334 911
Intangible assets	970 530	(523 017)	(101 173)	346 340
Current assets	4 466 786	523 017	101 173	5 090 976
Current intangible assets	–	523 017	101 173	624 190

	As at 1 January 2010 (approved figures)	Presentation change relating to energy certificates	Presentation change relating to greenhouse gas emission allowances	As at 1 January 2010 (restated figures)
Non-current assets	18 475 838	(481 885)	–	17 993 953
Intangible assets	824 751	(481 885)	–	342 866
Current assets	3 673 704	481 885	–	4 155 589
Current intangible assets	–	481 885	–	481 885

8.2. Changes in estimates

In the period covered by these consolidated financial statements, the following significant changes were made to estimates which affect the values reported in the consolidated financial statements:

- change in the assumptions underlying actuarial estimates – the impact of the changes in estimates on the amount of the provisions is presented in Note 27,

- estimates concerning provision for decommissioning liabilities related to mines,
- estimates of the useful lives of property, plant and equipment and intangible assets,
- estimates relating to assumptions used in goodwill impairment tests (Note 19).

9. Changes in accounting policies

The accounting policies applied to these consolidated financial statements are consistent with those applied to the consolidated financial statements of the Group for the year ended 31 December 2010, except for the application of the following amendments to standards and new interpretations applicable to annual periods beginning on 1 January 2011:

- Amendment to IAS 32 *Financial Instruments: Presentation: Classification of Rights Issues* – applicable to annual periods beginning on or after 1 February 2010. The application of these amendments had no impact on the financial position or results reported by the Group as there were no events to which they applied.
- IAS 24 *Related Party Disclosures* (amended in November 2009) – applicable to annual periods beginning on or after 1 January 2011. The revised IAS 24 is applied by the Group retrospectively to annual periods beginning 1 January 2011.
- Amendments to IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction: Prepayments of a Minimum Funding Requirement* – applicable to annual periods beginning on or after 1 January 2011. The application of these amendments had no impact on the financial position or results reported by the Group as there were no events to which they applied.
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* – applicable to annual periods beginning on or after 1 July 2010. The application of this interpretation had no impact on the financial position or results reported by the Group.
- Amendment to IFRS 1 *First-time Adoption of IFRSs: Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters* – applicable to annual periods beginning on or after 1 July 2010. The application of these amendments had no significant impact on the financial position or results reported by the Group.
- *Improvements to IFRSs* (issued in May 2010) – some improvements are applicable to annual periods beginning on or after 1 July 2010, while the rest is applicable to annual periods beginning on or after 1 January 2011. The application of these amendments had no significant impact on the financial position or results reported by the Group.

The Group has not decided to early apply any standard, interpretation or amendment that has already been issued but is not yet effective.

10. New standards and interpretations issued but not yet effective

The following standards and interpretations were issued by the International Accounting Standards Board or the IFRS Interpretations Committee but are not yet effective:

- Phase 1 of IFRS 9 *Financial Instruments: Classification and Measurement* – applicable to annual periods beginning on or after 1 January 2015 – not endorsed by the EU until the date of authorization of these financial statements. In the next phases, the IASB will deal with hedge accounting and impairment methodology. The application of Phase 1 of IFRS 9 will have an impact on the classification and measurement of the Group's financial assets. The Group will assess this impact in correspondence with the other phases of the project once they have been issued, in order to provide a consistent view,
- Amendment to IFRS 7 *Financial Instruments: Disclosures: Transfer of Financial Assets* – applicable to annual periods beginning on or after 1 July 2011,
- Amendments to IAS 12 *Income Taxes: Deferred Tax: Recovery of Underlying Assets* – applicable to annual periods beginning on or after 1 January 2012 – not endorsed by the EU as at the date of authorization of these financial statements,
- Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards: Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters* – applicable to annual periods beginning on or after 1 July 2011 – not endorsed by the EU as at the date of authorization of these financial statements,
- IFRS 10 *Consolidated Financial Statements* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,
- IFRS 11 *Joint Arrangements* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,
- IFRS 12 *Disclosure of Interests in Other Entities* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,
- IFRS 13 *Fair Value Measurement* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,

- Amendments to IAS 19 *Employee Benefits* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements. The most important amendment to IAS 19 from the Company’s perspective is the liquidation of the “corridor approach” and the requirement to recognize actuarial gains and losses retrospectively in other comprehensive income. The impact of those amendments on the Group is discussed in detail in Note 27.
- Amendments to IAS 1 *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income* – applicable to annual periods beginning on or after 1 July 2012 – not endorsed by the EU as at the date of authorization of these financial statements,
- IFRIC 20 *Stripping Cost of the Production Phase of a Surface Mine* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,
- Amendments to IFRS 7 *Financial Instruments: Disclosures: Offsetting Financial Assets and Financial Liabilities* – applicable to annual periods beginning on or after 1 January 2013 – not endorsed by the EU as at the date of authorization of these financial statements,
- Amendments to IAS 32 *Financial Instruments: Presentation: Offsetting Financial Assets and Financial Liabilities* – applicable to annual periods beginning on or after 1 January 2014 – not endorsed by the EU as at the date of authorization of these financial statements.

Apart from the impact of the amendment to IAS 19 involving the liquidation of the corridor approach, the Company’s Management Board has not determined whether or not and to what extent the introduction of the other aforementioned standards and interpretations may affect the Group’s accounting policies.

11. Summary of significant accounting policies

These consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and available-for-sale financial assets, which have been measured at fair value.

11.1. Basis of consolidation

These consolidated financial statements comprise financial information of TAURON Polska Energia S.A. and of its subsidiaries prepared by the individual entities for the years ended 31 December 2011 and 31 December 2010, and in the case of the subsidiaries acquired during the year 2011 (Note 30), for the period from the date of acquisition of control by the parent to 31 December 2011. The financial statements of the subsidiaries, after giving consideration to the adjustments made to achieve conformity with IFRS, are prepared for the same reporting period as those of the parent, using consistent accounting policies applied to similar business transactions and events.

All significant intercompany balances and transactions, including unrealized gains arising from intra-group transactions, have been eliminated in full. Unrealized losses are eliminated unless they indicate impairment.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which such control is transferred out of the Group. An entity is controlled by the parent when the parent has, either directly or indirectly through its subsidiaries, more than half of the votes at the shareholders’ meeting of that entity, unless it is possible to prove that such holding does not represent control. Control is also exercised if the Company has the power to govern the financial or operating policy of an enterprise without holding a majority interest in equity.

11.2. Interest in a joint venture

Interests in joint ventures, where the Group exercises a joint control, are recognized using the equity method. Prior to the calculation of the share in the net assets of a joint venture, proper adjustments are made to bring the financial data of such entities to conformity with the IFRSs applied by the Group.

Investments in jointly controlled entities are tested for impairment when there is evidence indicating that they are impaired or that an impairment loss recognized in prior years is no longer required.

11.3. Foreign currency translation

On initial recognition, transactions denominated in currencies other than Polish zloty are translated into Polish zloty at the foreign exchange rate prevailing on the transaction date. At the balance sheet date:

- monetary items are translated using the closing rate of exchange (i.e. the average NBP rate determined for the given currency at the given date),
- non-monetary items recognized at historical cost are translated at the historical foreign exchange rate prevailing on the date of the original transaction (the exchange rate of the bank used by the enterprise), and
- non-monetary items recognized at fair value are translated into Polish zloty using the rate of exchange prevailing on the date of re-measurement to fair value.

Exchange differences resulting from translation are recorded under finance income or finance costs, or, in the cases specified in accounting policies, are capitalized in the cost of the assets. Non-monetary assets and liabilities recognized at historical cost are translated at the historical foreign exchange rate prevailing on the transaction date.

Exchange differences resulting from translation of non-monetary items such as equity instruments carried at fair value through profit or loss are recognized as part of changes in fair value. Exchange differences resulting from translation of non-monetary items such as equity instruments classified as available-for-sale financial assets and measured at fair value are recognized in the statement of comprehensive income.

The following exchange rates were used for valuation purposes:

Currency	31 December 2011	31 December 2010
USD	3.4174	2.9641
EUR	4.4168	3.9603
CZK	0.1711	0.1580

11.4. Property, plant and equipment

Property, plant and equipment are fixed assets which:

- are held by the enterprise for use in the production or supply of goods or services, for administrative purposes or for the purpose of giving them over for use to other entities under rental agreement, and which do not represent investment property, and
- are expected to be used over a period exceeding one year,
- for which it is probable that future economic benefits associated with the asset will flow to the enterprise,
- the cost of the asset to the enterprise can be measured reliably.

The Group recognizes land and perpetual usufruct of land under property, plant and equipment.

Property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The initial cost of an item of property, plant and equipment comprises its purchase price or manufacturing cost plus any directly attributable costs of buying and bringing the asset to working condition for its intended use. Cost also comprises the expected cost of dismantling the items of property, plant and equipment, removing them and restoring the site on which the asset is located to the original condition, the obligation for which an entity incurs when the asset is installed or is used for purposes other than to produce inventories. Subsequent expenditures, such as repair or maintenance costs, are expensed in the reporting period in which they are incurred.

Upon purchase, property, plant and equipment are divided into components, which represent items with a significant value that can be allocated a separate useful life. General overhauls, routine repairs (if such costs are significant) and costs of replacement of major parts also represent asset components.

The Group recognizes specialist spare parts and servicing equipment as separate items of property, plant and equipment if their useful life exceeds 1 year.

Other spare parts and servicing equipment are presented under inventories and are recognized in profit or loss when used, except for the costs of replacement of spare parts as part of an overhaul of a given item of property, plant and equipment. The adopted materiality level is reviewed at least at the end of each financial year.

Depreciation is charged on the cost of the fixed asset decreased by its residual value. Depreciation begins when the asset is made available for use. Depreciation is charged in accordance with a depreciation plan which determines the estimated useful life of the asset. The depreciation method used reflects the pattern in which the asset's economic benefits are consumed by the enterprise.

Specialist spare parts and servicing equipment, which are recognized under property, plant and equipment, are depreciated over the useful life of the related asset (i.e. beginning from the date of purchase of the given part to the date of completion of the use of the asset).

The average useful lives of specific groups of fixed assets are as follows:

Type of assets	Average remaining depreciation period in years
Buildings, premises and civil engineering structures	18 years
Plant and machinery	12 years
Motor vehicles	7 years
Other fixed assets	8 years

Depreciation methods, depreciation rates and residual values of property, plant and equipment are reviewed at least at the end of each financial year. Any resulting amendments are recognized as a change of estimates. Depreciation expense is recognized in profit or loss in the expense category consistent with the function of the given asset.

The Group does not charge depreciation on land or perpetual usufruct of land.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its further use. Any gain or loss arising on derecognition of an asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognized in the profit or loss for the period in which derecognition took place.

Assets under construction include assets in the course of construction or assembly and are recognized at purchase price or cost of construction less any impairment losses. Assets under construction are not depreciated until completed and made available for use. Finance costs eligible for capitalization are also recognized as part of the cost of assets under construction. Capitalization of such expenses is discussed in detail in Note 16.

11.5. Intangible assets

Intangible assets of the Group include identifiable non-monetary assets without physical substance, such as:

- property rights acquired by the enterprise and included under non-current assets which can be of economic use and have an expected useful life of more than one year, designated to be used for internal purposes, including in particular:
 - copyright and related rights, concessions, licenses (including computer software licenses),
 - rights to inventions, patents, trademarks, utility and ornamental patterns, computer software,
 - know-how, i.e. value being the equivalent of the acquired industrial, commercial, scientific or organizational knowledge,
 - greenhouse gas allowances acquired for the purpose of cancellation, if, at the time of the purchase, the entity's intention is to fulfill the obligation to surrender them for cancellation with respect to the following years (where greenhouse gas emission allowances are acquired with the intention to fulfill the obligation for the current year, such allowances are classified as current intangibles under current assets – discussed in detail in Note 11.15),
 - renewable energy certificates and certificates of electricity generated using cogeneration or sources fuelled with natural gas, acquired or received due to production and designated for internal purposes i.e. cancellation, if the entity's intention is to fulfill the obligation to surrender them for cancellation with respect to the following years (where the entity's intention is to fulfill the obligation for the current year, such energy certificates are classified as current intangibles under current assets – discussed in detail in Note 11.15),
- development expenses,
- goodwill – excluding goodwill generated internally,
- other intangible assets recognized at acquisition as part of a business combination.

Intangible assets also include:

- third party intangible assets used in exchange for payments under rental, lease or other agreements of a similar nature if such agreements are classified as finance leases in accordance with IAS 17 *Leases*,
- property rights given over for use by other enterprises under rental, lease or other agreements of a similar nature if such agreements are classified as operating leases in accordance with IAS 17 *Leases*.

Intangible assets are measured on initial recognition at acquisition cost or cost of production in the case of development expenses. Following initial recognition, intangible assets are carried at cost less accumulated amortization and impairment losses.

Expenditures incurred for internally generated intangible assets, excluding capitalized development expenses, are not capitalized and are charged against profits in the period in which they are incurred.

The useful lives of intangible assets are assessed by the Group to be either finite or indefinite. If they are finite, the Group estimates the length of the useful life or the amount of production or other measure providing the basis for determining the useful life.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and method for intangible assets with finite useful lives are reviewed at least at the end of each financial year. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for on a prospective basis by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in profit or loss in the expense category consistent with the function of the intangible asset.

Intangible assets with indefinite useful lives and those that are not in use are tested for impairment on an annual basis.

Renewable energy certificates and certificates of electricity generated using cogeneration or sources fuelled with natural gas, acquired or received due to production and designated for internal purposes, are recognized at acquisition cost or fair value at the date of receipt, as appropriate.

Emission allowances received free of charge under the National Allocation Plan are recognized at nominal value i.e. zero. Additional emission allowances acquired in exchange for consideration are carried at cost less any impairment losses, taking into account their residual value.

Research costs are expensed in profit or loss as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured.

Except for development expenses, all intangible assets generated internally by the Group are not capitalized and are recognized in the profit or loss for the period in which the related expenditures were incurred. Intangible assets arising from development are recognized if and only if the enterprise can demonstrate the following:

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

Development activities include:

- the design, construction and testing of pre-production or pre-use prototypes and models,
- the design of tools, jigs, moulds and dies involving new technology,
- the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

The following average useful lives were adopted for specific groups of intangible assets:

Type of assets	Average remaining amortization period in years
Patents and licenses	3 years
Development expenses	2 years
Other (including software)	7 years

11.6. Goodwill

Goodwill arising on acquisition is initially recognized at cost being the excess of:

- the aggregate of:
 - consideration transferred,
 - the amount of any non-controlling interest in the acquiree and
 - in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously-held equity interest in the acquiree,
- over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. Goodwill is not amortized.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units that is expected to benefit from the combination. Each unit, or set of units, to which the goodwill has been allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes, and
- is not greater than a single business segment, in accordance with IFRS 8 *Operating Segments*.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit to which the goodwill has been allocated. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized.

Where goodwill represents part of a cash-generating unit and part of the operations within that unit is disposed of, the goodwill associated with the operations disposed of is included in the carrying amount of the operations when determining gain or loss on disposal of the operation. Goodwill disposed of in such circumstances is measured on the basis of the relative value of the operations disposed of and the value of the portion of the cash-generating unit retained.

11.7. Impairment of non-financial long-term assets

An assessment is made at each reporting date to determine whether there is any indication that any of non-financial long-term assets may be impaired. If such indication exists, or in case an annual impairment testing is required, the Group makes an estimate of the recoverable amount of that asset or the asset's cash-generating unit.

The recoverable amount of an asset or a cash-generating unit is the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognized in the expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Group makes an estimate of recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized immediately as income in profit or loss. After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset is adjusted in future periods to allocate the asset's carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

11.8. Borrowing costs

Borrowing costs are capitalized as part of the cost of property, plant and equipment and intangible assets (qualifying assets). Borrowing costs comprise interest calculated using the effective interest rate method, finance charges in respect of finance leases and exchange gains or losses arising from borrowings to the extent that they are regarded as an adjustment to interest costs.

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. A period of 12 months is deemed to be a substantial period of time.

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

These may include:

- costs related to the borrowing of funds for the purpose of acquisition or construction of a specific investment project (investment loans, specific-purpose loans) – specific-purpose borrowings,
- costs related to the borrowing of funds for no specified purpose, however used for the purpose of funding a qualifying asset (borrowings other than investment loans) – general-purpose borrowings.

For the purpose of calculation of borrowing costs eligible for capitalization, other-than-specific-purpose borrowings are considered to be general-purpose borrowings to the extent to which borrowing costs could have been avoided had the enterprise used its cash to pay the liabilities arising from the borrowing of funds.

After the completion of a qualifying asset that has been financed using a specific-purpose borrowing, the specific-purpose borrowing and the related borrowing costs are no longer included in the determination of borrowing costs eligible for capitalization.

The amount of borrowing costs related to general-purpose borrowings that are eligible for capitalization is determined by applying a capitalization rate to the expenditures incurred on qualifying assets. The capitalization rate is the weighted average of all borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than specific-purpose borrowings.

Capitalization of borrowing costs ceases when substantially all the activities necessary to prepare a given qualifying asset for its intended use or sale are complete. Interruptions in the implementation of an investment project that are due to the nature of the activities being conducted do not result in the interruption of capitalization of borrowing costs. In the event investment activities are suspended for any other reason, borrowing costs should not be capitalized from the moment of interruption of the investment activities until such activities are undertaken again.

11.9. Financial assets

Financial assets are classified into one of the following categories:

- financial assets held to maturity,
- financial assets at fair value through profit or loss,
- loans and receivables,
- financial assets available for sale.

Financial assets held to maturity

Financial assets held to maturity are financial assets with fixed or determinable payments and fixed maturities, which the Group has the positive intention and ability to hold until maturity, other than:

- those that upon initial recognition are designated as at fair value through profit or loss,
- those that are designated as available for sale and
- those that meet the definition of loans and receivables.

Financial assets held to maturity are measured at amortized cost using the effective interest rate. Financial assets held to maturity are classified as non-current assets if they are falling due within more than 12 months from the balance sheet date.

Financial assets at fair value through profit or loss

A financial asset at fair value through profit or loss is a financial asset that meets either of the following conditions:

- It is classified as held for trading. A financial asset is classified as held for trading if it is:
 - acquired principally for the purpose of selling it in the near term,
 - 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, or
 - a derivative – except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument.
- Upon initial recognition it was designated as at fair value through profit or loss, in accordance with IAS 39. Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different basis, or (ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a document risk management strategy, or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.
- Financial assets at fair value through profit or loss are measured at fair value taking into account their market value at the balance sheet date excluding costs to sell. Changes in the values of these financial instruments are recognized in the statement of comprehensive income as finance income or finance costs. If a contract includes one or more embedded derivatives, the whole contract can be classified as a financial asset at fair value through profit and loss. This does not relate to cases where the embedded derivative has no significant impact on the contractual cash flows or where separate recognition of embedded derivatives is clearly prohibited.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are classified as current assets provided their maturity does not exceed 12 months after the balance sheet date. Loans and receivables with maturities exceeding 12 months from the balance sheet date are classified under non-current assets. Loans and receivables are recognized at amortized cost.

Available-for-sale financial assets

All remaining financial assets are classified as available-for-sale financial assets. Available-for-sale financial assets are measured at fair value at each balance sheet date. The fair value of the assets for which a quoted market price is not available is determined with reference to the current market value of another instrument that is substantially the same or based on the estimated future cash flows of the asset (discounted cash flow method). Where no quoted market price is available in an active market and the fair value cannot be reliably measured using alternative methods, available-for-sale financial assets are measured at cost, adjusted for any impairment losses.

Positive and negative differences between the fair value of financial assets available for sale (if a quoted market price determined in an active regulated market is available or the fair value can be reliably measured using an alternative method) and the cost of such assets, net of deferred tax, are taken to the revaluation reserve, except for the following:

- impairment losses,
- foreign exchange gains and losses arising on monetary assets,
- interest calculated using the effective interest rate.

Dividends from equity instruments classified as available-for-sale are recognized in profit or loss when the entity's right to receive payment is established.

11.10. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortized cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through the use of an allowance amount. The amount of the loss is recognized in profit or loss for the period.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included on a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

Financial assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and has to be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Available-for-sale financial assets

If there is objective evidence that an impairment loss has been incurred on an available-for-sale financial asset, then the amount of the difference between its acquisition cost (net of any principal repayment and interest) and current fair value, less any impairment loss on that financial asset previously recognized in profit or loss, is removed from equity and recognized in profit or loss. Reversals of impairment losses on equity instruments classified as available for sale cannot be recognized in profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss.

11.11. Embedded derivatives

An embedded derivative is a component of a hybrid (combined) financial instrument that includes both the derivative and a host contract, with the effect that some of the cash flows of the combined instrument vary in a similar way to a stand-alone derivative.

The Group performs an analysis of the contracts being entered into and already in force with a view to identifying embedded derivatives.

Embedded derivatives are bifurcated from host contracts and treated as derivative financial instruments if all of the following conditions are met:

- the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract,
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative,
- the hybrid instrument is not recorded at fair value with gains and losses taken to profit or loss.

Embedded derivatives are recognized in a similar manner to that of separate instruments which have not been designated as hedging instruments.

Where the host contract is not a financial instrument, an embedded foreign currency derivative does not need to be bifurcated and separately measured if it is closely related to the economic characteristics and risks of the host contract. This covers circumstances where the currency of the host contract is:

- the functional currency of any of the parties to the contract,
- the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in international commerce,
- the common currency of purchase or sale of non-financial items on the market of a given transaction.

Bifurcated embedded derivatives are recognized in the statement of financial position at fair value, with any changes in fair value recognized in profit or loss.

The Group assesses embedded derivatives as to whether or not they are required to be separated from host contracts upon initial recognition. In the case of embedded derivatives acquired as part of business combination, the Group makes an assessment of embedded derivatives at the acquisition date, which is the date of their initial recognition by the Group.

11.12. Derivative financial instruments

The Group uses derivative financial instruments such as *forward currency contracts* and *interest rate swaps* to hedge against the risks associated with interest rate and foreign currency fluctuations. Such derivative financial instruments are measured at fair value. Derivatives are recognized as assets when their fair value is positive and as liabilities when their fair value is negative.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles or based on valuations provided by financial institutions. The fair value of interest rate swap contracts is determined based on computations derived from a mathematical model that is based on current FRA values and IRS quotations published by Reuters, or based on valuations provided by independent financial institutions.

11.13. Hedge accounting

The Group has a hedge accounting policy which determines the hedge accounting principles and types of hedges applied as well as the accounting treatment of hedging instruments and hedged items. In accordance with its policy, the Group applies cash flow hedge accounting. Cash flow hedge accounting involves hedging an exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction and that could affect profit or loss.

A cash flow hedge is accounted for as follows:

- the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized directly in other comprehensive income and
- the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss for the period.

More specifically, the accounting treatment applied to a cash flow hedge is as follows:

- the separate component of equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):
 - the cumulative gain or loss on the hedging instrument from inception of the hedge and
 - the cumulative change in the fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;
- any remaining gain or loss on the hedging instrument or a designated portion thereof (which is not an effective hedge) is included in profit or loss for the period and
- if the documented risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss or related cash flows on the hedging instrument from the assessment of hedge effectiveness, that excluded component of gain or loss is recognized in profit or loss for the period in which it arises unless it is classified as an available-for-sale financial asset.

Gains/losses on the remeasurement of a hedging instrument that were recognized in other comprehensive income are recognized directly in profit or loss for the period at the time the hedged item affects the profit or loss for the period, or are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability if the hedged item results in the recognition of a non-financial asset or liability.

At the inception of a hedge relationship, the hedge relationship, the risk management objective and strategy for undertaking the hedge are formally designated and documented.

The documentation should include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Hedges are expected to be highly effective in offsetting the exposure to changes

in the fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed on an ongoing basis to check if the hedge is highly effective throughout all financial reporting periods for which it was designated.

11.14. Other non-financial assets

The Group recognizes prepayments under other non-financial assets if the following conditions are met:

- they originate from past events – costs incurred by the enterprise for operating purposes,
- they are reliably measurable,
- they will cause an inflow of future economic benefits to the enterprise,
- they relate to future reporting periods.

Prepayments are recognized at the amount of incurred reliably measurable expenses that relate to future reporting periods and will cause an inflow of future economic benefits to the enterprise.

Prepaid expenses are amortized in accordance with the passage of time or level of performance. The time and method of settlement depends on the nature of the expense and takes into account the prudence concept.

At the end of the reporting period, the Group performs a review of prepaid expenses to check whether the probability that economic benefits will flow to the enterprise after the end of the current period is sufficient to recognize the given item as an asset.

During the reporting period, the following items are recognized under prepayments:

- property insurance expenses,
- current payments for perpetual usufruct of land,
- real estate tax,
- costs of preparing production in hard coal mines, including in particular costs of assembling longwalls and costs of drilling extraction tunnels that are not classified as items of property, plant and equipment,
- transfers to the Social Fund,
- subscriptions,
- other expenses relating to future reporting periods.

Other non-financial assets include in particular receivables from the state budget (except for CIT receivables which are presented as a separate item in the statement of financial position), the excess of Social Fund assets over Social Fund liabilities and advance payments for future purchases of property, plant and equipment, intangible assets and inventories. Advance payments are presented consistent with the nature of the related assets i.e. under non-current or current assets, as appropriate. Advance payments are not subject to discounting as they represent non-monetary assets.

11.15. Current intangible assets

Current intangible assets include renewable energy and cogeneration certificates acquired or received due to production and designated for internal purposes which have been acquired with the intention to submit them for cancellation due to sale of electricity to final users in the current year. Where the company's intention is to submit energy certificates for cancellation in order to fulfill the obligation relating to the following years, they are classified as intangibles under non-current assets (Note 11.5).

Renewable energy certificates and certificates of electricity generated using cogeneration or sources fuelled with natural gas, acquired or received due to production and designated for internal purposes, are recognized under current intangible assets at acquisition cost or fair value at the date of receipt, as appropriate.

Current intangible assets also include greenhouse gas emission allowances if they are acquired in order to fulfill the obligation arising from greenhouse gas emission for the current year. If the company acquires greenhouse gas emission allowances in order to fulfill the cancellation requirement arising from emission in the following years, such allowances are presented as intangibles under non-current assets (Note 11.5). The acquired greenhouse gas emission allowances are recognized at cost.

11.16. Inventories

Inventories include assets:

- held for sale in the ordinary course of business,
- in the process of production for such sale, or
- in the form of materials or raw materials to be consumed in the production process or in the rendering of services.

Inventories also include emission allowances and energy certificates purchased or received due to production of electricity using renewable sources, gas-fired plants or cogeneration, which are intended for sale.

Inventories are measured at the lower of cost and net realizable value.

Costs incurred in bringing each inventory item to its present location and condition are included in the cost of inventories. The closing balance of inventories is determined as follows:

- | | |
|-------------------------------------|--|
| Materials | – at cost determined on the “weighted average” basis, |
| Finished goods and work-in-progress | – at the cost of direct materials and labor and a proportion of manufacturing overheads based on normal operating capacity, excluding borrowing costs, |
| Goods for resale | – at cost determined on the “weighted average” basis. |

Energy certificates acquired free of charge due to production of electricity using renewable sources, gas-fired plants or cogeneration are recognized at fair value as of the date on which the granting of such certificates is assured.

The cost of inventories used for valuation at the balance sheet date must not be higher than their net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

11.17. Trade and other receivables

Trade receivables are recognized and carried at the original invoice amount unless the effect of the time value of money is material, less an allowance for any uncollectible amounts.

Doubtful debt allowances are recorded under operating expenses or finance costs, depending on the nature of the receivable.

If the effect of the time value of money is material, the value of receivables is determined by discounting the estimated future cash flows to present value using a discount rate that reflects current market assessments of the time value of money. Where discounting is used, any increase in the balance due to the passage of time is recognized as finance income.

11.18. Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash at bank and on hand as well as short-term deposits with an original maturity of three months or less.

The balance of cash and cash equivalents in the consolidated statement of cash flows consists of cash and cash equivalents as defined above. If bank overdrafts are used as part of cash management, subject to the provisions of IAS 7, the balance of cash and cash equivalents in the consolidated statement of cash flows is presented net of the outstanding bank overdrafts.

11.19. Issued capital

The issued share capital in the consolidated financial statements is recorded at the amount stated in the parent’s Articles of Association and registered in the court register. Contributions declared but unpaid are recognized as unpaid share capital with a negative value. Treasury shares are recognized as a separate item of equity with a negative value.

11.20. Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event and if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of the provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in profit or loss net of any reimbursement.

Provisions are recorded under operating expenses, other operating expenses or finance costs, depending on the underlying circumstances.

If the effect of the time value of money is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation.

The discount rate is determined as a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate does not reflect the risk that has been reflected in the estimated future cash flows. Where discounting is used, the increase in the provision due to the passage of time is recognized as finance cost.

In particular, the Group has recognized the following provisions:

- *provisions for post-employment benefits, jubilee bonuses and employment termination benefits*

In accordance with internal remuneration regulations, employees of the Group companies are entitled to the following benefits:

- retirement and disability benefits – payable on a one-off basis upon retirement,
- jubilee bonuses – payable after completion of a specified number of years in service,
- coal allowances – granted in nature at a specified amount or payable in the form of a cash equivalent,

- cash equivalents resulting from special electricity rates and charges granted to employees in the energy sector,
- death benefits,
- post-employment benefits from the Social Fund.

The carrying amount of the Group's liabilities resulting from those benefits is calculated at each balance sheet date by an independent actuary. The balance of these liabilities equals discounted payments which will be made in the future, accounts for staff turnover and relates to the period up to the balance sheet date. Demographic information and information on staff turnover are based on historical data.

With respect to post-employment benefits, actuarial gains and losses are recognized in accordance with the provisions of IAS 19 i.e. using the so-called "corridor approach". According to the "corridor approach", in measuring its defined benefit liability the Company recognizes a portion of its actuarial gains and losses as income or expense if the net cumulative unrecognized actuarial gains and losses at the end of the preceding reporting period exceed 10% of the present value of the defined benefit obligation at that date. The portion of actuarial gains and losses exceeding the above limit is recognized in the profit or loss for the period at an amount equal to the excess mentioned above divided by the expected average remaining working lives of the Company's employees.

In addition, in accordance with IAS 19.133, the Group recognizes provisions for benefits arising from termination of employment under the voluntary redundancy scheme. The measurement of such benefits is based on the estimated number of employees who are expected to participate in the scheme as well as the estimated amount of the related payments.

- *provision for decommissioning liabilities related to mines*

A provision for decommissioning liabilities related to mines is determined based on the estimates of future decommissioning costs prepared by independent experts, taking into account the discount rate and the balance of the MDF that is recognized under separate regulations. In relation to hard coal mines, a corresponding amount is recognized in accordance with IAS 16 as part of the cost of the relevant item of the mine's property, plant and equipment, and any changes in estimates are recognized in accordance with IFRIC 1 as adjustments to the balance of the provision and the capitalized future decommissioning costs.

- *provision for costs of repair of mining damages*

The provision is recognized on the basis of the reported and documented claims for repair of damages. The Group is not aware of any method that would enable it to reliably estimate the amount of mining damages that may arise in the future as a result of current mining activities.

- *provision for dismantling and removing property, plant and equipment*

The provision is recognized in accordance with the principles set out in IAS 16, IAS 37 and IFRIC 1.

- *provision for obligation to surrender energy certificates*

A provision for the obligation to surrender renewable energy certificates for cancellation is recognized as follows:

- in the portion covered by the certificates held at the balance sheet date – at the cost of certificates held,
- in the portion not covered by certificates held at the balance sheet date – at the market value of the certificates required to fulfill the obligation at the balance sheet date.

The provision is charged to operating expenses.

- *provision for gas emission obligations*

A provision for obligations relating to the emission of gases covered by the emission allowances scheme is only recognized when the actual emission shows a deficit of emission allowances with regard to allowances granted for the entire trading period.

The provision is recognized under operating expenses using the net liabilities method at the following amounts:

- in the portion covered by the allowances held at the balance sheet date – at the cost of allowances held i.e. if purchased, at carrying amount and if received, at zero value;
- in the portion not covered by the allowances held at the balance sheet date – at the lower of the market value of the allowances required to fulfill the obligation at the balance sheet date and the potential penalty.

- *Provision for use of real estate under power generation facilities without contract*

The Group companies recognize provisions for all claims reported by the owners of real estate on which distribution systems and heat installations are located, at the amount of probable costs of damages due to owners until the balance sheet date. The companies do not recognize provisions for unreported potential claims from owners of land with an unregulated status.

- *other provisions are presented by the Group at the reliably estimated present value of future obligations.*

11.21. Share-based payment transactions

A share-based payment is a transfer of the entity's equity instruments or their equivalents made by the entity or its shareholders to third parties (including employees) in return for goods or services provided to the entity by such parties unless the transfer is made for other purpose than payment of consideration for the goods and services provided to the entity.

The Group recognizes the goods or services received or acquired as part of an equity-settled share-based payment transaction and the corresponding increase in equity at the date of receipt of those goods or services. The goods or services received or acquired as part of a share-based payment transaction that do not qualify for recognition as an asset are expensed by the entity.

The Group measures the value of the goods or services received and the corresponding increase in equity at the fair value of the goods or services received unless their fair value cannot be measured reliably. Where the Group is unable to measure the fair value of the goods or services received reliably, then it determines the value of the goods or services received and the corresponding increase in equity indirectly by reference to the fair value of the equity instruments granted.

The cost of share-based payments to employees is recognized over the period from the grant date to the vesting date. The cost is measured by reference to the fair value at the date at which equity instruments are granted. Due to the fact that typically it is not possible to directly estimate the fair value of the employee services received, the entity is required to measure the fair value of the equity instruments granted. Market based performance features should be included in the grant-date fair value measurement. Non-market based performance features are not taken into account in the measurement of the fair value at the grant date. The initial cost is measured based on the estimated number of shares that will eventually vest, taking into account the probability of occurrence of other than market conditions. This cost is subsequently adjusted over the vesting period if the actual results differ from those expected.

Share-based payments resulting from the employees' right to acquire shares free of charge under the Act of 30 August 1996 on commercialization and privatization of state enterprises were recognized in accordance with the above policy over the period from the date of commercialization and incorporation of a given subsidiary to the date of allocation of shares. Employee share option schemes in the TAURON Group were completed in 2009.

11.22. Appropriation of profit for employee purposes and special funds

Appropriations of profit for the purpose of increasing the Social Fund or for payment of profit-based bonuses to employees are classified under operating expenses of the year to which such profit appropriation relates.

11.23. Loans and borrowings, including debt securities

All loans and borrowings, including debt securities, are initially recognized at the fair value net of transaction costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are measured at amortized cost using the effective interest rate method.

Amortized cost is calculated by taking into account any transaction costs, and any discount or premium on settlement.

Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the settlement using the effective interest rate.

11.24. Trade and other financial payables

Current trade payables are carried at the amount due and payable. Other payables include wages and salaries, which are measured at the amount due and payable.

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Financial liabilities may be designated at initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different basis, or (ii) the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy, or (iii) the financial liability contains an embedded derivative that would need to be separately recorded.

Financial liabilities at fair value through profit or loss are measured at fair value, reflecting their market value at the balance sheet date, less directly attributable sale transaction costs. Gains or losses on these liabilities are recognized in profit or loss as finance income or cost.

Financial liabilities other than financial instruments at fair value through profit or loss are measured at amortized cost using the effective interest rate method.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing debt instrument 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 recognized in profit or loss.

11.25. Other non-financial liabilities

Other non-financial liabilities include in particular VAT payables, other payables to the state budget (except for CIT payables which are recognized as a separate item in the statement of financial position), the excess of Social Fund liabilities over Social Fund assets and liabilities resulting from advance payments received that are to be settled by delivery of goods, services or fixed assets. Other non-financial liabilities are recognized at the amount payable.

11.26. Social Fund

The Social Fund Act dated 4 March 1994 (with subsequent amendments) requires enterprises that have more than 20 employees (counted on a full time basis) to establish and run a Social Fund ("the Fund"). The Group companies operate such Funds and make periodic contributions to the Fund. The Fund's purpose is to subsidize social activities of the Group, to grant loans to its employees and to incur other social expenses.

Since social assets are not controlled by the Group companies, they have been set off against Social Fund liabilities.

11.27. Gas emission allowances

Gas emission allowances received under the National Allocation Plan are presented at nominal value equal to zero. Additional allowances purchased on the market and designated for the Group's internal purposes are measured at cost less impairment losses with an account taken of their residual value and are presented under other intangible assets. Emission allowances acquired for trading purposes are presented under inventories.

A provision for obligations arising from gas emission is only recognized when the actual emission shows a deficit of emission allowances within the entire trading period.

Purchased Certified Emission Reductions (CERs), in the number allowed by law for cancellation during a given trading period, are cancelled in the first turn. Provision for liabilities is recognized with respect to CERs purchased for cancellation in a given trading period.

11.28. Leases

Group as lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss.

Capitalized leased assets are depreciated on a consistent basis with assets owned by the entity. Where it is not sufficiently certain that the lessee will acquire ownership of the asset before the lapse of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease and subsequent lease payments are recognized as an expense on a straight-line basis over the lease term.

11.29. Taxes

Current income tax

Income tax presented in profit or loss comprises the actual tax expense for the given reporting period as determined by the Group entities in accordance with the provisions of the Corporate Income Tax Act, any corrections of tax settlements for prior years as well as a movement in the balance of the deferred tax asset and deferred tax liability that is not settled against equity.

Deferred income tax

An entity recognizes deferred tax assets and deferred tax liabilities on all temporary differences between the carrying amounts of assets and liabilities and their tax bases and the tax loss available for utilization in the future.

A deferred tax liability is recognized for all taxable temporary differences unless the deferred tax liability arises from:

- the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and
- taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

A deferred tax asset is recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized, except for:

- cases in which the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and
- deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, for which deferred tax assets are only recognized to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable profit will be available that will allow the deferred tax asset to be recovered.

Deferred tax assets are determined at the amount that is expected to be deducted from the income tax in the future as a result of deductible temporary differences leading to a future decrease in taxable profit and tax loss available for utilization, taking into account the prudence principle. Deferred tax assets are only recognized if they are probable of realization.

A deferred tax liability is recognized at the amount of the income tax amount that will be payable in the future as a result of taxable temporary differences i.e. differences which will cause an increase in taxable profit in the future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

Deferred income tax assets and deferred income tax liabilities are offset, if legally enforceable right exists to set off current income tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Deferred income tax assets and deferred income tax liabilities of the companies comprising the Tax Capital Group are offset due to the fact that, beginning from 1 January 2012, these companies submit a consolidated tax return.

Value added tax

Revenues, expenses, assets and liabilities are recognized net of the amount of value added tax except:

- where the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case value added tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable, and
- receivables and payables, which are stated with the amount of value added tax included.

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

11.30. Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenues are recognized at the fair value of the consideration received or receivable, net of Value Added Tax, excise and other sales taxes or charges as well as rebates and discounts. The following specific recognition criteria must also be met before revenue is recognized.

Revenue from sale of goods for resale, finished goods and materials

Revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue and costs incurred can be reliably measured.

Revenue includes amounts due for finished goods, goods for resale and materials sold by the Group as well as other services relating to principal activities of the Group, determined on the basis of the net price, net of rebates and discounts granted by the Group and net of excise.

Revenue from sale of electricity also includes the amount of compensation for stranded costs. Revenue from compensations is recognized in line with compensation rights earned until the end of the period covered by the compensation scheme. Each time revenue is recognized the Group determines an index of the estimated stranded costs to the sum total of yearly advances received, returned and expected

(including the yearly advances received to date). The amount of revenue for a given financial year is the product of multiplying the index and the amounts of the yearly advances received to date, adjusted for annual adjustments and decreased by the amount of compensation revenue recognized in previous years.

Revenue from the rendering of services

Revenue from uncompleted long-term services in the period from the date of entering into the contract to the balance sheet date, after deduction of revenues recognized in profit or loss in previous reporting periods, is recognized in proportion to the stage of completion of such services if it can be reliably estimated. Depending on the type of transaction, the stage of completion can be measured using the following methods:

- surveys of work performed,
- determining the proportion of the contract work completed at a given date in relation to total work to be performed under the contract or
- percentage of costs incurred to date in relation to the total estimated costs necessary to complete the contract. Costs incurred to date include only those expenses that relate to the services completed until that date. Total estimated costs of the transaction include only expenses relating to services already completed or services to be completed.

When the outcome of the contract cannot be estimated reliably, then the revenue derived from the contract is recognized only to the extent of costs incurred that the entity expects to recover.

Revenue from the rendering of services also includes revenue from distribution activities and revenue from settlement of connection fees.

Revenue from illegal energy consumption (electricity or heat) is recognized as part of the principal operating activities of the Group.

Government grants

Government grants are recognized at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

When the grant relates to an expense item, income is recognized over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, its fair value is credited to a deferred income account and is released systematically to profit or loss over the estimated useful life of the relevant asset.

11.31. Costs

Cost of sales

Cost of sales includes:

- cost of production incurred during the given reporting period, adjusted for the movement in the stocks of products (finished goods, semi-finished goods and work-in-progress) and for the cost of goods produced for internal purposes,
- cost of goods for resale and materials sold at acquisition cost,
- impairment write-downs recognized against property, plant and equipment, intangible assets and receivables, and
- total selling expenses and administrative expenses incurred during the reporting period (recognized as profit or loss).

Costs of production which are directly attributable to income earned by an enterprise are recognized in profit or loss for the reporting period in which income is earned.

Costs of production which are only indirectly attributable to income or other benefits earned by an enterprise are recognized in the profit or loss of the enterprise to the extent they relate to the given reporting period, so as to match them to the related income or other economic benefits, taking into account the principles of valuation of property, plant and equipment and inventories.

11.32. Other operating income and expenses

Other operating income and expenses include in particular items resulting from:

- disposal of property, plant and equipment and intangible assets,
- recognition and reversal of provisions, except for provisions related to financial operations or recognized in operating expenses,
- donation or a free-of-charge receipt, including by way of donation of assets, and including cash and cash equivalents, and
- compensation, penalties and fines and other expenses unrelated to ordinary activities.

11.33. Finance income and finance costs

Finance income and finance costs include in particular items resulting from:

- disposal of financial assets,
- re-measurement of the value of financial instruments, excluding financial assets available for sale, for which the effects of revaluation are recognized under revaluation reserve,
- participation in the profits of other entities,
- interest,
- interest expense relating to the measurement of employee benefits in accordance with IAS 19,
- movements in the amount of the provision due to the approach of the date on which costs will be incurred (the effect of unwinding of the discount),
- exchange differences resulting from operations performed during the reporting period and balance sheet valuations of assets and liabilities at the end of the reporting period, except for exchange differences recognized in the initial cost of the item of property, plant and equipment, to the extent they are regarded as an adjustment to interest expense, and exchange differences resulting from the measurement of non-monetary items classified as available-for-sale, and
- other items related to financial activities.

The Group entities offset foreign exchange gains and losses if they arise from similar transactions. If the exchange differences are significant and do not arise from similar transactions, then the entity considers whether or not to present them separately.

Interest income and interest expense is recognized as interest accrues to the net carrying amount of the financial instrument using the effective interest rate method, taking into account the materiality concept.

Dividends are recognized when the shareholders' rights to receive the payment are established.

11.34. Earnings per share

Earnings per share for each reporting period is calculated as quotient of the net profit for the given accounting period attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding in that period.

11.35. Statement of cash flows

Statement of cash flows is prepared using the indirect method.

12. Segment information

The Group presents segment information for the current and comparative reporting periods in accordance with IFRS 8 *Operating segments*.

The Group is organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The Group's reporting format during the period from 1 January 2011 to 31 December 2011 and in the comparable period was based on the following operating segments:

- Mining Segment, which includes hard coal mining. The entity which operates in the Mining Segment of the TAURON Group is Południowy Koncern Węglowy S.A.,
- Generation Segment, which includes generation of electricity using conventional sources, including combined heat and power generation, as well as generation of electricity using joint combustion of biomass and other energy acquired thermally. The main types of fuel used by the Generation Segment are hard coal, biomass, coke-oven gas and blast-furnace gas. The following entities operate in the Generation Segment of the TAURON Group: TAURON Wytwarzanie S.A., Elektrociepłownia Tychy S.A. and Elektrociepłownia EC Nowa Sp. z o.o.,
- Renewable Sources of Energy Segment, which includes generation of electricity using renewable sources, excluding generation of electricity using joint combustion of biomass, which, due to the specific nature of such generation, has been included in the Generation Segment. Entities which operate in the Renewable Sources of Energy Segment of the TAURON Group are TAURON Ekoenergia Sp. z o.o., the two companies acquired in 2010: BELS INVESTMENT Sp. z o.o. and MEGAWAT MARSZEWO Sp. z o.o. as well as two companies acquired in 2011 Lipniki Sp. z o.o. and Vattenfall Wolin-North Sp. z o.o.,

TAURON Sprzedaż Sp. z o.o. also operated in this segment until 30 September 2010. On that date an organized part of the enterprise related to the generation of electricity using renewable sources – hydroelectric plants was separated out of TAURON Sprzedaż Sp. z o.o. and taken over by TAURON Ekoenergia Sp. z o.o.,

- Segment of Sale of Energy and Other Energy Market Products, which includes wholesale trading in electricity, trading in emission allowances and energy certificates and sale of electricity to domestic end users or entities which further resell electricity. Entities

which operate in that segment of the TAURON Group are TAURON Polska Energia S.A., Polska Energia Pierwsza Kompania Handlowa Sp. z o.o., TAURON Sprzedaż Sp. z o.o., TAURON Obsługa Klienta Sp. z o.o., TAURON Czech Energy s.r.o. and Vattenfall Sales Poland Sp. z o.o. under control since December 2011,

- Distribution Segment, including operations of TAURON Dystrybucja S.A. and, since 13 December 2011, Górnośląski Zakład Elektroenergetyczny S.A., Vattenfall Distribution Poland S.A. and Vattenfall Network Services Sp. z o.o.

In addition to the main business segments listed above, the TAURON Group also conducts operations in other areas, including heat distribution and sales (TAURON Ciepło S.A.), quarrying of stone (including limestone) for the power industry, metallurgy, construction and highway engineering industry as well as in the area of production of sorbents for use in wet desulfurization installations and fluidized bed combustors (Kopalnia Wapienia Czatkowice Sp. z o.o.). In addition, apart from the main business segments, the Group also conducts operations in the area of customer service as well as financial and accounting services for the companies acquired as part of the purchase of Górnośląski Zakład Elektroenergetyczny S.A. (Vattenfall Business Services Poland Sp. z o.o.).

As of 3 January 2011 EnergiaPro Gigawat Sp. z o.o. changed its name to TAURON Obsługa Klienta Sp. z o.o. based in Wrocław, with customer service as its principal activity and ENION Energia Sp. z o.o. changed its name to TAURON Sprzedaż Sp. z o.o. based in Cracow, whose principal activity is sale of electricity.

The Group settles transactions between segments as if they were made between unrelated parties, using current market prices.

Revenue from transactions between segments is eliminated on consolidation.

Segment assets do not include deferred tax, income tax receivable or financial assets, except for trade receivables and other financial receivables as well as cash and cash equivalents, which represent segment assets.

Segment liabilities do not include deferred tax, income tax payable or financial liabilities, except for trade payables, commitments resulting from the purchase of fixed and intangible assets and payroll creditors, which represent segment liabilities.

Capital expenditure relates to purchases of property, plant and equipment, intangible assets and investment property.

None of the Group's operating segments has been combined with another segment to create the above-mentioned reporting segments.

The Management Board separately monitors the operating results of the segments to take decisions on how to allocate the resources, to evaluate the effects of the allocation and to evaluate performance. Evaluation of performance is based on operating profit or loss, which to a certain extent, as explained in the table below, are measured differently from the operating profit or loss in the consolidated financial statements and EBITDA. The Group's financing (including finance costs and income) and income tax are monitored at the level of the Group and they are not allocated to segments.

The Group additionally presents its operations by geographical areas, which do not, however, represent operating segments of the Group.

12.1. Operating segments

The following tables present revenue and profit information and certain asset and liability information regarding the Group's operating segments for the years ended 31 December 2011 and 31 December 2010.

Year ended 31 December 2011	Coal mining	Generation of electricity and heat using conventional sources	Generation of electricity using renewable sources	Electricity distribution	Sales of electricity and other energy market products	Other	Unallocated items	Total	Eliminations	Total operations
Revenue										
Sales to external customers	533 548	5 734 461	2 438	1 465 151	12 459 208	560 416	–	20 755 222	–	20 755 222
Inter-segment sales	637 665	701 390	178 236	3 203 086	1 382 537	33 746	–	6 136 660	(6 136 660)	–
Segment revenue	1 171 213	6 435 851	180 674	4 668 237	13 841 745	594 162	–	26 891 882	(6 136 660)	20 755 222
Profit/(loss) of the segment	4 805	621 061	100 578	614 205	278 835	71 692	(4 720)	1 686 456	–	1 686 456
Unallocated expenses	–	–	–	–	–	–	(74 967)	(74 967)	–	(74 967)
Profit/(loss) from continuing operations before tax and net finance income (costs)	4 805	621 061	100 578	614 205	278 835	71 692	(79 687)	1 611 489	–	1 611 489
Share in profit/(loss) of associate and joint venture recognised using the equity method	–	(1 046)	–	–	–	–	–	(1 046)	–	(1 046)
Net finance income (costs)	–	–	–	–	–	–	(44 507)	(44 507)	–	(44 507)
Profit/(loss) before income tax	4 805	620 015	100 578	614 205	278 835	71 692	(124 194)	1 565 936	–	1 565 936
Income tax expense	–	–	–	–	–	–	(326 576)	(326 576)	–	(326 576)
Net profit/(loss) for the period	4 805	620 015	100 578	614 205	278 835	71 692	(450 770)	1 239 360	–	1 239 360
EBITDA	104 645	1 187 034	125 992	1 279 816	288 654	116 582	(79 687)	3 023 036	–	3 023 036
Assets and liabilities										
Segment assets	1 143 534	10 345 172	977 464	11 922 893	2 723 352	886 469	–	27 998 884	–	27 998 884
Investments in associates and joint ventures recognised using the equity method	–	22 717	–	–	–	–	–	22 717	–	22 717
Unallocated assets	–	–	–	–	–	–	391 930	391 930	–	391 930
Total assets	1 143 534	10 367 889	977 464	11 922 893	2 723 352	886 469	391 930	28 413 531	–	28 413 531
Segment liabilities	484 548	1 658 708	46 701	2 204 346	1 687 380	148 200	–	6 229 883	–	6 229 883
Unallocated liabilities	–	–	–	–	–	–	6 044 580	6 044 580	–	6 044 580
Total liabilities	484 548	1 658 708	46 701	2 204 346	1 687 380	148 200	6 044 580	12 274 463	–	12 274 463
Other segment information										
Capital expenditure*	177 617	921 455	44 030	1 284 707	30 213	45 701	–	2 503 723	–	2 503 723
Depreciation/amortization	(99 840)	(565 973)	(25 414)	(665 611)	(9 819)	(44 890)	–	(1 411 547)	–	(1 411 547)

* Capital expenditure includes expenditures for property, plant and equipment and intangible assets, excluding acquisition of greenhouse gas emission allowances and energy certificates.

Year ended 31 December 2010	Coal mining	Generation of electricity and heat using conventional sources	Generation of electricity using renewable sources	Electricity distribution	Sales of electricity and other energy market products	Other	Unallocated items	Total	Eliminations	Total operations
Revenue										
Sales to external customers	471 336	1 864 139	38 857	1 167 288	11 317 542	569 717	–	15 428 879	–	15 428 879
Inter-segment sales	610 062	3 999 069	128 345	3 341 745	776 300	28 246	–	8 883 767	(8 883 767)	–
Segment revenue	1 081 398	5 863 208	167 202	4 509 033	12 093 842	597 963	–	24 312 646	(8 883 767)	15 428 879
Profit/(loss) of the segment	5 908	656 169	89 407	509 281	183 934	35 445	9 341	1 489 485	–	1 489 485
Unallocated expenses	–	–	–	–	–	–	(90 226)	(90 226)	–	(90 226)
Profit/(loss) from continuing operations before tax and net finance income (costs)	5 908	656 169	89 407	509 281	183 934	35 445	(80 885)	1 399 259	–	1 399 259
Share in profit/(loss) of associate and joint venture recognised using the equity method	–	(236)	–	–	–	–	–	(236)	–	(236)
Net finance income (costs)	–	–	–	–	–	–	(141 709)	(141 709)	–	(141 709)
Profit/(loss) before income tax	5 908	655 933	89 407	509 281	183 934	35 445	(222 594)	1 257 314	–	1 257 314
Income tax expense	–	–	–	–	–	–	(265 931)	(265 931)	–	(265 931)
Net profit/(loss) for the period	5 908	655 933	89 407	509 281	183 934	35 445	(488 525)	991 383	–	991 383
EBITDA	1 110 614	1 197 947	114 945	1 137 804	192 029	86 032	(80 885)	2 758 486	–	2 758 486
Assets and liabilities										
Segment assets	1 200 022	9 749 717	727 065	7 720 068	2 755 409	841 196	–	22 993 477	–	22 993 477
Investments in associates and joint ventures recognised using the equity method	–	764	–	–	–	–	–	764	–	764
Unallocated assets	–	–	–	–	–	–	436 043	436 043	–	436 043
Total assets	1 200 022	9 750 481	727 065	7 720 068	2 755 409	841 196	436 043	23 430 284	–	23 430 284
Segment liabilities	496 260	1 394 426	24 411	1 908 521	1 399 603	121 255	–	5 344 476	–	5 344 476
Unallocated liabilities	–	–	–	–	–	–	2 873 737	2 873 737	–	2 873 737
Total liabilities	496 260	1 394 426	24 411	1 908 521	1 399 603	121 255	2 873 737	8 218 213	–	8 218 213
Other segment information										
Capital expenditure*	144 419	384 188	146 857	867 124	22 116	38 394	–	1 603 098	–	1 603 098
Depreciation/amortization	(104 706)	(541 778)	(25 538)	(628 523)	(8 095)	(50 587)	–	(1 359 227)	–	(1 359 227)

* Capital expenditure includes expenditures for property, plant and equipment and intangible assets, excluding acquisition of greenhouse gas emission allowances and energy certificates.

Up to the third quarter of 2010 (inclusive) the value of energy certificates used for internal purposes that were obtained due to the generation of electricity using TAURON Sprzedaż Sp. z o.o.'s hydroelectric plants was included in the revenues of the "Sales of electricity and other energy market products" segment. The value of those certificates in the end of 2010 was PLN 54,212 thousand. Since 30 September 2010, which was the date of the separation of an organized part of the enterprise related to the generation of electricity using renewable energy sources out of TAURON Sprzedaż Sp. z o.o. and the take-over of those assets by TAURON Ekoenergia Sp. z o.o., energy certificates have been included in the revenues of the "Generation of electricity using renewable sources" segment.

In the first quarter of 2011, the parent company decided to change the method of unallocated expenses analysis and to include administrative expenses of the parent in this item, after elimination of costs resulting from intercompany transactions. Administrative expenses of the parent company are incurred for the whole Group and are not directly attributable to any single operating segment.

The change in the method of analyzing unallocated expenses affected the presentation of the note relating to operating segments. In prior periods, administrative expenses of the parent were presented in the "Sales of electricity and other energy market products" segment. The note for the comparable period has been restated according to the amended principles of presentation of unallocated expenses as a result of the change in the method of analyzing segments by the Group.

12.2. Geographical areas

The majority of the Group's operations are conducted on the territory of Poland. Sales to overseas clients during the years ended 31 December 2011 and 31 December 2010 amounted to PLN 665,279 thousand and PLN 228,867 thousand, respectively.

13. Revenues and expenses

13.1. Sales revenue

	Year ended 31 December 2011	Year ended 31 December 2010
Revenue from sale of goods for resale, finished goods and materials, of which:	15 888 724	10 690 314
Electricity	13 553 113	8 472 903
Heat energy	594 071	628 955
Property rights arising from energy certificates	249 226	296 227
Greenhouse gas emission allowances	258 032	119 350
Compensation for termination of PPAs	414 795	437 875
Coal	501 581	443 365
Furnace blast	149 711	139 625
Compressed air	70 406	66 646
Grit	29 382	20 337
Milling products	27 899	26 327
Stone	10 256	9 420
Scrap	12 762	9 802
Other goods for resale, finished goods and materials	17 490	19 482
Rendering of services, of which:	4 825 806	4 698 111
Distribution and trade services	4 473 534	4 408 443
Connection fees	148 140	121 811
Maintenance of road lighting	76 240	68 864
IT and data processing services	29 078	17 455
Charges for illegal electricity consumption	10 451	9 357
Other services	88 363	72 181
Other revenue, of which:	40 692	40 454
Rental income	40 692	40 454
Total sales revenue	20 755 222	15 428 879

The increase in sales of electricity in the year ended 31 December 2011 compared with the comparative period is mainly due to the amended Energy Law which came into force on 9 August 2010 and imposed an obligation on electricity generators to sell electricity to the public. As a result of the above, the companies from the segment of generation of electricity from conventional sources sold through the power exchange and energy trading platforms about 92% of the total volume of electricity sold by them. Prior to the aforementioned amendment, sales of electricity by the companies from the segment of generation of electricity using conventional sources were eliminated in the consolidation of financial statements due to the fact that almost all of the electricity generated was sold to Group companies.

13.2. Other operating income

	Year ended 31 December 2011	Year ended 31 December 2010
Penalties, fines, compensations received or receivable	30 840	53 308
Reversal of provisions	26 894	1 018
Subsidies/grants	11 032	9 350
Reduced estimates of provisions for existing pensioners	8 537	2 920
Reversal of impairment losses recognised for other assets	3 692	1 782
Surplus inventories	3 543	3 302
Tax refunds (other than CIT)	3 515	21
Court proceedings costs, litigation and enforcement costs received or receivable	2 110	2 221
Income from perpetual usufruct received free of charge	1 599	9 837
Preferential loans valuation	1 526	1 526
Sale/recovery of scrap metal	1 497	1 127
Statute-barred/forgiven liabilities	534	168
Equivalent of depreciation charges on fixed assets received free of charge	65	5 299
Other	10 778	13 307
Total other operating income	106 162	105 186

Other operating income arising from the reversal of provisions in the year ended 31 December 2011 mainly includes the reversal of part of the provision for real estate tax amounting to PLN 11,441 thousand by Południowy Koncern Węglowy S.A. and the reversal of part of the provision amounting to PLN 4,274 thousand, recognized by TAURON Dystrybucja S.A. due to the proceedings before the Competition and Consumers Protection Office, as discussed in Note 32.2.

13.3. Other operating expenses

	Year ended 31 December 2011	Year ended 31 December 2010
Recognition of provisions	(28 501)	(25 593)
Increase in provisions for existing pensioners	(19 900)	(18 229)
Loss on the disposal of property, plant and equipment/intangible assets	(15 387)	(12 841)
Costs of electrical and other damages to non-current assets	(13 140)	(46 206)
Social activity costs	(7 876)	(7 189)
Court fees, litigation and enforcement costs	(5 270)	(3 948)
Penalties, fines, compensations	(2 388)	(2 529)
Recognition of impairment losses against other assets	(4 313)	(363)
Delegated employees	(3 757)	(3 973)
Donations	(2 296)	(6 962)
Membership fees	(2 040)	(1 362)
Write-off for abandoned investments and production as well as liquidated materials	(1 015)	(1 404)
Electricity equivalents paid under special rates and charges to former employees	(192)	(4 662)
Other	(10 968)	(8 857)
Total other operating expenses	(117 043)	(144 118)

Other operating expenses arising from the recognition of provisions mainly includes the recognition by TAURON Dystrybucja S.A. of provisions for the use of real estate without contract, amounting to PLN 13,047 thousand, and provisions for court disputes amounting to PLN 5,425 thousand. In addition, Południowy Koncern Węglowy S.A. recognized a provision for costs of repair of mining damages in the amount of PLN 3,227 thousand.

13.4. Finance income

	Year ended 31 December 2011	Year ended 31 December 2010
Income from financial instruments, of which:	109 006	91 275
Interest income	91 776	76 718
Dividends	8 203	4 804
Reversal of write-downs for financial assets	7 315	8 994
Revaluation of financial assets	1 712	759
Other finance income, of which:	6 761	1 009
Reversal of interest write-downs	5 645	295
Interest on amounts due from the state budget	76	16
Other	1 040	698
Total finance income	115 767	92 284

The increase in interest income in the year ended 31 December 2011 compared with the comparative period results from the implementation of the central financing model in the Group in the fourth quarter of 2010.

13.5. Finance costs

	Year ended 31 December 2011	Year ended 31 December 2010
Financial instrument costs, of which:	(85 983)	(161 665)
Interest costs	(63 933)	(114 406)
Recognition of impairment losses	(7 710)	(9 615)
Revaluation of financial assets	(342)	(5 964)
Foreign exchange losses	(5 168)	(830)
Commission relating to borrowings and debt securities	(6 205)	(30 751)
Loss on disposal of investments	(2 625)	(99)
Other finance costs, of which:	(74 291)	(72 328)
Interest on employee benefits	(68 348)	(66 619)
Interest on amounts due to the state budget	(903)	(472)
Other finance costs	(5 040)	(5 237)
Total finance costs	(160 274)	(233 993)

The decrease in interest costs in the year ended 31 December 2011 compared with the comparative period results from the implementation of the central financing model in the Group in the fourth quarter of 2010.

13.6. Costs by type

	Year ended 31 December 2011	Year ended 31 December 2010
Costs by type		
Depreciation of property, plant and equipment and amortization of intangible assets	(1 411 547)	(1 359 227)
Impairment of property, plant and equipment and intangible assets	(71 519)	(7 697)
Materials and energy	(2 873 756)	(2 660 228)
Maintenance and repair services	(210 396)	(226 124)
Distribution services	(1 316 462)	(1 291 731)
Other external services	(706 256)	(653 355)
Taxes and charges	(594 243)	(544 181)
Employee benefits expense	(2 552 727)	(2 592 938)
Inventory write-downs	(946)	(1 526)
Allowance for doubtful debts	(35 561)	(13 049)
Other	(120 264)	(116 692)
Total costs by type	(9 893 677)	(9 466 748)
Change in inventories, prepayments, accruals and deferred income	(4 925)	(13 143)
Cost of goods produced for internal purposes	409 152	298 544
Selling and distribution expenses	283 684	231 252
Administrative expenses	664 350	670 308
Cost of goods for resale and materials sold	(9 643 402)	(4 809 341)
Cost of sales	(18 184 818)	(13 089 128)

The increase of the cost of sales in the year ended 31 December 2011 in relation to the comparative period is mainly due to the amended Energy Law which came into force on 9 August 2010 and imposed an obligation on electricity generators to sell electricity to the public, as described in Note 13.1.

13.7. Depreciation/amortization expense and impairment recognized in the statement of comprehensive income

	Year ended 31 December 2011	Year ended 31 December 2010
Items included in cost of sales:	(1 424 037)	(1 320 807)
Depreciation of property, plant and equipment	(1 333 091)	(1 292 934)
Impairment of property, plant and equipment	34 086	(7 450)
Amortization of intangible assets	(18 774)	(20 403)
Impairment of intangible assets	(106 258)	(20)
Items included in selling and distribution expenses:	(4 070)	(4 950)
Depreciation of property, plant and equipment	(3 037)	(3 758)
Amortization of intangible assets	(1 033)	(1 192)
Items included in administrative expenses:	(42 869)	(36 163)
Depreciation of property, plant and equipment	(27 627)	(25 010)
Impairment of property, plant and equipment	653	(255)
Amortization of intangible assets	(15 895)	(10 898)
Items included in cost of goods produced for internal purposes:	(12 090)	(5 032)
Depreciation of property, plant and equipment	(10 730)	(4 052)
Amortization of intangible assets	(1 360)	(980)
Items included in other operating expenses and income:	–	590
Impairment of property, plant and equipment	–	590
Total depreciation/amortization expense and impairment	(1 483 066)	(1 366 362)

13.8. Employee benefits expenses

	Year ended 31 December 2011	Year ended 31 December 2010
Wages and salaries	(1 867 258)	(1 853 839)
Social security costs	(339 433)	(340 820)
Jubilee bonuses	(16 521)	(61 558)
Social Fund	(72 181)	(74 858)
Post-employment benefits expenses, of which:	(92 577)	(89 898)
Provision for retirement, disability and similar benefits	(10 660)	(10 566)
Coal allowances and special electricity rates and charges	(14 398)	(12 942)
Social Fund	(2 594)	(2 528)
Contributions to employee retirement plans	(64 925)	(63 862)
Voluntary termination benefits	(82 473)	(86 217)
Other employee benefits expenses	(82 284)	(85 748)
Employee benefits expenses, of which:	(2 552 727)	(2 592 938)
Items included in cost of sales	(1 749 005)	(1 805 466)
Items included in selling and distribution expenses	(140 240)	(119 768)
Movement in stocks of finished goods	(140 800)	(174 444)
Items included in administrative expenses	(378 207)	(392 310)
Items included in cost of goods produced for internal purposes	(144 475)	(100 950)

14. Income tax

14.1. Tax expense

Major components of income tax expense for the years ended 31 December 2011 and 31 December 2010 are as follows:

	Year ended 31 December 2011	Year ended 31 December 2010
Current income tax	(210 343)	(210 807)
Current income tax expense	(206 181)	(209 188)
Adjustments to current income tax from previous years	(4 162)	(1 619)
Deferred tax	(116 233)	(55 124)
Income tax expense in profit/(loss)	(326 576)	(265 931)
Income tax expense relating to other comprehensive income	–	(211)

14.2. Reconciliation of the effective income tax rate

A reconciliation of income tax expense applicable to accounting profit before tax at the statutory income tax rate to income tax expense at the Group's effective income tax rate for the years ended 31 December 2011 and 31 December 2010 is as follows:

	Year ended 31 December 2011	Year ended 31 December 2010
Profit/(loss) before tax from continued operations	1 565 936	1 257 314
Profit/(loss) before taxation	1 565 936	1 257 314
Tax at Poland's statutory tax rate of 19%	(297 528)	(238 890)
Adjustments to income tax from previous years	(4 162)	(1 619)
Tax non-deductible costs, of which:	(30 936)	(25 111)
Recognition of non-deductible provisions and write-downs/allowances	(7 044)	(3 082)
National Disabled Persons Rehabilitation Fund (PFRON)	(4 283)	(3 652)
Permanent differences on costs related to tangible assets	(4 081)	(3 238)
Other	(15 528)	(15 139)
Income not included in taxable profit, of which:	11 971	6 566
Dividends	1 550	878
Reversal of non-deductible provisions and write-downs/allowances	1 848	790
Other	8 573	4 898
Changes in deferred tax estimates	(818)	(7 194)
Other	(5 103)	317
Tax at the effective rate of 20.9% (2010 – 21.2%)	(326 576)	(265 931)
Income tax (expense) in profit/(loss)	(326 576)	(265 931)

14.3. Deferred income tax

Deferred income tax relates to the following:

	As at 31 December 2011	As at 31 December 2010	Movement in the year ended 31 December 2011	
			resulting from acquisition of subsidiaries	recognized in the statement of comprehensive income
Deferred tax liability				
– investment tax credits	89	102	–	(13)
– difference between tax base and carrying amount of fixed and intangible assets	1 730 720	1 537 110	106 852	86 758
– difference between tax base and carrying amount of assets measured at fair value through profit or loss	1 147	558	1 088	(499)
– difference between tax base and carrying amount of financial assets available for sale	8 025	8 800	2	(777)
– difference between tax base and carrying amount of financial assets held to maturity	120	238	–	(118)
– difference between tax base and carrying amount of loans and receivables	4 222	1 633	1	2 588
– difference between tax base and carrying amount of financial assets excluded from the scope of IAS 39	98	101	–	(3)
– different timing of recognition of sales revenue for tax purposes	108 010	69 601	4 051	34 358
– recognition of estimated revenue from sale of power distribution services	4 912	14 292	1 992	(11 372)
– difference between tax base and carrying amount of property rights arising from energy certificates	63 750	14 085	22 197	27 468
– compensation for termination of long-term contracts	93 859	86 103	–	7 756
– other	29 693	23 792	4 500	1 401
Deferred tax liability	2 044 645	1 756 415	140 683	147 547
Deferred tax assets				
– difference between tax base and carrying amount of fixed and intangible assets	1 770	5 661	–	(3 891)
– difference between tax base and carrying amount of inventories	4 568	1 877	–	2 691
– difference between tax base and carrying amount of other non-financial assets	364	213	–	151
– power infrastructure received free of charge and received connection fees	86 115	88 085	–	(1 970)
– provisions	504 018	437 423	48 555	18 040
– difference between tax base and carrying amount of assets measured at fair value through profit or loss	1 620	1 563	1 084	(1 027)
– difference between tax base and carrying amount of financial assets available for sale	900	990	322	(412)
– difference between tax base and carrying amount of loans and receivables	25 569	3 483	14 070	8 016
– difference between tax base and carrying amount of financial assets excluded from the scope of IAS 39	2 097	2 277	–	(180)
– difference between tax base and carrying amount of financial liabilities measured at fair value through profit or loss	114	–	–	114
– difference between tax base and carrying amount of financial liabilities measured at amortized cost	3 552	935	18	2 599
– difference between tax base and carrying amount of liabilities under guarantees, factoring and excluded from the scope of IAS 39	11	27	–	(16)
– accrued audit expenses and actuary's fees	117	107	30	(20)
– different timing of recognition of cost of sales for tax purposes	70 806	56 914	–	13 892
– other accrued expenses	19 460	5 597	1 270	12 593
– tax losses	6 272	47 340	347	(41 415)
– different timing of recognition of revenue from sales of greenhouse gas emission allowances for tax purposes	61 182	31 920	–	29 262
– other	17 685	18 194	6 604	(7 113)
Deferred tax assets	806 220	702 606	72 300	31 314
After setting off balances at the level of individual Group companies, deferred tax for the Group is presented as:				
Deferred tax asset	31 965	161 806		
Deferred tax liability	(1 270 390)	(1 215 615)		

As at 31 December 2011, deferred tax assets and deferred tax liabilities of the companies comprising the Tax Capital Group as described in detail in Note 14.4 were offset due to the fact that, beginning from 1 January 2012, these companies will submit a consolidated tax return.

Movement in deferred tax liability

	Year ended 31 December 2011	Year ended 31 December 2010
Opening balance as at 1 January	1 756 415	1 642 949
Increases (relating to)	497 194	590 574
in correspondence with profit or loss	356 511	590 574
in correspondence with equity	–	–
acquisition of a subsidiary	140 683	–
Decreases (relating to)	(208 964)	(477 108)
in correspondence with profit or loss	(208 964)	(477 108)
in correspondence with equity	–	–
Closing balance as at 31 December	2 044 645	1 756 415

Movement in deferred tax assets

	Year ended 31 December 2011	Year ended 31 December 2010
Opening balance as at 1 January	702 606	644 475
Increases (relating to)	661 702	443 678
in correspondence with profit or loss	589 402	440 793
in correspondence with equity	–	2 885
acquisition of a subsidiary	72 300	–
Decreases (relating to)	(558 088)	(385 547)
in correspondence with profit or loss	(558 088)	(382 451)
in correspondence with equity	–	(3 096)
Closing balance as at 31 December	806 220	702 606

14.4. Tax Capital Group

On 28 November 2011, the Head of the First Śląski Tax Office in Sosnowiec issued a decision on the registration of a Tax Capital Group for the period of three fiscal years from 1 January 2012 to 31 December 2014.

TAURON Polska Energia S.A., as the Company Representing the Tax Capital Group, is responsible for paying monthly advances in respect of the corporate income tax of the Tax Capital Group, in accordance with the provisions of the Corporate Income Tax Act. The share of each company of the Tax Capital Group in the monthly advance for the corporate income tax is determined based on the percentage share of the tax base reported by the given company in the tax base reported by the Tax Capital Group, excluding the companies reporting tax losses. Where the final amount of a given company's share is lower than the initial amount transferred by that company to the Company Representing the Tax Capital Group, the latter returns the difference to that company immediately. The ultimate share of each company in the corporate income tax of the Tax Capital Group is calculated by the 15th day of the fourth month following the fiscal year, based on the percentage share of the tax base reported by a given company in the tax base reported by the Tax Capital Group.

15. Social assets, Social Fund liabilities and special funds

The tables below present an analysis of the individual funds:

- Social Fund

	As at 31 December 2011	As at 31 December 2010
Loans granted to employees	48 001	47 413
Cash	27 161	27 531
Other Fund assets and liabilities	(129)	(210)
Social Fund liabilities	(72 231)	(72 204)
Net balance	2 802	2 530
Transfers made to the Social Fund during the period	(73 904)	(75 100)

- Mine Decommissioning Fund

In accordance with the provisions of the Geological and Mining Law and the executive regulations issued based on that Act, the mining companies being part of the Group set up a Mine Decommissioning Fund ("MDF"). The MDF is set up as a certain percentage of the value of depreciation of property plant and equipment recognized for tax purposes or by reference to the exploitation fee, by way of a transfer of cash equivalent to such depreciation charges to a separate bank account. The financial assets of the MDF are presented in the statement of financial position as long-term financial assets, whereas the balance of the MDF is recognized as part of the provision for decommissioning liabilities related to mines. The tables below present the amount of the transfer to the MDF, the balance of the MDF assets and the balance of net decommissioning liabilities.

Financial assets of the Mine Decommissioning Fund

	Year ended 31 December 2011	Year ended 31 December 2010
Assets as at 1 January	21 025	20 029
Contributions made	3 037	149
Interest	100	847
Utilization	-	-
Assets as at 31 December	24 162	21 025
Transfers made to the MDF in the period	(2 724)	(2 893)

Financial liabilities of the Mine Decommissioning Fund

	Year ended 31 December 2011	Year ended 31 December 2010
Mine Decommissioning Fund	26 774	23 950
Surplus of discounted estimated decommissioning costs	2 508	2 288
Surplus of Mine Decommissioning Fund over discounted estimated decommissioning costs	(6 240)	(4 578)
Total decommissioning liability	23 042	21 660

16. Property, plant and equipment

Year ended 31 December 2011

	Land	Perpetual usufruct	Buildings, premises and civil engineering structures	Plant and machinery	Motor vehicles	Other	Tangible fixed assets, total	Assets under construction	Property, plant and equipment, total
COST									
Opening balance	61 995	789 048	10 656 165	9 753 514	255 375	257 369	21 773 466	723 919	22 497 385
Adjustments	(3 425)	3 425	-	-	-	-	-	-	-
Opening balance after adjustments	58 570	792 473	10 656 165	9 753 514	255 375	257 369	21 773 466	723 919	22 497 385
Direct purchase	-	-	1	292	163	88	544	2 317 551	2 318 095
Transfer of assets under construction	3 249	750	888 692	672 640	51 550	32 572	1 649 453	(1 649 453)	-
Sale, disposal	30	(5 173)	(10 621)	(2 379)	(4 072)	(2 631)	(24 846)	(10 619)	(35 465)
Reclassifications	-	1	(132)	96 075	-	(95 944)	(95 944)	-	-
Donations and free-of-charge transfers	-	-	-	(228)	(3)	(180)	(411)	-	(411)
Liquidation	(6)	(6)	(35 347)	(142 972)	(1 843)	(3 919)	(184 093)	(139)	(184 232)
Received free of charge	31	1 568	32 942	642	-	-	35 183	-	35 183
Acquisition of subsidiary	2 566	46 321	2 246 171	789 690	33 066	50 221	3 168 035	122 334	3 290 369
Received for use under rental, lease or similar agreements	-	-	-	4 542	1 503	-	6 045	(4 542)	1 503
Contribution in kind	-	-	-	-	-	-	-	-	-
Spare parts allocated to fixed assets	-	-	105	(7 033)	-	(284)	(7 212)	-	(7 212)
Overhaul expenses	-	-	455	5 918	-	-	6 373	95 888	102 261
Write-off of discontinued investments	-	-	-	-	-	-	-	(871)	(871)
Transfers to intangible assets	-	-	-	-	-	-	-	(7 551)	(7 551)
Items discovered	12	-	2 910	48	-	3	2 973	-	2 973
Items generated internally	-	-	-	-	-	-	-	31 602	31 602
Other movements	(27)	(293)	(1 452)	1 017	22	(189)	(922)	9 951	9 029
Foreign exchange differences from translation of foreign entities	-	-	-	8	-	1	9	-	9
Closing balance	64 425	835 641	13 779 889	11 171 774	335 761	237 107	26 424 597	1 628 070	28 052 667
ACCUMULATED DEPRECIATION									
Opening balance	(374)	(1 341)	(2 353 470)	(2 391 976)	(93 111)	(126 277)	(4 966 549)	(5 900)	(4 972 449)
Adjustments	-	-	-	-	-	-	-	-	-
Opening balance after adjustments	(374)	(1 341)	(2 353 470)	(2 391 976)	(93 111)	(126 277)	(4 966 549)	(5 900)	(4 972 449)
Depreciation for the period	-	-	(605 643)	(706 126)	(38 864)	(23 852)	(1 374 485)	-	(1 374 485)
Increase of impairment	(322)	(259)	(632)	(1 127)	(5)	(44)	(2 389)	-	(2 389)
Decrease of impairment	-	147	29 930	6 175	163	306	36 721	407	37 128
Sale, disposal	-	682	9 840	2 381	3 261	1 574	17 789	-	17 789
Reclassifications	51	-	43	(29 305)	-	29 262	-	-	-
Donations and free-of-charge transfers	-	-	-	203	3	127	333	-	333
Liquidation	-	-	14 322	132 342	1 650	3 023	151 337	399	151 736
Contribution in kind	-	-	-	-	-	-	-	-	-
Depreciation posted to assets under construction	-	-	-	-	-	68	68	(68)	-
Other movements	-	-	439	58	8	150	655	66	721
Foreign exchange differences from translation of foreign entities	-	-	-	(4)	-	-	(4)	-	(4)
Closing balance	(645)	(771)	(2 905 171)	(2 987 379)	(126 895)	(115 663)	(6 136 524)	(5 096)	(6 141 620)
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	61 621	787 707	8 302 695	7 361 538	162 264	131 092	16 806 917	718 019	17 524 936
NET CARRYING AMOUNT AT THE END OF THE PERIOD	63 780	834 870	10 874 718	8 184 395	208 866	121 444	20 288 073	1 622 974	21 911 047

Year ended 31 December 2010

	Land	Perpetual usufruct	Buildings, premises and civil engineering structures	Plant and machinery	Motor vehicles	Other	Tangible fixed assets, total	Assets under construction	Property, plant and equipment, total
COST									
Opening balance	57 747	783 111	10 090 384	9 247 487	213 779	221 163	20 613 671	351 397	20 965 068
Direct purchase	-	-	61	1 325	969	415	2 770	1 328 114	1 330 884
Transfer of assets under construction	5 386	2 335	554 644	541 314	42 113	39 024	1 184 816	(1 184 816)	-
Sale, disposal	(897)	(2 032)	(5 473)	(1 083)	(2 076)	(71)	(11 632)	(416)	(12 048)
Reclassifications	-	-	14 245	(14 434)	-	189	-	-	-
Donations and free-of-charge transfers	-	(4 159)	(615)	(52)	(14)	-	(4 840)	-	(4 840)
Liquidation	(248)	(7)	(14 856)	(52 163)	(1 464)	(3 714)	(72 452)	(261)	(72 713)
Received free of charge	3	9 837	18 981	1 579	-	54	30 454	-	30 454
Acquisition of a subsidiary	-	-	-	-	-	-	-	111 352	111 352
Received for use under rental, lease or similar agreements	-	-	-	522	1 410	-	1 932	(522)	1 410
Contribution in kind	-	(362)	(3 464)	(139)	-	(203)	(4 168)	(57)	(4 225)
Spare parts allocated to fixed assets	-	-	(54)	7 667	-	1 291	8 904	3 969	12 873
Overhaul expenses	-	-	1 166	12 781	561	-	14 508	86 022	100 530
Write-off of discontinued investments	-	-	-	-	-	-	-	(1 710)	(1 710)
Transfer to intangible assets	-	-	-	-	-	-	-	(1 576)	(1 576)
Items discovered	-	347	1 812	497	-	66	2 722	-	2 722
Items generated internally	-	-	-	-	-	-	-	32 318	32 318
Other movements	4	(22)	(666)	8 213	97	(845)	6 781	105	6 886
Closing balance	61 995	789 048	10 656 165	9 753 514	255 375	257 369	21 773 466	723 919	22 497 385
ACCUMULATED DEPRECIATION									
Opening balance	(867)	(1 065)	(1 755 603)	(1 774 164)	(64 427)	(97 229)	(3 693 355)	(11 140)	(3 704 495)
Depreciation for the period	-	-	(597 301)	(665 203)	(31 192)	(32 058)	(1 325 754)	-	(1 325 754)
Increase of impairment	-	(297)	(11 755)	(3 638)	(135)	(302)	(16 127)	(333)	(16 460)
Decrease of impairment	493	24	3 180	434	31	51	4 213	5 132	9 345
Sale, disposal	-	25	583	735	1 242	58	2 643	-	2 643
Reclassifications	-	-	(1 878)	1 739	-	(133)	(272)	272	-
Donations and free-of-charge transfers	-	-	318	47	9	-	374	-	374
Liquidation	-	-	8 228	48 064	1 429	2 334	60 055	244	60 299
Contribution in kind	-	-	225	80	-	160	465	-	465
Depreciation posted to assets under construction	-	-	-	-	-	-	-	-	-
Other movements	-	(28)	533	(70)	(68)	842	1 209	(75)	1 134
Closing balance	(374)	(1 341)	(2 353 470)	(2 391 976)	(93 111)	(126 277)	(4 966 549)	(5 900)	(4 972 449)
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	56 880	782 046	8 334 781	7 473 323	149 352	123 934	16 920 316	340 257	17 260 573
NET CARRYING AMOUNT AT THE END OF THE PERIOD	61 621	787 707	8 302 695	7 361 538	162 264	131 092	16 806 917	718 019	17 524 936

The recognition and reversal of impairment losses on property, plant and equipment relate to individually determined fixed assets.

The carrying amount of plant and equipment held under finance lease agreements or hire purchase contracts at 31 December 2011 is PLN 64,178 thousand (31 December 2010: PLN 109,143 thousand). Leased assets and assets under hire purchase contracts are pledged as security for the related finance lease and hire purchase liabilities.

The carrying amount of buildings and structures held under finance lease agreements or hire purchase contracts at 31 December 2011 is PLN 22,266 thousand (31 December 2010: PLN 23,598 thousand). Leased assets and assets under hire purchase contracts are pledged as security for the related finance lease and hire purchase liabilities.

In 2011, the Group capitalized interest of PLN 28,495 thousand in the cost of assets under construction and intangible assets not made available for use.

As at 31 December 2011, taking into account the assumptions prevailing on that date, including those resulting from the effects of the merger of PEC Dąbrowa Górnicza S.A. and PEC Katowice S.A. (currently TAURON Ciepło S.A.), an analysis performed confirmed that the non-current assets of TAURON Ciepło S.A. were not impaired at the balance sheet date, which resulted in the reversal in 2011 of the entire impairment allowance for property, plant and equipment recognized in previous years in the amount of PLN 33.3 million. The Group estimated the amount of the discounted free cash flows for the cash generating unit ("CGU") identified i.e. TAURON Ciepło. The analysis was performed based on a 5-year financial forecast and the following assumptions relating to, among others, the number of CGUs (identified as one CGU for TAURON Ciepło S.A.), level of sales, selling prices, level of costs and the discount ratio in the consecutive years of operations (pre-tax WACC at the level of 9.69%). The Group expects that none of the reasonably possible and highly probable changes in any of the key assumptions used in the analysis will result in the carrying amount of the property, plant and equipment exceeding their recoverable amount.

17. Non-current assets classified as held for sale

Non-current assets classified as held for sale, amounting to PLN 8,951 thousand as at 31 December 2011, included:

- Megaukład Ciepłownia Zawodzie (The Zawodzie Heating Plant Mega-system) located in Częstochowa, being the property of TAURON Dystrybucja S.A., with the carrying amount of PLN 2,709 thousand. The asset was held for sale as at 31 December 2010 and it was not sold until the balance sheet date despite the tenders announced for its sale. Further activities are being undertaken to sell the asset, and a revaluation of the property has been performed;
- Ośrodek Szkoleniowo-Wypoczynkowy Rożnów (Rożnów Training and Recreation Center) with the carrying amount of PLN 2,664 thousand and Ośrodek Szkoleniowo-Wypoczynkowy Jaga (Jaga Training and Recreation Center) with the carrying amount of PLN 1,907 thousand, being the property of TAURON Dystrybucja S.A. Based on the decision of the company's Board of Directors dated 15 February 2011, the said recreation centers were designated for sale. The company has undertaken activities to sell these assets through an estate agency;
- A property with a value of PLN 1,671 thousand, owned by Elektrociepłownia Tychy S.A., located in Kossów, commune of Radków, the Świętokrzyskie voivodship, comprising a developed plot of land with a surface of 3.1900 ha. This asset was held for sale as at 31 December 2010. The company's management has been continuing its efforts to sell this asset.

Non-current assets classified as held for sale, amounting to PLN 4,397 thousand as at 31 December 2010, include:

- Megaukład Ciepłownia Zawodzie (The Zawodzie Heating Plant Mega-system) located in Częstochowa, which includes land together with buildings: a boiler room, engine room, distribution room as well as a heat generation installation, being the property of TAURON Dystrybucja S.A., with a value of PLN 2,709 thousand as at 31 December 2010. Based on resolution of the Ordinary General Shareholders' Meeting dated 25 June 2009 and resolution of the Extraordinary General Shareholders' Meeting dated 3 August 2010, the shareholders agreed for the disposal of a portion of the company's assets representing Megaukład Ciepłownia Zawodzie.
- A property with a value of PLN 1,671 thousand, located in Kossów, commune of Radków, the Świętokrzyskie voivodship, representing a developed plot of land with a surface of 3.1900 hectares. In the past, this was the location of Zakład Produkcji Biomasy (The Biomass Production Plant) of Elektrociepłownia Tychy S.A.
- A recreational plot with cabins with the carrying amount of PLN 17 thousand as at 31 December 2011. In 2011 this property was sold with a profit of PLN 53 thousand.

18. Leases

18.1. Operating lease commitments – Group as the lessee

On 30 April 2008, a subsidiary of TAURON Polska Energia S.A., Południowy Koncern Energetyczny S.A., now TAURON Wytwarzanie S.A., due to the sale of property located in Katowice at ul. Lwowska 23 to PKE Broker Sp. z o.o., concluded a lease agreement for the use of this property. TAURON Polska Energia S.A. is a sub-lessee of a portion of the property. The value of the leased property that is not included under non-current assets is PLN 52,386 thousand. Annual lease charges in the years 2011 and 2010 amounted to PLN 6,032 thousand and PLN 6,052 thousand, respectively.

In addition, the subsidiary Południowy Koncern Węglowy S.A. uses mining plant and equipment under operating lease agreements. The value of the property, plant and equipment used was PLN 40,101 thousand as at 31 December 2011 and PLN 39,345 thousand as at 31 December 2010. Annual lease charges in the years 2011 and 2010 amounted to PLN 18,629 thousand and PLN 17,417 thousand, respectively.

18.2. Finance lease and hire purchase commitments

As at 31 December 2011 and 31 December 2010, future minimum rentals payable under finance leases and hire purchase contracts and the present value of the net minimum lease payments are as follows:

	As at 31 December 2011		As at 31 December 2010	
	Minimum lease payments	Present value of lease payments	Minimum lease payments	Present value of lease payments
Within 1 year	19 529	14 761	28 329	23 452
Within 1 to 5 years	65 113	56 232	61 964	52 025
More than 5 years	–	–	16 502	15 785
Minimum lease payments, total	84 642	70 993	106 795	91 262
Less amounts representing finance charges	(13 649)	–	(15 533)	–
Present value of minimum lease payments, of which:	70 993	70 993	91 262	91 262
current	14 761	14 761	23 452	23 452
non-current	56 232	56 232	67 810	67 810

19. Intangible assets

Long-term intangible assets, year ended 31 December 2011

	Development expenses	Goodwill	Software	Other acquired concessions, patents, licenses and similar items	Greenhouse gas emission allowances	Other intangible assets	Intangible assets not made available for use	Intangible assets, total
COST								
Opening balance	4 389	169 553	210 046	3 371	59 977	4 430	10 362	462 128
Direct purchase	-	-	294	1 241	41 776	-	47 863	91 174
Transfer of intangible assets not made available for use	-	-	38 058	54	-	6 219	(44 331)	-
Sale, disposal	-	-	-	-	(4 699)	-	-	(4 699)
Reclassifications	-	-	-	-	-	-	-	-
Donations and free-of-charge transfers	-	-	(55)	-	-	-	-	(55)
Liquidation	-	-	(4 323)	(247)	-	(9)	-	(4 579)
Received free of charge	-	-	-	-	-	453	-	453
Acquisition of a subsidiary	-	556 816	19 864	913	-	23 626	-	601 219
Contribution in kind	-	-	-	-	-	-	-	-
Write-off of discontinued investments	-	-	-	-	-	-	(638)	(638)
Transfers from assets under construction	-	-	6 633	-	-	90	828	7 551
Other movements	-	-	415	(412)	441	(40)	(293)	111
Foreign exchange differences from translation of foreign entities	-	-	-	-	-	-	40	40
Closing balance	4 389	726 369	270 932	4 920	97 495	34 769	13 831	1 152 705
ACCUMULATED AMORTIZATION								
Opening balance	(2 913)	-	(109 559)	(1 247)	(22)	(1 596)	(450)	(115 787)
Amortization for the period	(569)	-	(35 201)	(517)	-	(775)	-	(37 062)
Increase of impairment	-	-	-	-	(15 166)	-	-	(15 166)
Decrease of impairment	-	-	-	-	22	-	-	22
Sale, disposal	-	-	-	-	-	-	-	-
Reclassifications	-	-	-	-	-	-	-	-
Donations and free-of-charge transfers	-	-	36	-	-	-	-	36
Liquidation	-	-	3 579	163	-	8	450	4 200
Received free of charge	-	-	-	-	-	-	-	-
Contribution in kind	-	-	-	-	-	-	-	-
Other movements	-	-	(101)	103	-	-	-	2
Closing balance	(3 482)	-	(141 246)	(1 498)	(15 166)	(2 363)	-	(163 755)
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	1 476	169 553	100 487	2 124	59 955	2 834	9 911	346 340
NET CARRYING AMOUNT AT THE END OF THE PERIOD	907	726 369	129 686	3 422	82 329	32 406	13 831	988 950

Long-term intangible assets, year ended 31 December 2010

	Development expenses	Goodwill	Software	Other acquired concessions, patents, licenses and similar items	Greenhouse gas emission allowances	Other intangible assets	Intangible assets not made available for use	Intangible assets, total
COST								
Opening balance	4 104	169 553	187 529	3 034	52 701	3 969	7 266	428 156
Direct purchase	-	-	1 502	467	7 276	-	26 020	35 265
Transfer of intangible assets not made available for use	-	-	23 700	12	-	281	(23 993)	-
Sale, disposal	-	-	-	-	-	-	-	-
Reclassifications	-	-	16	3	-	(19)	-	-
Donations and free-of-charge transfers	-	-	-	-	-	-	-	-
Liquidation	-	-	(3 002)	(145)	-	(1)	-	(3 148)
Received free of charge	-	-	-	-	-	-	-	-
Contribution in kind	-	-	(44)	-	-	-	-	(44)
Write-off of discontinued investments	-	-	-	-	-	-	-	-
Transfers from assets under construction	-	-	331	-	-	200	1 045	1 576
Other movements	285	-	14	-	-	-	24	323
Closing balance	4 389	169 553	210 046	3 371	59 977	4 430	10 362	462 128
ACCUMULATED AMORTIZATION								
Opening balance	(2 038)	-	(80 615)	(878)	-	(1 309)	(450)	(85 290)
Amortization for the period	(875)	-	(31 555)	(513)	-	(530)	-	(33 473)
Increase of impairment	-	-	2	-	(22)	-	-	(20)
Decrease of impairment	-	-	-	-	-	-	-	-
Sale, disposal	-	-	-	-	-	-	-	-
Reclassifications	-	-	(241)	(1)	-	242	-	-
Donations and free-of-charge transfers	-	-	-	-	-	-	-	-
Liquidation	-	-	2 846	145	-	1	-	2 992
Received free of charge	-	-	-	-	-	-	-	-
Contribution in kind	-	-	16	-	-	-	-	16
Other movements	-	-	(12)	-	-	-	-	(12)
Closing balance	(2 913)	-	(109 559)	(1 247)	(22)	(1 596)	(450)	(115 787)
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	2 066	169 553	106 914	2 156	52 701	2 660	6 816	342 866
NET CARRYING AMOUNT AT THE END OF THE PERIOD	1 476	169 553	100 487	2 124	59 955	2 834	9 911	346 340

Current intangible assets, year ended 31 December 2011

	Energy certificates	Greenhouse gas emission allowances	Current intangible assets, total
COST			
Opening balance	523 017	101 173	624 190
Direct purchase	728 799	187 126	915 925
Sale, disposal	(4 953)		(4 953)
Energy certificates generated internally	297 747	–	297 747
Cancellation of energy certificates	(855 721)	–	(855 721)
Cancellation of emission allowances	–	(101 173)	(101 173)
Acquisition of subsidiary	87 589	–	87 589
Other movements	(1 536)		(1 536)
Closing balance	774 942	187 126	962 068
ACCUMULATED AMORTIZATION			
Opening balance	–	–	–
Increase of impairment	(91 114)	–	(91 114)
Decrease of impairment	–	–	–
Closing balance	(91 114)	–	(91 114)
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	523 017	101 173	624 190
NET CARRYING AMOUNT AT THE END OF THE PERIOD	683 828	187 126	870 954

Current intangible assets, year ended 31 December 2010

	Energy certificates	Greenhouse gas emission allowances	Current intangible assets, total
COST			
Opening balance	481 885	–	481 885
Direct purchase	437 112	101 173	538 285
Sale, disposal	(45 336)	–	(45 336)
Energy certificates generated internally	304 357	–	304 357
Cancellation of energy certificates	(654 535)	–	(654 535)
Other movements	(466)	–	(466)
Closing balance	523 017	101 173	624 190
ACCUMULATED AMORTIZATION			
Opening balance	–	–	–
Increase of impairment	–	–	–
Decrease of impairment	–	–	–
Closing balance	–	–	–
NET CARRYING AMOUNT AT THE BEGINNING OF THE PERIOD	481 885	–	481 885
NET CARRYING AMOUNT AT THE END OF THE PERIOD	523 017	101 173	624 190

As at the date of these consolidated financial statements, the President of the Energy Regulatory Office (URE) has not approved some of TAURON Wytwarzanie S.A.'s applications relating to certificates of electricity generated using renewable sources of energy and certificates of electricity generated using cogeneration. The delay in the granting of renewable energy certificates results from pending verification proceedings regarding the fulfillment of the physical and chemical parameters of the combusted biomass. As for cogeneration certificates, the procedure of concession change is in progress.

In the opinion of management of TAURON Wytwarzanie S.A., all conditions necessary for the granting of certificates have been fulfilled and there is no risk that they will not be obtained.

At the balance sheet date, an impairment test was conducted on goodwill with respect to net assets increased by the amount of goodwill at the end of 2011 for the particular operating segments: Mining Segment, Renewable Energy Segment, Distribution Segment, Sale of Electricity and Other Energy Market Products Segment and Other Segment.

The table below presents goodwill as at 31 December 2011 allocated to the particular segments:

	Coal mining	Generation of electricity using renewable sources	Electricity distribution	Sales of electricity and other energy market products	Other	Total
Opening balance	13 973	–	–	–	155 580	169 553
Acquisition of Górnośląski Zakład Elektroenergetyczny S.A.	–	9 504	442 756	52 654	–	504 914
Acquisition of Lipniki Sp. z o.o.	–	51 902	–	–	–	51 902
Closing balance	13 973	61 406	442 756	52 654	155 580	726 369

The key assumptions affecting the estimation of the value in use of the segments tested are as follows:

Generation of electricity using renewable sources

- The volumes of green energy production arising from production capacities together with the adopted prices of electricity based on the wholesale price of black energy from the previous year, prices of certificates based on current regulations;
- Maintenance of the production capacities of the existing non-current assets as a result of conducting replacement investments.

Distribution of electricity

- The regulated income of distribution companies ensures the coverage of reasonable costs and the achievement of a return on capital employed on a reasonable level. The level of the return depends on the so-called Regulatory Value of Assets;
- Maintaining electricity distribution capacity using the existing non-current assets as a result of conducting replacement investments.

Sale of electricity and other energy market products

- The volumes of sales taking into account GDP growth and increasing market competition;
- The adopted prices of electricity based on the wholesale price of black energy, taking into account the cost of excise, the cost of the obligation to submit energy certificates for cancellation and the appropriate level of the margin.

Other

- Tariff income of heat companies ensuring coverage of reasonable costs and achievement of a return on capital employed on a reasonable level.
- Maintaining heat production, distribution and sales capacities using the existing non-current assets as a result of conducting replacement investments.

The sensitivity analyses performed indicate that the most significant factor affecting the estimate of the value in use of the cash generating units is the forecasted wholesale prices of electricity and the adopted discount rates.

The test was conducted based on the present value of estimated cash flows from operations. Calculations were performed for cash flows for 2012–2021 and the residual value. The basis for the calculation of cash flows is the planned EBIT for 2012–2021 and amortization for this period. The amount of EBIT results from the approved and adopted operating plan for 2012 and the company's long-term plan up to 2021. The above-mentioned plans of operations of the entities for which goodwill is presented are based on the assumption that they will achieve a profit on their operating activities in the particular years. It was also assumed that the company's working capital in the tested period will not show any significant changes.

The discount rate adopted for calculation reflects the weighted average cost of capital (WACC) after taxation at the level of 7.13%–8.84%, taking into account a risk-free interest rate corresponding to the current yield of 10-year State Treasury bonds (at the level of 5.8%) and the premium for the risk of operations specific to the power industry (5%). Based on the results of the test conducted, no need was identified to recognize impairment of goodwill for any of the aforementioned segments.

The impairment tests were conducted using 10-year forecasts prepared based on the standards applied by the Group, which was in particular due to long-term investment processes in the power industry. Macroeconomic and industry-related assumptions are updated when indications of their change are observed on the market. The forecasts also take into consideration any anticipated changes in legal environment.

The Group expects that none of the reasonably possible and highly probable changes in any of the key assumptions used in the analyses will result in the carrying amount of the non-current assets of the particular segments exceeding their recoverable amount.

20. Inventories

	As at 31 December 2011	As at 31 December 2010
Historical cost		
Raw materials	443 660	294 712
Semi-finished goods and work-in-progress	97 213	87 409
Finished goods	8 118	11 195
Goods for resale	2 329	14
Property rights arising from energy certificates	29 099	15 626
Emission allowances	–	4 664
Total	580 419	413 620
Write-downs to net realisable value		
Raw materials	(4 273)	(4 578)
Semi-finished goods and work-in-progress	–	–
Finished goods	–	(277)
Goods for resale	–	–
Property rights arising from energy certificates	(1 356)	–
Emission allowances	–	(205)
Total	(5 629)	(5 060)
Net realisable value		
Raw materials	439 387	290 134
Semi-finished goods and work-in-progress	97 213	87 409
Finished goods	8 118	10 918
Goods for resale	2 329	14
Property rights arising from energy certificates	27 743	15 626
Emission allowances	–	4 459
Total	574 790	408 560
Movement in write-downs to net realisable value		
Opening balance	(5 060)	(3 777)
Recognition	(5 592)	(1 662)
Reversal	4 571	177
Utilization	347	202
Contribution in kind	–	–
Other	105	–
Closing balance	(5 629)	(5 060)

21. Trade and other receivables

For terms and conditions relating to related party transactions, refer to Note 36. Doubtful debts allowances and aging analysis of receivables are presented in Note 38.4.5.

Trade receivables are non-interest bearing and are usually receivable within 30 days with respect to institutional clients. Amounts due from individual clients are received on a monthly basis or every two months.

Except for sales to individual clients, sales are made only to customers who have undergone an appropriate credit verification procedure. As a result, Management believe there is no additional credit risk that would exceed the doubtful debts allowance recognized for trade receivables of the Group.

22. Cash and cash equivalents

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods, usually between one day and one month, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates.

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprised the following:

	As at 31 December 2011	As at 31 December 2010
Cash at bank and in hand	264 082	366 849
Short-term deposits (up to 3 months)	200 456	1 106 180
Other	41 132	952
Total cash and cash equivalents presented in the statement of financial position, of which:	505 670	1 473 981
– restricted cash	176 241	165 862
Bank overdraft	–	(2 464)
Foreign exchange and other differences	146	143
Total cash and cash equivalents presented in the statement of cash flows	505 816	1 471 660

The difference between the balance of cash and cash equivalents in the statement of financial position and the balance in the statement of cash flows is mainly due to bank overdrafts and exchange differences arising from valuation of cash held in foreign currency accounts.

The balance of restricted cash is mainly comprised of the balance of cash held by the parent in the settlement account used for trading in electricity at Towarowa Gielda Energii S.A. (the Polish Power Exchange), amounting to PLN 150,775 thousand, and the balance of cash held by the parent in the specific account used for trading in electricity at the POEE power exchange, amounting to PLN 10,874 thousand.

23. Other assets

23.1. Other financial assets

	As at 31 December 2011	As at 31 December 2010
Other shares in unlisted and listed companies	166 590	150 125
Bonds, T-bills and other debt securities	101 732	1 500
Deposits	25 250	35 493
Other long-term receivables	9 796	6 405
Other	2 126	12 122
Total	305 494	205 645
non-current	197 470	177 452
current	108 024	28 193

The increase in bonds, T-bills and other debt securities as at 31 December 2011 compared with the 2010 year-end balance is due to the acquisition by Vattenfall Sales Poland Sp. z o.o. and Vattenfall Distribution Poland S.A., in December 2011, of bonds issued by the State Treasury with a value of PLN 99,507 thousand at the balance sheet date.

In the year ended 31 December 2011, proceeds from sale of financial assets presented in the consolidated cash flow statement at the amount of PLN 114,304 thousand are mainly comprised of proceeds from sale of investment fund units by the Company and by the subsidiary TAURON Wytwarzanie S.A., amounting to PLN 91,813 thousand. Expenditures incurred for the purchase of financial assets, amounting to PLN 147,989 thousand, are mainly comprised of expenditures incurred by the Company for the purchase of investment fund units, amounting to PLN 85,000 thousand, and expenditures incurred by the subsidiaries Vattenfall Distribution Poland S.A. and Vattenfall Sales Poland Sp. z o.o. for the purchase of State Treasury bonds, amounting to PLN 47,512 thousand.

In the year ended 31 December 2010, proceeds from sale of financial assets presented in the consolidated cash flows statement at the amount of PLN 56,189 thousand were mainly comprised of proceeds from termination of short-term deposits of TAURON Ekoenergia S.A. with maturities exceeding 3 months, amounting to PLN 41,787 thousand. Expenditures incurred for the purchase of financial assets, amounting to PLN 69,570 thousand, were mainly comprised of cash invested by the subsidiaries TAURON Ekoenergia Sp. z o.o. and Kopalnia Wapienia Czatkowice Sp. z o.o. in short-term deposits with maturities exceeding 3 months, amounting to PLN 54,787 thousand.

23.2. Other long-term non-financial assets

	As at 31 December 2011	As at 31 December 2010
Prepayments for assets under construction and intangible assets	26 178	54 233
Other prepayments	3 372	3 852
Costs of preparing production in hard coal mines	59 649	60 945
Other	7 150	4 583
Total	96 349	123 613

23.3. Other current non-financial assets

	As at 31 December 2011	As at 31 December 2010
Subscription	159	251
Property and tort insurance	31 466	29 530
Membership fees, training	996	65
IT, telecom and postal services	2 789	3 324
Other deferred costs	13 996	7 663
Costs of preparing production in hard coal mines	41 192	37 915
Costs of extraction tunnels	56 728	46 216
Prepayments for deliveries	499	2 429
Receivables from input VAT	97 761	65 394
Receivables from excise duty	36 826	8 086
Other tax receivables	198	2 370
Surplus of Social Fund assets over Social Fund liabilities	2 802	2 530
Other current assets	3 622	2 385
Total	289 034	208 158

24. Other non-financial liabilities

24.1. Other long-term liabilities

As at 31 December 2011 and 31 December 2010, the Group had no other long-term liabilities.

24.2. Other current liabilities

	As at 31 December 2011	As at 31 December 2010
Taxes, customs, social security and other payables, of which:	418 669	526 852
Excise	70 494	73 811
VAT	116 817	223 489
Social security	143 012	150 408
Personal Income Tax	50 007	42 017
Environmental charges	28 525	30 441
Real Estate Tax	4 164	2 558
Other	5 650	4 128
Other non-financial liabilities, of which:	226 241	225 967
Payments from customers relating to future periods, of which:	224 708	215 031
prepayments for connection fees	96 724	64 584
amounts overpaid by customers	121 846	142 793
other	6 138	7 654
Other	1 533	10 936
Total	644 910	752 819

25. Accruals

25.1. Deferred income and government grants

	As at 31 December 2011	As at 31 December 2010
Deferred income		
Donations, fixed assets received free-of-charge	204 535	186 784
Non-government subsidies	299	461
Perpetual usufruct of land	524	572
Subsidies received for the purchase of fixed assets	57 944	59 290
Connection fees	314 204	334 352
Other	7 180	12 245
Total, of which:	584 686	593 704
Non-current	536 499	540 789
Current	48 187	52 915
Government grants		
Forgiven loans from environmental funds	8 987	10 040
Other	104 849	98 333
Total, of which:	113 836	108 373
Non-current	106 050	103 733
Current	7 786	4 640

Other government grants comprise mainly government grants received by Południowy Koncern Węglowy S.A. for initial investments in coal mines, amounting to PLN 40,810 thousand, and the remeasurement of preferential loans received by TAURON Wytwarzanie S.A. to market value, amounting to PLN 41,972 thousand.

The increase in the balance of deferred income relating to government grants is mainly due to the government grant of an aggregate amount of PLN 44,546 thousand, obtained by Południowy Koncern Węglowy S.A. under the agreement of 7 September 2007 on the functioning of the hard coal mining sector in 2008–2015 (Journal of Laws No. 192, item 1379) for the financing of the following initial investments:

- Providing access to the Byczyna section as well as access to mining on the first pilot wall at the Sobieski Mining Enterprise – PLN 25,221 thousand,
- Construction of the 500 m level at the Janina Mining Enterprise – PLN 19,325 thousand.

25.2. Accrued expenses

	As at 31 December 2011	As at 31 December 2010
Unused holidays	26 025	22 301
Bonuses	180 289	99 301
Audit fees	680	537
Environmental protection charges	1 268	–
Excise tax accrued	8 162	5 249
Other	6 661	4 769
Total, of which:	223 085	132 157
Non-current	–	–
Current	223 085	132 157

The increase of accrued expenses for bonuses results mainly from the implementation of changes in remuneration principles by the Group companies.

26. CO₂ emission allowances

The first National Allocation Plan for CO₂ allowances included years 2005–2007. On 14 November 2008, the Council of Ministers adopted the National Allocation Plan for CO₂ allowances for the years 2008–2012 (“NAP II”) under the EU emissions trading system, which allocated the CO₂ emission limits (caps) to the individual installations participating in the emissions trading system. The adopted

regulation is based on the draft regulation of 12 February 2008, with account taken of the amendments dated 16 May 2008. In accordance with the decisions of the European Commission, Polish companies covered by the allowances allocation plan are allowed to emit approximately 1,043 million metric tons of CO₂ within a five-year period, i.e. approximately 209 million metric tons annually.

In accordance with the Group's accounting policy, the Group recognizes a provision for the deficit in emission allowances if the level of actual emission exceeds the emission allowances granted for the entire trading period.

The tables below present the CO₂ emission allowances granted under the National Allocation Plan and acquired on the secondary market, including a break-down into the portion of allowances used for internal purposes and the portion sold in the years ended 31 December 2011 and 31 December 2010.

CO₂ emission allowances in the year ended 31 December 2011

Company	Opening balance of CO ₂ allowances	Acquired	CO ₂ emission	Sold	Closing balance of CO ₂ allowances
TAURON Polska Energia S.A.	3 095 000	19 781 042	–	(13 032 000)	9 844 042
TAURON Wytwarzanie S.A.	37 951 879	8 807 767	(21 345 745)	(13 455 041)	11 958 860
TAURON Dystrybucja S.A.	1 649	–	–	–	1 649
Elektrociepłownia Tychy S.A.	654 248	115 418	(384 003)	(131 418)	254 245
Elektrociepłownia EC Nowa Sp. z o.o.	5 850 373	1 382 812	(2 855 964)	(725 815)	3 651 406
TAURON Ciepło S.A.	233 951	23 768	(83 529)	(46 859)	127 331
Total	47 787 100	30 110 807	(24 669 241)	(27 391 133)	25 837 533

CO₂ emission allowances in the year ended 31 December 2010

Company	Opening balance of CO ₂ allowances	Acquired	CO ₂ emission	Sold	Closing balance of CO ₂ allowances
TAURON Polska Energia S.A.	–	6 453 000	–	(3 358 000)	3 095 000
TAURON Wytwarzanie S.A.	56 597 864	3 232 884	(21 028 869)	(850 000)	37 951 879
TAURON Dystrybucja S.A.	1 649	–	–	–	1 649
Elektrociepłownia Tychy S.A.	989 550	–	(335 302)	–	654 248
Elektrociepłownia EC Nowa Sp. z o.o.	7 637 112	1 027 150	(2 683 889)	(130 000)	5 850 373
TAURON Ciepło S.A.	323 643	–	(89 692)	–	233 951
Total	65 549 818	10 713 034	(24 137 752)	(4 338 000)	47 787 100

27. Employee benefits

Based on a valuation performed using actuarial methods, the Group recognizes provisions for future employee benefits, including:

- retirement, disability and death benefits,
- reduced electricity rates and charges granted to employees,
- transfers to the Social Fund for present and future pensioners,
- coal allowances,
- jubilee bonuses.

The corridor approach presented below relates to part of provisions for post-employment benefits. Post-employment benefits relating to present pensioners are not presented using the corridor approach, as is the case with jubilee bonuses.

The International Accounting Standards Board made amendments to IAS 19 *Employee benefits*, applicable to annual periods beginning on or after 1 January 2013. The most important changes from the Group's perspective include liquidation of the "corridor approach" as an allowed treatment of actuarial gains and losses and the introduction of the requirement to present the effects of remeasurement in other comprehensive income. In accordance with its accounting policy, the Group applies the corridor approach in determining the defined benefit obligation and recognizing actuarial gains and losses in profit or loss. Elimination of this approach will result in the requirement to immediately recognize all actuarial gains and losses in other comprehensive income as well as in the increase of the provision for future employee benefits recognized in the statement of financial position up to the present value of the obligation as per actuarial valuation. The revised IAS 19 is to be applied retrospectively. At the date of authorization of these financial statements, amendments to IAS 19 *Employee benefits* have not been endorsed by the EU.

In addition, several Group companies implemented voluntary redundancy schemes, which are not measured using actuarial methods due to the fact that they relate to employment termination benefits.

The amounts of these provisions and a reconciliation presenting movements in provisions during the financial period are presented in the tables below.

Movement in provisions for employee benefits, year ended 31 December 2011

	Provision for retirement, disability and similar benefits	Employee electricity rates	Social Fund	Provision for coal allowances	Jubilee bonuses	Voluntary redundancy schemes	Provisions, total
Opening balance	183 009	351 573	105 955	33 526	468 688	50 330	1 193 081
Acquisition of subsidiary	12 362	35 144	4 744	–	33 507	217	85 974
Current service costs	8 403	4 815	2 134	1 728	27 061	–	44 141
Actuarial gains and losses	2 555	14 222	5 840	3 441	(10 540)	–	15 518
Benefits paid	(26 696)	(18 118)	(5 634)	(1 323)	(58 828)	(87 949)	(198 548)
Past service costs	–	7 957	–	–	–	–	7 957
Interest expense	12 457	22 503	6 329	2 252	24 807	–	68 348
Other movements	(16)	–	–	–	(52)	–	(68)
Recognition of provision for VRS	–	–	–	–	–	87 762	87 762
Reversal of provision for VRS	–	–	–	–	–	(15 088)	(15 088)
Closing balance	192 074	418 096	119 368	39 624	484 643	35 272	1 289 077
CURRENT	31 398	23 015	5 302	1 624	57 282	35 055	153 676
NON-CURRENT	160 676	395 081	114 066	38 000	427 361	217	1 135 401

Provisions for employee benefits under corridor approach, year ended 31 December 2011

	Provision for retirement, disability and similar benefits	Employee electricity rates	Social Fund	Provision for coal allowances	Provisions, total
Present value of liability at the end of the period	230 815	158 526	54 504	22 244	466 089
Unrecognized liability, of which:	(38 741)	(26 101)	(632)	1 286	(64 188)
Unrecognized actuarial gains/losses	(38 741)	42 715	(632)	1 286	4 628
Unrecognized past service costs	–	(68 816)	–	–	(68 816)
Net liability at the end of period	192 074	132 425	53 872	23 530	401 901
Present value of the liability at the beginning of period	236 043	168 335	58 394	27 054	489 826
Net cumulative unrecognized actuarial gains/(losses) at the beginning of period	(53 034)	12 520	(10 845)	(7 220)	(58 579)
Corridor limits	23 603	16 834	5 838	2 705	48 980
Exceeded	(31 347)	7 169	(5 084)	(4 514)	(33 776)
Actuarial gain (loss) to be recognized	(2 555)	535	(461)	(432)	(2 913)
Actuarial gain (loss) for the period	11 738	30 730	9 752	8 074	60 294
Unrecognized actuarial gains/(losses) at the end of period	(38 741)	42 715	(632)	1 286	4 628

Movement in provisions for employee benefits, year ended 31 December 2010

	Provision for retirement, disability and similar benefits	Employee electricity rates	Social Fund	Provision for coal allowances	Jubilee bonuses	Voluntary redundancy schemes	Provisions, total
Opening balance	176 385	319 772	98 009	26 642	441 186	–	1 061 994
Current service costs	8 772	4 470	2 060	606	25 612	–	41 520
Actuarial gains and losses	1 771	14 332	4 588	5 573	35 356	–	61 620
Benefits paid	(16 545)	(17 480)	(4 753)	(841)	(57 877)	(35 887)	(133 383)
Past service costs	–	7 945	–	–	–	–	7 945
Interest expense	12 077	22 534	6 051	1 546	24 411	–	66 619
Other movements	549	–	–	–	–	–	549
Recognition of provision for VRS	–	–	–	–	–	86 217	86 217
Closing balance	183 009	351 573	105 955	33 526	468 688	50 330	1 193 081
CURRENT	38 264	20 085	4 939	1 334	54 540	50 330	169 492
NON-CURRENT	144 745	331 488	101 016	32 192	414 148	–	1 023 589

Provisions for employee benefits under corridor approach, year ended 31 December 2010

	Provision for retirement, disability and similar benefits	Employee electricity rates	Social Fund	Provision for coal allowances	Provisions, total
Present value of liability at the end of the period	236 043	168 335	58 394	27 054	489 826
Unrecognized liability, of which:	(53 034)	(64 255)	(10 845)	(7 220)	(135 354)
Unrecognized actuarial gains/losses	(53 034)	12 520	(10 845)	(7 220)	(58 579)
Unrecognized past service costs	–	(76 775)	–	–	(76 775)
Net liability at the end of period	183 009	104 080	47 549	19 834	354 472
Present value of the liability at the beginning of period	214 626	161 067	50 801	18 513	445 007
Net cumulative unrecognized actuarial gains/(losses) at the beginning of period	(38 236)	6 204	(8 590)	(366)	(40 988)
Corridor limits	21 462	16 106	5 081	1 851	44 500
Exceeded	(21 374)	3 779	(3 723)	–	(21 318)
Actuarial gain (loss) to be recognized	(1 771)	282	(301)	–	(1 790)
Actuarial gain (loss) for the period	(16 569)	6 598	(2 556)	(6 854)	(19 381)
Unrecognized actuarial gains/(losses) at the end of period	(53 034)	12 520	(10 845)	(7 220)	(58 579)

In 2011, the Group continued the voluntary redundancy schemes (“VRS”) that had been launched in 2010.

In 2011, TAURON Wytwarzanie S.A. recognized a provision for the voluntary redundancy scheme amounting to PLN 26,701 thousand and paid benefits amounting to PLN 39,490 thousand. Due to the resignation of part of employees from participation in the scheme, a provision of PLN 442 thousand was reversed. In 2011, employment contracts were terminated with 357 employees.

As at 31 December 2011, the company had a provision for costs arising from an agreement relating to the decommissioning of the Halemba Power Plant, amounting to PLN 5,719 thousand. Employees could file declarations to join the agreement until the end of August 2011. The previous voluntary redundancy scheme in TAURON Wytwarzanie S.A., which was in force from 2010, was completed on 31 December 2011.

In 2011, TAURON Dystrybucja S.A. recognized a provision for the voluntary redundancy scheme amounting to PLN 61,061 thousand, paid benefits of PLN 48,459 thousand and reversed part of the provision amounting to PLN 14,646 thousand.

In April 2011 and December 2011, the company announced a Redundancy Payment Scheme as part of voluntary redundancy schemes. Declarations to join the scheme were accepted until the end of 2011. On 20 December 2011, another early retirement scheme and pre-retirement benefit scheme were announced on the same basis as those announced in 2010. The schemes were started in December 2011 and will be completed in December 2012. In 2011, 674 employment contracts were terminated under the voluntary redundancy scheme, resulting in total one-off redundancy payments of PLN 55,761 thousand, of which PLN 48,458 thousand was paid using the related provision.

In addition, a voluntary redundancy scheme was set up in Przedsiębiorstwo Energetyki Ciepłej Katowice S.A., currently TAURON Ciepło S.A., based on Regulation dated 28 April 2011. The benefits under this scheme, amounting to PLN 963 thousand, were paid out by the company in May 2011, hence there was no need to recognize a provision for the costs of the scheme. Another voluntary redundancy scheme was set up in Przedsiębiorstwo Energetyki Ciepłej w Dąbrowie Górniczej S.A., which was acquired by TAURON Ciepło S.A. in September 2011, based on resolution dated 10 August 2011. The benefits under this scheme, amounting to PLN 1,287 thousand, were paid out in August 2011, hence there was no need for TAURON Ciepło S.A. to recognize a provision for the costs of the scheme.

In Vattenfall Network Services Poland Sp. z o.o., the amount of the provision for the voluntary redundancy scheme as at 31 December 2011 amounted to PLN 217 thousand.

As at 31 December 2011, the following provisions were recognized for amounts payable under voluntary redundancy schemes:

- PLN 29,336 thousand in TAURON Dystrybucja S.A.,
- PLN 5,719 thousand in TAURON Wytwarzanie S.A.,
- PLN 217 thousand in Vattenfall Network Services Poland Sp. z o.o.

As at 31 December 2010, the following provisions were recognized for amounts payable under voluntary redundancy schemes:

- PLN 20,704 thousand in ENION S.A. and PLN 10,676 thousand in EnergiaPro S.A. – i.e. the total of PLN 31,380 thousand in the Distribution Segment,
- PLN 17,830 thousand in Południowy Koncern Energetyczny S.A. and PLN 1,120 thousand in Elektrownia Stalowa Wola S.A. – i.e. the total of PLN 18,950 thousand in the Generation Segment.

The total amount of benefits paid out under the schemes in 2011 was PLN 87,949 thousand, while in 2010 it was PLN 35,887 thousand. In addition, in 2011 certain payments were made under the voluntary redundancy scheme which were directly expensed and for which no provision was recognized.

Except for the provision for benefits paid under the voluntary redundancy scheme, the Group determines provisions for future employee benefits at an amount estimated using actuarial methods, taking into account the discount rate defined on the basis of market rates of return from treasury bonds. Analysis of provisions into non-current and current is made by the Group based on estimates relating to the distribution of payments over time, prepared using actuarial techniques. The main assumptions adopted by the actuary at the balance sheet date for the calculation of the amount of liability are as follows:

	31 December 2011	31 December 2010
Discount rate (%)	5.75%	5.50%
Estimated inflation rate (%)	2.52%	2.50%
Employee rotation rate (%)	0.40% – 5.15%	0.48% – 4.82%
Estimated salary increase rate (%)	2.52% – 3.03%	2.50%
Estimated electricity price increase rate (%)	3.48%	2.80%
Estimated increase rate for contribution to the Social Fund (%)	3.60% – 5.00%	4.20%
Remaining average employment period	9.41 – 14.50	9.62 – 16.30

28. Earnings per share

In principle, basic earnings per share amounts is calculated by dividing the net profit for the period attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the period.

Presented below is the data concerning profit and shares, which was used in the calculation of basic and diluted earnings per share as presented in the statement of comprehensive income.

	Year ended 31 December 2011	Year ended 31 December 2010
Net profit from continuing operations attributable to equity holders of the parent	1 220 011	858 656
Profit from discontinued operations attributable to equity holders of the parent	–	–
Net profit	1 220 011	858 656
Net profit attributable to ordinary shareholders, used to compute diluted earnings per share	1 220 011	858 656
Number of ordinary shares used to compute basic earnings per share	1 752 549 394	1 600 730 480
Number of ordinary shares used to compute diluted earnings per share	1 752 549 394	1 600 730 480

The table below presents earnings per share for the years ended 31 December 2011 and 31 December 2010 as presented in the statement of comprehensive income.

Earnings per share (in PLN)	Year ended 31 December 2011	Year ended 31 December 2010
Basic, for profit for the period attributable to equity holders of the parent	0.70	0.54
Basic, for profit for the period from continuing operations attributable to equity holders of the parent	0.70	0.54
Diluted, for profit for the period attributable to equity holders of the parent	0.70	0.54
Diluted, for profit for the period from continuing operations attributable to equity holders of the parent	0.70	0.54

29. Dividends paid and proposed

	Year ended 31 December 2011	Year ended 31 December 2010
Dividends paid in the period		
Dividends paid throughout the year by subsidiaries	(13 676)	(5 573)
Final dividends paid by the parent	(262 882)	–
Payment from profit made by the parent	–	32
Payment from profit made by subsidiaries	–	–
Total dividends	(276 558)	(5 541)

The Board of Directors of the parent has proposed to allocate 30% of the consolidated profit of the Group for 2011 attributable to the equity holders of the parent for distribution in the form of dividend.

The restrictions for dividend distribution are described in Note 31.4 of explanatory notes to these consolidated financial statements.

On 6 May 2011, the Ordinary General Shareholders' Meeting resolved to distribute an amount of PLN 262,882 thousand for dividends to the Company's shareholders, which gives PLN 0.15 per share. This amount is composed of the Company's net profit for 2010 in the amount of PLN 190,478 thousand and utilization of the Company's reserve capital of PLN 72,404 thousand, which represents part of the Company's net profit for 2009 allocated to the reserve capital. The dividend payment date was 20 July 2011.

On 4 March 2010, the Ordinary General Shareholders' Meeting resolved to allocate the Company's net profit for 2009 of PLN 184,535 thousand for payment from profit made under separate regulations in the amount of PLN 8,376 thousand and for the Company's reserve capital in the amount of PLN 176,159 thousand.

The dividend per share paid by the parent for particular years is as follows:

	Year ended 31 December 2011	Year ended 31 December 2010
Dividend paid per share (PLN)	0.15	–

30. Business combinations and acquisitions of non-controlling interests

Issues relating to acquisitions and business combinations are generally regulated in IFRS 3 *Business Combinations*. However, transactions between entities under joint control are excluded from the scope of this standard. The entities contributed to the Company in 2007 were under the control of the State Treasury, which means that, at the moment of contribution, both the Company and the entities contributed were under joint control of the State Treasury. Therefore, in the opinion of the Company, the transaction of contribution of companies meets the definition of a transaction under joint control and is therefore excluded from the scope of IFRS 3.

The situation where a given transaction or business event which should be recognized in the IFRS financial statements is not regulated by the provisions of the individual standards is regulated by the provisions of IAS 8 paragraphs 10–12. These provisions require an entity preparing financial statements in accordance with IFRS to establish its own set of accounting policies, while indicating the following features of such accounting policies: faithful representation of financial position, results of operations and cash flows, reflecting the economic substance of the transaction, neutrality, prudence and completeness in all respects.

From the analyses performed by the Company, it is preferable to apply the pooling of interests method in the accounting for a combination of entities under joint control.

The assumption underlying this method is that the combining entities were controlled by the same shareholder both before and after the transaction and therefore the consolidated financial statements reflect the continuity of joint control and do not reflect any change of

the value of net assets to fair value (or recognition of new assets) or valuation of goodwill, since none of the combining entities is in fact acquired. Therefore, the financial statements are prepared as if the combining entities had always been combined.

Acquisition of shares in Górnosławski Zakład Elektroenergetyczny S.A.

On the basis of the preliminary agreement for the sale of shares in Górnosławski Zakład Elektroenergetyczny S.A. (GZE S.A.) signed with Vattenfall AB on 23 August 2011 and having fulfilled, on 30 November 2011, the condition precedent which was to obtain unconditional consent of the President of the Competition and Consumers Protection Office (UOKiK) for the transaction and, on 13 December 2011, contractual conditions including the payment of cash required under the transaction, on 13 December 2011 TAURON Polska Energia S.A. acquired 1,249,693 shares in the share capital of GZE S.A. with a nominal value of PLN 100 each and a total nominal value of PLN 124,969 thousand, representing 99.98% of the company's share capital.

The total value of the transaction was PLN 4,625,955 thousand, of which PLN 3,623,517 thousand was paid on the transaction date (this amount includes the deposit of PLN 120,000 thousand that had been provided to Vattenfall AB under the preliminary purchase agreement, together with accrued interest), while the amount of PLN 1,002,438 thousand represents Vattenfall AB's debt towards GZE S.A. and its subsidiaries that has been taken over by TAURON Polska Energia S.A. as part of the transaction. Costs directly attributable to the acquisition, amounting to PLN 5,500 thousand, were charged against profit.

As a result of acquisition of GZE S.A.'s shares, TAURON Polska Energia S.A. became an indirect owner of shares in the following significant subsidiaries of GZE S.A.: Vattenfall Distribution Poland S.A., Vattenfall Sales Poland Sp. z o.o., Vattenfall Network Services Poland Sp. z o.o., Vattenfall Wolin-North Sp. z o.o., and Vattenfall Business Services Poland Sp. z o.o.

As the above-mentioned transaction took place near the end of the financial year, TAURON as the acquirer has not completed its valuation of the acquired assets and liabilities and it therefore presents temporary amounts in these consolidated financial statements for those items for which the accounting process has not been completed.

Temporary fair value of identifiable assets, liabilities and contingent liabilities of GZE S.A. and its subsidiaries at the date of acquisition

Property, plant and equipment	3 113 437
Intangible assets	131 992
Shares in subsidiaries and associates	10 457
Other long-term non-financial assets	6 249
Inventories	2 277
Trade and other receivables	349 639
Financial assets	81 974
Cash and cash equivalents	314 792
Other current non-financial assets	13 532
Long-term provisions	(88 948)
Deferred tax liability	(68 575)
Deferred income and long-term government grants	(43 242)
Trade and other payables	(391 975)
Income tax payable	(7 067)
Deferred income and short-term government grants	(15 589)
Short-term provisions and accrued expenses	(184 778)
Other current liabilities	(110 153)
Net assets	3 114 022
Net assets attributable to TAURON	3 113 243
Cost of acquisition	3 618 157
Goodwill arising on acquisition	504 914

Goodwill of PLN 504,914 thousand was allocated to the specific CGUs which are expected to generate synergies arising from acquisition. In this case, the CGUs correspond to the operating segments of the TAURON Group. Allocation of goodwill was made based on the allocation key consisting in the share of the individual segments being acquired in the valuation made for the purpose of the acquisition of GZE S.A.'s assets.

Goodwill allocated to operating segments

Generation of electricity using renewable sources	Electricity distribution	Sales of electricity and other energy market products	Total
9 504	442 756	52 654	504 914

Calculation of the cost of acquisition of GZE S.A.

Cash paid	3 623 517
Seller's debt taken over by TAURON	1 002 438
Settlement of the relationship existing at the date of acquisition – payables of the TAURON Group to GZE S.A.	(1 007 802)
Settlement of the relationship existing at the date of acquisition – receivables of the TAURON Group from GZE S.A.	4
Cost of acquisition	3 618 157

The value of non-controlling interests in the Group increased by PLN 778 thousand as a result of the aforementioned transaction.

Acquisition of special purpose entity Lipniki Sp. z o.o.

On 28 September 2011, TAURON Ekoenergia Sp. z o.o. acquired 100% of shares in Lipniki Sp. z o.o., including the Lipniki wind farm, from German power corporation WSB Neue Energien GmbH. Lipniki Sp. z o.o. is a special purpose entity set up for the purpose of building and operating the Lipniki wind park including 15 wind turbines with a total capacity of 30.75 MW, which was made operational in July 2011.

The selling price was determined at a total amount of PLN 93,317 thousand, which includes settlement of refundable additional payments made by the seller to Lipniki Sp. z o.o. in the amount of PLN 19,358 thousand. The selling price was determined as the difference between the sum total of the value of the enterprise and the amount of its cash, and the company's net debt. Immediately after the acquisition, the Company repaid the bank loan existing at that date using intercompany funding.

The acquisition of Lipniki Sp. z o.o. gave rise to a goodwill of PLN 51,902 thousand, which was allocated to the Renewable Sources of Energy Segment.

The fair value of the identifiable assets, liabilities and contingent liabilities of Lipniki Sp. z o.o. at the date of its acquisition is presented in the table below.

Fair value of identifiable assets, liabilities and contingent liabilities of Lipniki Sp. z o.o. at the date of acquisition

Property, plant and equipment	176 932
Inventories	996
Other long-term non-financial assets	4 218
Other current non-financial assets	1 048
Cash and cash equivalents	762
Interest-bearing loans and borrowings	(141 087)
Deferred tax liability	(166)
Other current liabilities	(1 288)
Net assets	41 415
Cost of acquisition	93 317
Goodwill arising on acquisition	51 902

Since the date of its acquisition, Lipniki Sp. z o.o. generated revenues of PLN 6,640 thousand and a loss of PLN 999 thousand, which were included in the consolidated statement of comprehensive income for the reporting period.

Calculation of the cost of acquisition of Lipniki Sp. z o.o.

Cash paid	72 201
Cash paid – amount relating to rights to refundable additional payments	19 358
Settlement of the relationship existing at the date of acquisition – payables of the TAURON Group to Lipniki Sp. z o.o.	(438)
Settlement of the relationship existing at the date of acquisition – receivables of the TAURON Group from Lipniki Sp. z o.o.	2 196
Cost of acquisition	93 317

Analysis of cash flows arising from the acquisition of Lipniki Sp. z o.o.

Cash paid for the acquisition of the subsidiary (included under investing activities)	(72 201)
Cash held by the subsidiary at the date of acquisition	762
Expenditures directly attributable to the acquisition (included under operating activities)	(922)
Total	(72 361)

Total cash flows arising from the acquisition of the subsidiaries by the Group, presented under investing activities in the consolidated cash flow statement, are as follows:

	Year ended 31 December 2011
Cash paid for the acquisition of subsidiaries	(3 694 251)
Cash held by the subsidiaries at the date of acquisition	315 555
Change in liabilities arising from acquisition of subsidiaries	(919)
Total	(3 379 615)

Merger of subsidiaries

Due to the reorganization of the Group's structure significant mergers of subsidiaries took place in the third quarter of 2011.

On 31 August 2011, merger of Południowy Koncern Energetyczny S.A. (acquirer) and Elektrownia Stalowa Wola S.A. (acquiree) was registered with the National Court Register. On 1 September 2011, Południowy Koncern Energetyczny S.A. changed its name to TAURON Wytwarzanie S.A.

On 1 September 2011, merger of EnergiaPro S.A. (acquirer) and ENION S.A. (acquiree) was registered with the National Court Register. At the same time, EnergiaPro S.A. changed its name to TAURON Dystrybucja S.A.

On 1 September 2011, merger of Przedsiębiorstwo Energetyki Ciepłej Katowice S.A. (acquirer) and Przedsiębiorstwo Energetyki Ciepłej w Dąbrowie Górniczej S.A. (acquiree) was registered with the National Court Register. At the same time, Przedsiębiorstwo Energetyki Ciepłej Katowice S.A. changed its name to TAURON Ciepło S.A.

The above-mentioned business combinations were effected through merger by acquisition i.e. in accordance with Article 492 § 1 point 1 of the Code of Commercial Companies, by the transfer of all assets and liabilities of the acquired company (acquiree) to the acquiring company (acquirer) in exchange for shares which the acquirer issues to the shareholders of the acquiree. As a result, the acquired companies were dissolved without liquidation.

The aforementioned mergers resulted in the reduction of non-controlling interests by PLN 62 thousand and the increase of retained earnings by PLN 25 thousand.

Division of TAURON Obsługa Klienta Sp. z o.o.

At the beginning of 2011, the organizational structure of the Group's companies dealing with sales was changed. The existing selling companies of the TAURON Group changed the scope of their operations: TAURON Sprzedaż Sp. z o.o. sells electricity to all clients (under the TAURON Polska Energia brand), while TAURON Obsługa Klienta Sp. z o.o. provides customer service to mass clients and part of business clients. The integration of activities relating to sales and customer service results from the Group's implementation of a business model representing part of its restructuring plan.

On 3 January 2011, the District Court in Cracow registered the increase of the share capital of TAURON Sprzedaż Sp. z o.o. The division of TAURON Obsługa Klienta Sp. z o.o. was effected pursuant to Article 529 § 1 point 4 of the CCC, i.e. by way of the acquisition by TAURON Sprzedaż Sp. z o.o. of part of the assets of TAURON Obsługa Klienta Sp. z o.o. representing an organized part of the enterprise which comprised tangible and intangible assets and liabilities related to the sale of electricity. The share capital of

TAURON Sprzedaż Sp. z o.o. was increased by PLN 196,433 thousand, from PLN 282,597 thousand to PLN 479,030 thousand, by way of creating 3,928,649 shares with a nominal value of PLN 50 each, all of which were taken up by TAURON Polska Energia S.A.

As a result of the division of TAURON Obsługa Klienta Sp. z o.o., its share capital was decreased by PLN 32,932 thousand, from PLN 35,650 thousand to PLN 2,718 thousand, by way of redemption of 329,316 shares with a value of PLN 100 each. The decrease of the share capital was registered on 31 December 2010.

Due to the fact that the changes discussed above were of restructuring nature and took place in the Group companies, they had no impact on the consolidated financial statements prepared as at 31 December 2011.

Increase of interest in Polska Energia Pierwsza Kompania Handlowa Sp. z o.o.

In March 2011, Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. signed contracts for the purchase of 200 of its own shares with a total nominal value of PLN 1,200 thousand from the shareholders of Katowicki Holding Węglowy S.A. and KWK Kazimierz Juliusz Sp. z o.o.

The purchase of shares for the purpose of redeeming them using the net profit was made based on the resolution of the Extraordinary Shareholders' Meeting of Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. dated 30 December 2010. The consideration for the shares was paid to both of the existing shareholders until the end of March 2011. On 21 April 2011, the District Court in Katowice registered redemption of shares of Polska Energia Pierwsza Kompania Handlowa Sp. z o.o.

As a result of this transaction, the direct interest of TAURON Polska Energia S.A. in the share capital of Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. increased from 10% to 12.50% (in the governing body: – from 27.78% to 31.25% votes), while the direct interest of Południowy Koncern Energetyczny S.A. (currently: TAURON Wytwarzanie S.A.) – from 70% to 87.50% (in the governing body – from 61.11% to 68.75% of votes).

The reacquisition of own shares for the purpose of their redemption by Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. resulted in the decrease of non-controlling interests by PLN 11,833 thousand and in the increase of retained earnings by PLN 207 thousand.

On 26 July 2011, Południowy Koncern Energetyczny S.A., currently TAURON Wytwarzanie S.A., signed an agreement with TAURON Polska Energia S.A. for the disposal of shares in Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. in lieu of fulfilling part of Południowy Koncern Energetyczny S.A.'s liability to pay a dividend due to TAURON Polska Energia S.A. for the financial year ended 31 December 2010. Południowy Koncern Energetyczny S.A. disposed of all of its shares in Polska Energia Pierwsza Kompania Handlowa Sp. z o.o., i.e. 700 shares with a total nominal value of PLN 4,200 thousand, for a total of PLN 42,170 thousand. The value of the acquired shares was determined based on the valuation dated 20 June 2011. On 26 July 2011 the shares were transferred to the Company. As a result of this transaction, TAURON Polska Energia S.A. increased its direct interest in the company's capital and governing body to 100%, which resulted in the reduction of non-controlling interests and a simultaneous increase of retained earnings by PLN 213 thousand.

Acquisition of non-controlling interests

In August 2011, TAURON Polska Energia S.A. acquired the following from non-controlling equity holders:

- 9,477 shares in Południowy Koncern Energetyczny S.A., currently TAURON Wytwarzanie S.A., with a nominal value of PLN 10 each, representing 0.0061% of the company's share capital, for the price of PLN 235 thousand,
- 6,149,541 shares in ENION S.A., currently TAURON Dystrybucja S.A., with a nominal value of PLN 0.01 each, representing 0.0245% of the company's share capital, for the price of PLN 676 thousand.

Consideration for the acquired shares was paid in August 2011.

As a result of the acquisition of shares, the amount of non-controlling interests decreased by PLN 1,104 thousand, while retained earnings increased by PLN 192 thousand.

Mandatory squeeze-out

During the year 2011, the processes of mandatory squeeze-out were continued by the following companies of the TAURON Polska Energia S.A. Group: TAURON Wytwarzanie S.A. (including, before the date of the merger, by Południowy Koncern Energetyczny S.A. and Elektrownia Stalowa Wola S.A.), TAURON Dystrybucja S.A. (including, before the date of the merger, by ENION S.A. and EnergiaPro S.A.), Elektrociepłownia Tychy S.A., and also, before the date of the merger – by Przedsiębiorstwo Energetyki Ciepłej Katowice S.A.

As a result of the reacquisition of own shares, the amount of non-controlling interests decreased during the year 2011 by PLN 38,536 thousand, while retained earnings increased by PLN 14,772 thousand.

31. Issued capital and other items of equity

31.1. Issued capital

Issued capital as at 31 December 2011

Class/issue	Type of shares	Type of preference	Number of shares	Nominal value of one share (in PLN)	Value of class/issue at nominal value	Method of payment
AA	bearer shares	–	1 589 438 762	5	7 947 194	cash/in-kind contribution
BB	registered shares	–	163 110 632	5	815 553	in-kind contribution
Total			1 752 549 394		8 762 747	

Issued capital as at 31 December 2010

Class/issue	Type of shares	Type of preference	Number of shares	Nominal value of one share (in PLN)	Value of class/issue at nominal value	Method of payment
AA	bearer shares	–	1 589 438 762	9	14 304 949	cash/in-kind contribution
BB	registered shares	–	163 110 632	9	1 467 996	in-kind contribution
Total			1 752 549 394		15 772 945	

On 25 March 2011, the District Court in Katowice registered a decrease of the Company's share capital effected by way of the reduction of the nominal value of shares. The share capital decreased from PLN 15,772,945 thousand to PLN 8,762,747 thousand, due to the reduction of the nominal value of each share from PLN 9 to PLN 5. The resulting amount of PLN 7,010,198 thousand was allocated to the reserve capital. The decrease of the share capital was made in order to restructure the Company's equity.

Shareholding structure as at 31 December 2011 (to the Company's best knowledge)

Shareholder	Value of shares	Percentage of share capital	Percentage of total vote
State Treasury (notification of 29 March 2011)	2 634 419	30.06%	30.06%
KGHM Polska Miedź S.A. (notification of 23 March 2011)	910 553	10.39%	10.39%
ING Otwarty Fundusz Emerytalny (notification of 28 December 2011)	443 715	5.06%	5.06%
Other shareholders	4 774 060	54.49%	54.49%
Total	8 762 747	100.00%	100.00%

Shareholding structure as at 31 December 2010 (to the Company's best knowledge)

Shareholder	Value of shares	Percentage of share capital	Percentage of total vote
State Treasury (notification of 28 February 2011)	6 618 257	41.96%	41.96%
KGHM Polska Miedź S.A.*	736 402	4.67%	4.67%
Other shareholders	8 418 286	53.37%	53.37%
Total	15 772 945	100.00%	100.00%

* According to the notification of 1 July 2010, the share of KGHM Polska Miedź S.A. in the share capital and total vote was 5.15%. On 2 November 2010, there was an increase in the share capital and in the number of shares to 1,752,549,394, as a result of which the share of KGHM Polska Miedź S.A. in the share capital and total vote as at 31 December 2010 amounted to 4.67%.

31.2. Shareholders rights

State Treasury rights

On 18 August 2005, the Act of 3 June 2005 on Special Powers of the State Treasury and their Exercise in Companies of Significant Importance for Public Order or Public Security (Journal of Laws No. 132, item 1108) came into force. TAURON Polska Energia S.A. is subject to the provisions of this Act under relevant executive regulations. In the directors' opinion, the Company operates in conformity with the binding law. No observer has been appointed as at the date of these financial statements.

31.3. Reserve capital

Reserve capital results from appropriations of profits generated by the parent in previous financial years, amounting to PLN 240,209 thousand, and the surplus of the issue price of shares class BB (PLN 10.44 each) over their par value (PLN 9 each), amounting to PLN 234,879 thousand.

In the current period, movements in reserve capital resulted from the following events:

- In accordance with the resolution of the Ordinary General Shareholders' Meeting of TAURON Polska Energia S.A. dated 6 May 2011, described in detail in Note 29 to the consolidated financial statements, part of the Company's reserve capital in the amount of PLN 72,404 thousand resulting from the net profit for 2009 was allocated for the payment of dividend to the Company's shareholders.
- As a result of registration of the decrease of the Company's share capital by way of reduction of the nominal value of shares with the District Court in Katowice on 25 March 2011, as described in detail in Note 31.1 to the consolidated financial statements, an amount of PLN 7,010,198 thousand was allocated to the Company's reserve capital.

31.4. Retained earnings and restrictions on distribution

Retained earnings also include amounts that are not eligible for distribution i.e. cannot be distributed in the form of dividends by the parent:

	As at 31 December 2011	As at 31 December 2010
Retained earnings not distributable by the parent:	(1 581 456)	(1 733 447)
– retained earnings of subsidiaries, attributable to equity holders of the parent	(1 435 805)	(1 587 796)
– 8% statutory net profit of the parent allocated to reserve capital under the Commercial Companies Code	–	–
– retained earnings from accounting for merger with subsidiaries	(145 651)	(145 651)
Retained earnings of the parent eligible for distribution	1 083 461	190 510
Total retained earnings in the consolidated financial statements, attributable to equity holders of the parent	(497 995)	(1 542 937)

In accordance with the provisions of the Code of Commercial Companies, the parent and the subsidiaries having the legal form of a joint-stock company are required to create a reserve capital for absorption of losses. Transferred to this capital category is at least 8% of the profit for the given financial year reported in the separate financial statements of the company until such time as the balance of the reserve capital reaches at least one third of the issued share capital of the company. As the amount of the Company's reserve capital exceeds one third of its issued share capital, the Company is not required to transfer 8% of the profit for the year to the reserve capital. Appropriation of the reserve capital and other reserves depends on the decision of the General Meeting of Shareholders; however, the reserve capital in the amount of one third of the issued share capital may be used solely for the absorption of losses reported in the separate financial statements of the company and shall not be used for any other purpose.

As at 31 December 2011, the value of the issued share capital of the parent reported in the statutory financial statements was PLN 8,762,747 thousand, and the value of the reserve capital was PLN 7,412,882 thousand.

Retained earnings arising from the settlement of capital resulting from share-based payments after the completion of the share option plan as well as retained earnings arising from accounting for business combinations with the subsidiaries are not available for distribution.

As at 31 December 2011 and as at the date of authorization of these financial statements for issue, there are no other restrictions on distribution of profit in the form of dividends.

31.5. Non-controlling interests

	Year ended 31 December 2011	Year ended 31 December 2010
At the beginning of period	507 246	2 375 100
Dividends paid by subsidiaries	(14 278)	(6 027)
Share in the change in value of financial instruments	–	135
Acquisition of non-controlling interests by the Group	(1 104)	(1 983 152)
Mandatory squeeze-out	(50 582)	(11 537)
Share in subsidiaries' net profit or loss	19 349	132 727
Acquisition of subsidiaries from the GZE S.A. Group	778	–
Change in non-controlling interests due to mergers	(62)	–
At the end of period	461 347	507 246

The expenditures incurred for the acquisition of non-controlling interests, presented in the consolidated cash flow statement at an amount of PLN 37,800 thousand, are comprised of the following: expenditures of PLN 25,225 thousand incurred by the Group subsidiaries for the mandatory squeeze-out of shares, expenditures of PLN 11,626 thousand incurred by the subsidiary Polska Energia Pierwsza Kompania Handlowa Sp. z o.o. for the acquisition of shares with a view to their redemption, and expenditures of PLN 949 thousand incurred by the parent for the acquisition of non-controlling interests in the subsidiaries.

32. Provisions

32.1. Movements in provisions

Year ended 31 December 2011

	Provision for counterparty claims, court disputes, onerous contracts, disputes with employees	Provision for restructuring	Provision for restoration of land and dismantling and removal of fixed assets	Provision for gas emission obligations	Provision for obligation to submit energy certificates	Provision for use of real estate under power generation facilities without contract and other provisions	Provisions, total
Opening balance	34 274	612	34 699	101 173	787 031	66 903	1 024 692
Acquisition of subsidiary	576	765	8 679	–	100 559	30 575	141 154
Discount rate adjustment	–	–	1 014	–	–	–	1 014
Recognition	12 640	797	23 726	187 132	1 018 586	20 948	1 263 829
Reversal	(7 905)	(1)	–	–	–	(29 336)	(37 242)
Utilisation	(96)	(1 229)	–	(101 173)	(1 199 103)	(4 222)	(1 305 823)
Other movements	3 660	–	1 732	–	(3 624)	1 360	3 128
Foreign exchange differences from translation of foreign entities	–	–	–	–	–	16	16
Closing balance	43 149	944	69 850	187 132	703 449	86 244	1 090 768
CURRENT	43 149	944	3 250	187 132	703 449	85 404	1 023 328
NON-CURRENT	–	–	66 600	–	–	840	67 440

Year ended 31 December 2010

	Provision for counterparty claims, court disputes, onerous contracts, disputes with employees	Provision for restructuring	Provision for restoration of land and dismantling and removal of fixed assets	Provision for gas emission obligations	Provision for obligation to submit energy certificates	Provision for use of real estate under power generation facilities without contract and other provisions	Provisions, total
Opening balance	19 552	238	22 639	–	750 015	62 360	854 804
Discount rate adjustment	–	–	961	–	–	–	961
Recognition	18 777	374	8 461	101 173	1 071 510	13 939	1 214 234
Reversal	(3 948)	–	(256)	–	(10 478)	(2 006)	(16 688)
Utilisation	(107)	–	–	–	(1 024 016)	(7 390)	(1 031 513)
Other movements	–	–	2 894	–	–	–	2 894
Closing balance	34 274	612	34 699	101 173	787 031	66 903	1 024 692
CURRENT	34 274	612	–	101 173	787 031	66 163	989 253
NON-CURRENT	–	–	34 699	–	–	740	35 439

32.2. Details of significant provisions

32.2.1. Provision for counterparty claims, court disputes, onerous contracts

Provision for proceedings before the Consumers and Competition Protection Office

Provision for the proceedings pending before the Competition and Consumers Protection Office amounts to PLN 11,576 thousand. Part of the provision amounting to PLN 4,274 thousand was reversed in December 2011 as a result of winning part of the dispute.

Provision for claims of ArcelorMittal Poland S.A.

The provision for the claims of ArcelorMittal Poland S.A. amounts to PLN 7,200 thousand and did not change in comparison to the provision as at 31 December 2010.

Provision for the claims of IPW Polin Sp. z o.o.

The subsidiary Elektrociepłownia EC Nowa Sp. z o.o. recognized provisions for a potential dispute with IPW Polin Sp. z o.o. over settlements arising from the use of invention projects. In December 2011, the company was served with a suit for the calculation and payment of cash to IPW Polin for the use of a technology enhancing boiler efficiency which was covered by invention projects. Also in December 2011, the company was served with a summons before a court in the capacity of a defendant in a case relating to consideration for the use of inventions registered for protection with the Polish Patent Office. The suit was filed by one of the co-authors of the invention projects enhancing boilers efficiency. The company's management, being aware of the difficulties in estimating the probability of a favorable outcome of the court dispute, decided to recognize provisions for the full amount of the claims, i.e. PLN 8,731 thousand.

In the settlements with IPW Polin Sp. z o.o., the subject of the dispute also includes the results of the application of new technologies in the operation of turbogenerators. The company's management estimates that the provision for a potential settlement of invention projects relating to turbogenerators should account for 50% of the total estimated settlement. Based on the methodology applied to date, the estimated provision in this respect amounts to PLN 1,550 thousand.

32.2.2. Provision for restoration of land and costs of dismantling and removal of fixed assets

Under the Geological and Mining Law, Południowy Koncern Węglowy S.A. and Kopalnia Wapienia Czatkowice Sp. z o.o. recognize provisions for future decommissioning costs of their mining facilities. These provisions are recognized based on the estimate of the anticipated decommissioning costs related to the dismantling and removal of mining and other technological facilities and the restoration of land to its original condition after completion of mining activities. The amounts of the provisions are estimated based on expert studies and technological and economic analyses prepared by in-house staff or external experts. The amounts of the provisions are estimated and reviewed at each balance sheet date on the basis of current cost estimates, assessments of the usage of land and inflation and discount rates. As at 31 December 2011, the provision recognized by Kopalnia Wapienia Czatkowice Sp. z o.o.

amounted to PLN 3,591 thousand, and the provision recognized by Południowy Koncern Węglowy S.A., including the Mine Decommissioning Fund, amounted to PLN 25,691 thousand.

In 2011, TAURON Wytwarzanie S.A. recognized a provision for the restoration of land under waste dumps at an amount of PLN 18,000 thousand.

Vattenfall Wolin-North Sp. z o.o. and Lipniki Sp. z o.o. recognized a provision for the cost of dismantling wind farms after the completion of their usage, at an amount of PLN 8,698 thousand and PLN 4,912 thousand, respectively.

Due to the legal obligation to dismantle and remove fixed assets after the period of their usage, TAURON Wytwarzanie S.A. recognizes a provision for the estimated future costs necessary to discharge this obligation. As at 31 December 2011, the provision amounted to PLN 8,958 thousand.

32.2.3. Provision for obligation to surrender energy certificates

Due to the sale of electricity to final users, the Group is required to surrender for cancellation a certain number of certificates of electricity generated using renewable sources, gas-fired plants and cogeneration. As at 31 December 2011, the provision recognized in this respect amounted to PLN 703,449 thousand.

32.2.4. Provision for gas emission related obligations

As a result of the purchase of greenhouse gas emission allowances by TAURON Wytwarzanie S.A., Elektrociepłownia EC Nowa Sp. z o.o. and Elektrociepłownia Tychy S.A., during the year under review those companies recognized a provision for the cost of surrendering those allowances for cancellation. As at 31 December 2011, the provision amounted to PLN 187,132 thousand.

32.2.5. Other provisions

Provision for use of land without a contract

The Group companies recognize provisions for all claims reported by the owners of real estate on which distribution systems and heat installations are located. As at 31 December 2011, the provision amounted to PLN 42,466 thousand. The companies do not recognize provisions for unreported potential claims from owners of land with an unregulated status.

Provision for real estate tax

Due to pending tax proceedings, and taking into consideration the verdict of the Constitutional Tribunal of 13 September 2011 as well as the current case law, Południowy Koncern Węglowy S.A. recognizes a provision for the real estate tax on structures located in underground workings. As at 31 December 2011, the provision for real estate tax including interest amounted to PLN 2,036 thousand. In 2011, the company reversed a provision for real estate tax including interest in the amount of PLN 13,938 thousand.

The remaining amount of provisions includes provisions for reported and acknowledged mining damages and potential penalties and indemnities.

33. Capital commitments

As at 31 December 2011, the Group has commitments to incur expenditures for property, plant and equipment at an amount of PLN 1,603,316 thousand, which mainly include the capital commitment of PLN 165,914 thousand relating to boiler accommodation in the Jaworzno III Power Plant, being the property of TAURON Wytwarzanie S.A., to reduce emission of greenhouse gases, and the capital commitment of PLN 151,795 thousand relating to the restoration of production capacity in the Bielsko-Biała CHP Plant, being part of TAURON Wytwarzanie S.A.

As at 31 December 2010, the TAURON Polska Energia S.A. Group had commitments to incur expenditures for property, plant and equipment at an amount of PLN 1,096,642 thousand. The largest item was the capital commitment of PLN 360,700 thousand relating to the restoration of production capacities in the Bielsko-Biała CHP Plant, being part of TAURON Wytwarzanie S.A.

34. Contingent liabilities

Mining damages

The Group, as part of its policy to recognize provisions for future liabilities, recognizes and presents in its consolidated financial statements provisions for mining damages resulting from the mining activities of the mining companies, at the amount of documented claims reported, acknowledged or examined by courts in this respect. The mining companies being part of the Group are not aware of any method to determine the amount of future mining damages that would enable them to reliably estimate the amount of future costs of repair of mining damages arising in the course of extraction of deposits.

Use of real estate without a contract

The distribution companies being part of the Group does not have the legal title to all plots of land on which the distribution systems and the related equipment are situated. In the future the Group may be required to incur costs for the use of real estate without underlying contracts; however, it must be emphasized that the risk of loss of assets is remote. The Group recognizes a provision for all court disputes in this respect. The Group does not recognize a provision for unreported potential claims from owners of land with an unregulated status due to the lack of a detailed record of unregulated land and the resulting inability to reliably estimate the amount of potential claims. However, considering the history of reported claims and the costs incurred in this respect in previous years, the risk of incurring significant costs in respect of such claims can be considered as remote.

Compensation for stranded costs

As a result of the Act of 29 June 2007 on the Principles for Covering Costs Incurred by Electricity Generators due to Early Termination of Long-term Power Purchase Agreements (Journal of Laws of 2007, No. 130, item 905 – “the PPA Act”) coming into effect, TAURON Wytwarzanie S.A. volunteered to join the program of early termination of long-term power purchase agreements (“PPAs”) by signing an agreement to terminate such contracts. The signing of such an agreement provides a basis for electricity generators to receive funds to cover their expenses that are not covered by the income derived from the sale of generated electricity, reserve capacity and system-related services on a competitive market after early termination of PPAs, resulting from the expenditures incurred by such companies for assets related to electricity generation up to 1 May 2004. Under the PPA Act, the maximum amount of stranded costs and the amounts used in the calculation of annual adjustments to stranded costs were established for each electricity generator. After termination of PPAs, beginning from the year 2008, TAURON Wytwarzanie S.A. receives quarterly cash advances based on the submitted requests. Annual adjustments will be subsequently made to stranded costs throughout the so-called adjustment period, lasting until the expiry of the longest long-term agreement held by the given company. The final adjustment to stranded costs will be made in the year following the year in which the adjustment period of the given company ceases.

In accordance with the accounting policy adopted, in 2008, 2009, 2010 and 2011 Południowy Koncern Energetyczny S.A. (now TAURON Wytwarzanie S.A.) recognized, based on the developed financial model, compensation revenue amounting to PLN 192,163 thousand, PLN 483,956 thousand, PLN 437,875 thousand and PLN 414,795 thousand, respectively.

Under the decision of the President of the Energy Regulatory Office (URE) dated 31 July 2009, TAURON Wytwarzanie S.A. was required to return an amount of PLN 159,508 thousand to Zarządca Rozliczeń S.A. by 30 September 2009. The company appealed against the above decision to the Regional Court in Warsaw – the Court for Competition and Consumers Protection through the President of URE and submitted a motion to suspend its execution. On 24 September 2009, the Court issued a decision to suspend the execution of the decision with regard to amounts exceeding PLN 79,754 thousand. In accordance with the Court’s ruling, the company paid the amount referred to above.

In the judgment of the Regional Court in Warsaw – the Court for Competition and Consumers Protection dated 26 May 2010, the Court modified the challenged decision and acknowledged the company’s right to make a positive adjustment to stranded costs of PLN 79,088 thousand.

On 8 July 2010, the President of URE lodged an appeal against the judgment of the Regional Court in Warsaw – the Court for Competition and Consumers Protection with the Court of Appeal in Warsaw (The 6th Civil Department).

On 9 February 2012, a hearing was held before the Court of Appeal in Warsaw in the case relating to the President of URE’s appeal from the judgment of the Regional Court in Warsaw – the Court for Competition and Consumers Protection dated 26 May 2010. The Court of Appeal did not pass a judgment; instead it adjourned the hearing and obligated the President of URE to submit additional explanations within 14 days. The deadline for the next hearing is to be set ex officio. It is expected that the next hearing will be held no earlier than in two months.

At the date of these consolidated financial statements, the issue of the annual adjustment to stranded costs for 2008 is still under dispute.

In the decision of 29 July 2011, the President of URE determined the amount of the annual adjustment to be made by TAURON Wytwarzanie S.A. to stranded costs for 2010 at PLN 205,703 thousand. On 30 September 2011, Zarządca Rozliczeń S.A. paid the amount of the annual adjustment for the year 2010 to the company.

	Year ended 31 December 2011	Year ended 31 December 2010
Revenue from compensations for terminated PPAs	414 795	437 875
Proceeds from compensations for terminated PPAs	373 975	339 323

Antimonopoly proceedings

The Competition and Consumers Protection Office is conducting two antimonopoly proceedings with respect to TAURON Dystrybucja S.A. These proceedings relate to the alleged abuse of the dominant position on the electricity distribution market. Appeals have been filed against the decision of the Competition and Consumers Protection Office (see Note 32.2.1 concerning provisions). The Company’s directors

and management of TAURON Dystrybucja S.A. believe that the company's operations in the area of electricity distribution are carried out in conformity with binding regulations and the outcome of the above-mentioned proceedings will have no significant impact on the Group's financial position.

Administrative proceedings instituted by the President of the Energy Regulatory Office

TAURON Dystrybucja S.A., TAURON Sprzedaż Sp. z o.o.

Due to interruptions in electricity supply, in 2010 the President of the Energy Regulatory Office (URE) instituted ex officio proceedings in the matter of imposing cash penalties on ENION S.A. (now TAURON Dystrybucja S.A.) and TAURON Sprzedaż Sp. z o.o. due to the identification of a breach of law in their operations consisting in the application of rates and charges that were inconsistent with the terms relating to bonuses granted for interruptions in electricity supply. These proceedings ended with the Decision of the President of URE of 11 March 2011 imposing cash penalties on ENION S.A. at an amount of PLN 1,000 thousand and on TAURON Sprzedaż Sp. z o.o. at an amount of PLN 500 thousand. Both companies filed an appeal against the aforementioned decision with the Court of Competition and Consumers Protection. At the same time, in March 2011 TAURON Sprzedaż Sp. z o.o. recognized a provision of PLN 500 thousand for the potential obligation to pay the above-mentioned penalty. On 22 September 2011 TAURON Sprzedaż Sp. z o.o. received a reply of the President of URE to the company's appeal. In his reply the President of URE asked for the dismissal of the appeal. As at the date of these consolidated financial statements, no date has been set for the hearing before the Court of Competition and Consumers Protection.

Vattenfall Sales Poland Sp. z o.o.

In addition, the President of URE instituted administrative proceedings in the matter of imposing a cash penalty on Vattenfall Sales Poland Sp. z o.o. under Article 56 section 1 point 5 of the Energy Law, based on the allegation that, in 2008–2011, the company used prices and tariffs which had not been submitted for the required approval. The company is of the opinion that it did not breach any law in this respect. In order to avoid being charged with a direct allegation of failing to fulfill the request of the President of URE and thus falling under the provisions of the Energy Law, the company, at the request of the President of URE, submitted electricity tariffs for the years 2008–2011 for approval, although it was exempt from the requirement to submit electricity tariffs (exemption based on the position of the President of URE dated 28 June 2001). However, the applications for the years 2008, 2009 and 2011 were not approved, and the proceedings for the approval of the electricity tariff for 2010 were cancelled based on the Decision of the President of URE.

The administrative proceedings for the approval of the tariff for 2011 are pending since 11 February 2011. Vattenfall Sales Poland Sp. z o.o. filed an appeal with the Court for Competition and Consumers Protection from the Decision of the President of URE refusing to approve electricity tariffs for 2011. The President of URE filed a reply to the company's appeal. The case is pending at the date of authorization of these financial statements.

Elektrociepłownia EC Nowa Sp. z o.o.

On 23 February 2012, the subsidiary Elektrociepłownia EC Nowa Sp. z o.o. was served with a notification about administrative proceedings instituted on 17 February 2012 by the President of Energy Regulatory Office in the matter of imposing a cash penalty. These proceedings relate to the disclosure of irregularities consisting in non-compliance with the requirements referred to in Article 49a section 1 of the Energy Law, i.e. the requirement to sell electricity generated in the period from 9 August 2010 to 31 December 2010 on commodity exchange markets or on a regulated market.

As of 9 August 2010, an amendment to the Energy Law imposing a requirement on electricity generators to sell not less than 15% of electricity on commodity exchange markets (Article 49a) came into effect. Among others, this requirement did not extend to power which:

- was supplied by a power generating company to the final user through a direct line,
- was produced in cogeneration,
- was produced in a generation unit with total installed capacity not exceeding 50 MW.

In its correspondence with the Energy Regulatory Office, EC Nowa Sp. z o.o. expressed an opinion that all the above-mentioned exemptions apply to the company. However, despite the numerous arguments in favor of the application to EC Nowa of the three aforementioned exemptions from the requirement to sell electricity through power exchange markets, the Energy Regulatory Office in Warsaw instituted administrative proceedings in this matter. The amount of the cash penalty that may be imposed by the President of URE may not exceed 15% of revenue from licensed activities. Thus, the maximum amount of the potential penalty may be as follows:

- for the period from 9 August to 31 December 2010: PLN 2,927 thousand,
- for the period from 1 January to 31 December 2011: PLN 9,706 thousand.

In the company's opinion, the Energy Regulatory Office made an overinterpretation of the conditions for exemption from the requirement to sell electricity, by changing or supplementing the original provisions of the Energy Law. In addition, the President of URE did not take into consideration all of the company's explanations previously made in this respect. The company, therefore, maintains its position that it is exempt from the requirement to sell part of electricity through exchange markets. The company's management believe that

the probability of an unfavorable outcome in this case, even in the court, is minimal. Therefore, it has not recognized any provision for those events.

Administrative proceedings instituted by the President of the Competition and Consumers Protection Office

In the letter dated 26 July 2011, the President of the Competition and Consumers Protection Office (UOKiK) notified TAURON Sprzedaż Sp. z o.o. about instituting administrative proceedings with regard to the company's alleged use of practices violating collective consumers' interests. In the letter dated 16 September 2011, the company's attorney applied for conducting the said proceedings in the direction of issuing a decision imposing on the company the requirement to fulfill an obligation to discontinue activities violating collective consumers' interests and to undertake activities to prevent continued existence of the alleged violations. On 14 November 2011, the President of the Competition and Consumers Protection Office accepted the obligation of TAURON Sprzedaż Sp. z o.o. and imposed on it a requirement to fulfill the obligation, while setting the deadline for its fulfillment at 1 June 2012. The Company is in the course of fulfilling the obligation imposed on it.

Claims of Huta Łaziska S.A.

In recent years, the subsidiary Górnośląski Zakład Elektroenergetyczny S.A. (GZE) was party to court disputes with Huta Łaziska S.A. (Huta). The main reason for this was the withholding of electricity supplies to Huta by GZE in 2001 due to payment arrears.

Based on the decision of 12 October 2001, the President of URE ordered GZE to resume electricity supplies to Huta on the terms of the agreement dated 30 July 2001 at the price of PLN 67/MWh until the date of final resolution of the dispute, and on 14 November 2001 the President of URE finally resolved the dispute by issuing a decision stating that the withholding of electricity supplies was not unjustified. Huta appealed against this decision. On 25 July 2006, the Court of Appeal in Warsaw passed a final judgment ending the dispute over the decision of the President of URE dated 14 November 2001. Huta lodged a cassation appeal against the judgment of the Court of Appeal, which was dismissed by the judgment of the Supreme Court dated 10 May 2007.

Due to the withholding of electricity supplies, Huta has raised a number of various claims against GZE, none of which was recognized by the courts as justified. Currently an action is pending under Huta's suit of 13 March 2007 against GZE and the State Treasury for the payment of PLN 182,060 thousand together with interest from the date of filing the suit to the date of payment, for damages to be paid for alleged losses resulting from alleged GZE's failure to comply with the decision of the President of URE dated 12 October 2001. In this case, on 26 October 2009 the Regional Court in Warsaw passed a judgment dismissing the claim in whole, and the Court of Appeal dismissed in whole Huta's appeal; however, in the judgment of 29 December 2011 the Supreme Court overruled the judgment of the Court of Appeal and remanded the case for reexamination by this Court.

Based on the company's legal analysis of the claims raised by Huta and by its main shareholder, GEMI Sp. z o.o., the company believes that they are groundless and the risk of their satisfaction is remote. As a result, there is no need to recognize a provision for any costs associated with these claims.

Excise

Contingent liabilities resulting from excise are presented in Note 35.

Other contingent liabilities

	As at 31 December 2011	As at 31 December 2010
Loans'/credits' repayment guarantee	2 408	3 108
Promissory note's repayment guarantee	–	414
Bank's guarantee liabilities	1 898	2 251
Legal action's liabilities	2 797	2 400
Other contingent liabilities	2 863	2 195
Total contingent liabilities	9 966	10 368

35. Tax settlements

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 severe fines, penalties and interest charges. The lack of reference to well established regulations in Poland results in a lack of clarity and integrity in the regulations. 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 substantially more significant than those typically found in countries with more developed tax systems.

Tax authorities may examine the accounting records within 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. The Group believes that adequate provisions have been recorded for known and quantifiable risks in this regard as at 31 December 2011.

As at the date of these consolidated financial statements, the following proceedings are pending in the Group companies in respect of state budget settlements:

Excise

Due to the non-compliance of Polish regulations regarding excise charged on electricity with EU regulations, on 11 February 2009 the power plants and combined heat and power plants being part of the TAURON Group submitted corrections of their tax declarations along with requests to recognize an overpayment of excise for the years 2006–2008 and for January and February 2009. The total amount of the overpayment stated in the requests (excluding interest) was approximately PLN 901,428 thousand. Currently proceedings relating to the individual companies in the TAURON Group are pending before the appropriate Customs Chambers and Voivodship Administrative Courts.

On 12 February 2009, the European Court of Justice passed a judgment confirming that Poland had breached the EU law by failing to adjust, until 1 January 2006, its electricity taxation system to the requirements of Article 21 paragraph 5 of the European Council Directive 2003/96/EC of 27 October 2003 on Restructuring the Community Framework for the Taxation of Energy Products and Electricity (amended by the Council Directive 2004/74/EC dated 29 April 2004), as, in the period until 28 February 2009, the tax obligation in respect of excise on electricity in Poland arose at the moment the electricity was issued by the generator instead of at the moment of its supply by the distributor or redistributor.

In the light of the above, there are grounds for obtaining a refund of the excise paid in breach of the EU law. The Ministry of Finance is, however, of the opinion that such a refund would result in an unjustified enrichment of electricity-generators and hence it is groundless. For this reason, the process of excise recovery may extend until court decisions.

At the same time, certain contractors of the TAURON Group submitted claims against companies selling electricity for adjustment of the prices of purchased electricity, on the grounds that the price of electricity included excise which should be refunded by the State Treasury to electricity purchasers.

Due to the significant uncertainty regarding the final resolution of the above issue, in these consolidated financial statements the Group did not recognize any effects of the potential refund of overpaid excise or the existing or potential claims of electricity purchasers.

Real estate tax

The details of provisions for disputes relating to real estate tax on workings and the related structures are presented in Note 32.2.5.

The approach to taxation of equipment used for generation and transmission of electricity with real estate tax is subject to varying interpretations. Due to the fact that the real estate tax is collected by local authorities, their approach is not consistent and sometimes the calculation of taxable base is challenged. At the date of these consolidated financial statements, the potential outcomes of the proceedings conducted in this respect are not significant for the TAURON Group. The Group's position with regard to taxation of energy equipment with real estate tax may change in the future, depending on the decisions issued by courts and potential changes in law.

36. Related party disclosures

The main shareholder of the Group is the State Treasury of the Republic of Poland, therefore State Treasury companies are treated as related parties.

36.1. Transactions with State Treasury companies

The total value of transactions with State Treasury companies is presented in the table below.

Revenues and expenses

	Year ended 31 December 2011	Year ended 31 December 2010 (adjusted figures)
Revenue	1 746 443	1 502 099
Costs*	(3 168 992)	(3 585 358)

* Includes costs recognized in the statement of comprehensive income.

Receivables and payables

	As at 31 December 2011	As at 31 December 2010 (adjusted figures)
Receivables	469 020	249 525
Payables	571 740	379 597

Among the State Treasury companies, the following were the largest clients of the TAURON Polska Energia S.A. Group during the year 2011: PSE Operator S.A., KGHM Polska Miedź S.A. and Kompania Węglowa S.A. Total sales to these counterparties accounted for almost 85% of revenue from transactions with State Treasury companies. The largest purchase transactions were made by the Group with PSE Operator S.A., Kompania Węglowa S.A. Purchases from these counterparties accounted for over 77% of the value of purchases from the State Treasury companies during the year 2011.

Among the State Treasury companies, the following were the largest clients of the TAURON Polska Energia S.A. Group during the year 2010: PSE Operator S.A., KGHM Polska Miedź S.A. and Kompania Węglowa S.A. Total sales to these counterparties accounted for almost 78% of revenue from transactions with State Treasury companies. The largest purchase transactions were made by the Group with PSE Operator S.A. and Kompania Węglowa S.A. The related costs accounted for 62% of the costs incurred as a result of purchases from the State Treasury companies during the year 2010. The Group enters into significant transactions in the energy market through Izba Rozliczeniowa Giełd Towarowych S.A. As this entity only deals with organization of commodities exchange trading, a decision was taken not to consider purchase and sale transactions made through this entity as related party transactions. The comparative figures for 2010 have been restated.

Transactions with State Treasury companies mainly relate to the operating activities of the Group and are made at an arm's length.

36.2. Compensation of key management personnel

Up until 28 June 2010, the compensation of the Directors and Supervisory Board members was subject to the provisions of the Act of 3 March 2000 on Remunerating Individuals Being in Charge of Certain Legal Entities (companies with a majority shareholding of the State Treasury). In accordance with the provisions of this Act, the maximum monthly remuneration cannot exceed six times the amount of the average monthly remuneration in the business sector excluding profit-based bonuses in the fourth quarter of the preceding year, as announced by the President of the Central Statistical Office. The amount of the annual bonus for the Board of Directors must not exceed three times their average monthly remuneration in the year preceding the year in which the bonus was granted.

Other transactions, arising from civil law contracts concluded between the parent and members of its governing bodies, relate to the use of business cars for private purposes.

In addition, during the year covered by these consolidated financial statements, members of the executive and supervisory bodies of the Group companies received loans from the Social Fund. The balance of outstanding loans as at 31 December 2011 was PLN 18 thousand.

	Parent		Subsidiaries	
	Year ended 31 December 2011	Year ended 31 December 2010	Year ended 31 December 2011	Year ended 31 December 2010
Board of Directors	8 863	5 967	23 860	15 318
Short-term employee benefits (salaries and surcharges)	7 933	5 200	20 740	14 282
Jubilee bonuses	–	73	42	246
Post-employment benefits	83	41	756	–
Employment termination benefits	–	–	325	31
Other	847	653	1 997	759
Supervisory Board	812	329	2 067	2 872
Short-term employee benefits (salaries and surcharges)	812	329	1 971	2 691
Jubilee bonuses	–	–	–	–
Post-employment benefits	–	–	–	–
Employment termination benefits	–	–	–	–
Other	–	–	96	181
Total	9 675	6 296	25 927	18 190
Other key management personnel	7 163	5 745	33 846	32 826
Short-term employee benefits (salaries and surcharges)	6 245	5 079	32 472	31 549
Jubilee bonuses	202	91	842	736
Post-employment benefits	–	–	–	61
Employment termination benefits	88	–	305	–
Other	628	575	227	480

37. Financial instruments

37.1. Carrying amounts and fair values of categories and classes of financial instruments

Categories and classes of financial assets	Carrying amount	
	As at 31 December 2011	As at 31 December 2010
1 Assets at fair value through profit or loss	100 225	7 658
Shares in unlisted and listed companies (current)	716	553
Investment fund units	2	6 848
Derivative instruments	–	257
Bonds, T-bills and other debt securities	99 507	–
2 Financial assets available for sale	170 223	156 089
Shares in unlisted and listed companies (non-current)	161 286	148 514
Shares in unlisted and listed companies (current)	4 588	1 058
Investment fund units	2 124	2 958
Bonds, T-bills and other debt securities	2 225	1 500
Other financial assets available for sale	–	2 059
3 Financial assets held to maturity	–	–
4 Loans and receivables	2 778 390	2 315 043
Trade receivables	1 881 992	1 567 937
Deposits	25 250	35 493
Loans granted	–	240
Other financial receivables	871 148	711 373
5 Financial assets excluded from the scope of IAS 39	22 717	764
Investments in associates and joint ventures recognised using the equity method	22 717	764
5 Derivative hedging instruments (assets)	–	–
6 Cash and cash equivalents	505 670	1 473 981
Total, including	3 577 225	3 953 535
Non-current assets	220 187	178 216
Investments in associates and joint ventures recognised using the equity method	22 717	764
Other long-term financial assets	197 470	177 452
Current assets	3 357 038	3 775 319
Trade and other receivables	2 743 344	2 273 145
Other current financial assets	108 024	28 193
Cash and cash equivalents	505 670	1 473 981

Categories and classes of financial liabilities	Carrying amount	
	As at 31 December 2011	As at 31 December 2010
1 Financial liabilities at fair value through profit or loss	80	6 917
Derivative instruments	80	6 917
2 Financial liabilities measured at amortized cost	6 823 202	3 030 921
Preferential loans	176 966	243 323
Arm's length loans	141 973	309 411
Bank overdrafts	–	2 464
Issued debentures and other debt securities	4 147 174	846 007
Trade payables	1 471 434	945 457
Other financial liabilities	71 744	90 057
Commitments resulting from purchases of fixed and intangible assets	630 295	388 467
Salaries and wages	148 393	178 482
Insurance contracts	35 223	27 253
3 Liabilities under guarantees, factoring and excluded from the scope of IAS 39	70 993	91 262
Obligations under finance leases and hire purchase contracts	70 993	91 262
4 Derivative hedging instruments (liabilities)	–	–
Total, including	6 894 275	3 129 100
Long-term liabilities	4 316 144	1 150 898
Interest-bearing loans and borrowings	4 251 944	1 076 178
Finance lease and hire purchase commitments	56 232	67 810
Trade payables and other financial long-term liabilities	7 968	6 910
Short-term liabilities	2 578 131	1 978 202
Trade and other payables	2 349 201	1 629 723
Current portion of interest-bearing loans and borrowings	214 169	325 027
Current portion of finance lease and hire purchase commitments	14 761	23 452

The fair value of the financial instruments held by the Group as at 31 December 2011 and 31 December 2010 did not significantly differ from their carrying amounts in the financial statements for the individual years, due to the following reasons:

- the potential discounting effect relating to short-term instruments is not significant;
- the instruments relate to arm's length transactions; and
- where necessary, the carrying amount of shares not traded on an active market was determined taking into account impairment and approximates fair value.

37.2. Items of income, expense, gains and losses recognized in the statement of comprehensive income, by category of financial instruments

Year ended 31 December 2011

	Assets at fair value through profit or loss	Financial assets available for sale	Financial assets held to maturity	Loans and receivables	Financial assets excluded from the scope of IAS 39	Financial liabilities at fair value through profit or loss	Financial liabilities at amortized cost	Liabilities under guarantees, factoring and excluded from the scope of IAS 39	Hedging instruments	Total
Dividends and shares in profits	-	8 196	-	-	7	-	-	-	-	8 203
Interest income/(expense)	54 015	-	18	37 369	-	(2 892)	(54 902)	(5 765)	-	27 843
Currency translation differences	(204)	-	-	7 763	-	(2)	(11 548)	(1 177)	-	(5 168)
Reversal of impairment losses/"upwards" revaluation	18	1 060	315	5 940	-	1 694	-	-	-	9 027
Recognition of impairment losses/"downwards" revaluation	(5)	(268)	-	(7 442)	-	(337)	-	-	-	(8 052)
Commission relating to borrowings and debt securities	-	-	-	-	-	-	(6 205)	-	-	(6 205)
Gain/(loss) on disposal of investments	(35)	(2 590)	-	-	-	-	-	-	-	(2 625)
Net profit (loss)	53 789	6 398	333	43 630	7	(1 537)	(72 655)	(6 942)	-	23 023

Year ended 31 December 2010

	Assets at fair value through profit or loss	Financial assets available for sale	Financial assets held to maturity	Loans and receivables	Financial assets excluded from the scope of IAS 39	Financial liabilities at fair value through profit or loss	Financial liabilities at amortized cost	Liabilities under guarantees, factoring and excluded from the scope of IAS 39	Hedging instruments	Total
Dividends and shares in profits	3	4 351	-	-	450	-	-	-	-	4 804
Interest income/(expense)	36 437	-	570	38 969	-	(16)	(100 703)	(6 880)	(6 065)	(37 688)
Currency translation differences	(196)	-	-	(589)	-	-	(521)	476	-	(830)
Reversal of impairment losses/"upwards" revaluation	759	-	-	8 994	-	-	-	-	-	9 753
Recognition of impairment losses/"downwards" revaluation	(192)	(1 802)	(2 932)	(4 881)	-	-	-	-	(5 772)	(15 579)
Commission relating to borrowings and debt securities	-	-	-	-	-	-	(30 751)	-	-	(30 751)
Gain/(loss) on disposal of investments	(107)	8	-	-	-	-	-	-	-	(99)
Net profit (loss)	36 704	2 557	(2 362)	42 493	450	(16)	(131 975)	(6 404)	(11 837)	(70 390)

37.3. Details of significant items within the individual categories of financial instruments

37.3.1. Assets at fair value through profit or loss

The largest item of assets at fair value through profit or loss is comprised of State Treasury bonds in the amount of PLN 99,507 thousand, acquired by Vattenfall Sales Poland Sp. z o.o. and Vattenfall Distribution Poland S.A.

37.3.2. Financial assets available for sale

Available-for-sale financial assets are mainly comprised of shares in the following companies:

- shares in Spółka Ciepłowniczo-Energetyczna Jaworzno III Sp. z o.o. with a value of PLN 35,694 thousand;
- shares in Knauf Jaworzno III Sp. z o.o. with a value of PLN 19,857 thousand,
- shares in Przedsiębiorstwo Energetyki Ciepłej Sp. z o.o. Tychy with a value of PLN 31,608 thousand.

The increase in the value of shares in comparison to 2010 is mainly due to the acquisition of shares in Vattenfall Generation Poland Sp. z o.o., amounting to PLN 9,337 thousand.

37.3.3. Loans and receivables

Trade receivables are described in detail in Notes 21 and 38.

37.3.4. Financial assets excluded from the scope of IAS 39

As at 31 December 2011 and 31 December 2010, the Group had a joint venture which was accounted for using the equity method. This is the special purpose entity Elektrociepłownia Stalowa Wola S.A., in which Elektrownia Stalowa Wola S.A., currently TAURON Wytwarzanie S.A., and PGNiG Energia S.A. hold 50% stakes in the share capital and in the governing body. The investment has been described in detail in Note 2.

37.3.5. Financial liabilities measured at amortized cost

Loans taken out

The tables below present loans taken out as at 31 December 2011 and 31 December 2010.

Loans taken out as at 31 December 2011

Currency	Interest rate	Value of loans as at the balance sheet date		of which maturing within (after the balance sheet date):					
		currency	PLN	less than 3 months	3–12 months	1–2 years	2–3 years	3–5 years	over 5 years
PLN	floating	297 859	297 859	32 909	164 609	52 503	30 776	8 062	9 000
	fixed	12 055	12 055	493	1 507	1 903	1 359	2 717	4 076
Total PLN		309 914	309 914	33 402	166 116	54 406	32 135	10 779	13 076
EUR	floating	1 898	8 381	906	2 039	2 718	2 718	–	–
	fixed	–	–	–	–	–	–	–	–
Total EUR		1 898	8 381	906	2 039	2 718	2 718	–	–
USD	floating	17	59	–	59	–	–	–	–
	fixed	–	–	–	–	–	–	–	–
Total USD		17	59	–	59	–	–	–	–
Total			318 354	34 308	168 214	57 124	34 853	10 779	13 076
	Interest increasing carrying amount		585						
Total loans			318 939						

Loans taken out as at 31 December 2010

Currency	Interest rate	Value of loans as at the balance sheet date		of which maturing within (after the balance sheet date):					
		currency	PLN	less than 3 months	3–12 months	1–2 years	2–3 years	3–5 years	over 5 years
PLN	floating	534 046	534 046	152 240	158 589	168 500	36 576	18 119	22
	fixed	210	210	210	–	–	–	–	–
Total PLN		534 256	534 256	152 450	158 589	168 500	36 576	18 119	22
EUR	floating	2 461	9 748	609	1 828	2 437	2 437	2 437	–
	fixed	–	–	–	–	–	–	–	–
Total EUR		2 461	9 748	609	1 828	2 437	2 437	2 437	–
USD	floating	3 641	10 793	–	10 793	–	–	–	–
	fixed	–	–	–	–	–	–	–	–
Total USD		3 641	10 793	–	10 793	–	–	–	–
Total			554 797	153 059	171 210	170 937	39 013	20 556	22
Interest increasing carrying amount			401						
Total loans			555 198						

The table below demonstrates movements in the balance of loans without interest increasing their carrying amount for the years ended 31 December 2011 and 31 December 2010.

	Year ended 31 December 2011	Year ended 31 December 2010
Opening balance	554 797	1 178 270
Acquisition of a subsidiary	138 261	–
Movement in bank overdrafts	(2 464)	(56 989)
Movement in loans (excluding bank overdrafts):	(372 240)	(566 484)
Taken out	87 254	167 115
Repaid	(467 183)	(744 020)
Change in valuation	7 689	10 421
Closing balance	318 354	554 797

Significant items of loans as at 31 December 2011 are the investment loans taken out by TAURON Wytwarzanie S.A. for investment projects including mainly construction of a power unit at the Łagisza Power Plant, which was financed using a preferential loan granted by the National Fund for Environmental Protection and Water Management and an investment loan granted by Bank Ochrony Środowiska S.A. These liabilities are denominated in Polish currency and have floating interest rates. Their carrying amounts as at 31 December 2011 and 31 December 2010 are presented in the table below.

Lender	As at 31 December 2011	As at 31 December 2010	Final repayment deadline
National Fund for Environmental Protection and Water Management	85 604	176 000	20 December 2012
Bank Ochrony Środowiska S.A.	48 486	60 000	31 December 2013
Total	134 090	236 000	

In addition, as at 31 December 2011 TAURON Dystrybucja S.A. had an investment loan with the carrying amount of PLN 77,782 thousand. The loan was granted under the loan agreement signed in 2010 with Bank Polska Kasa Opieki S.A. for the refinancing of capital expenditures incurred in 2008 and 2009. The final deadline for the repayment of the loan is in the fourth quarter of 2014.

In 2011, TAURON Wytwarzanie S.A. repaid a loan received for the reconstruction of units I and II in the Siersza Power Plant, with the carrying amount of PLN 48,395 thousand as at 31 December 2010.

In 2011, due to the implementation of the central financing model and the refinancing of part of the subsidiaries' debt by the parent, EnergiaPro S.A., currently TAURON Dystrybucja S.A., made an early repayment of an investment loan with the initial cost of PLN 80,000 thousand, maturing in August 2013. The carrying amount of the loan as at 31 December 2010 was PLN 53,592 thousand.

In addition, a loan of PLN 138,261 thousand, increased by accrued interest, which had been taken over by the Group as a result of the acquisition of Lipniki Sp. z o.o. was repaid by the company immediately after its acquisition.

TAURON Polska Energia S.A. took out two preferential loans from the European Investment Bank with a total value of PLN 510,000 thousand. Agreements were signed on 24 October 2011. Those funds will be used for the implementation of two investment projects in the area of generation.

The Company received two loans:

- PLN 300,000 thousand to be used for the conversion and making available for use of a high-efficiency coal-fired cogeneration unit together with the accompanying infrastructure in Zespół Elektrociepłowni w Bielsku-Białej. Thanks to these funds the TAURON Group will replace the current unit with a higher efficiency 50 MWe and 182 MWt unit. The construction of this unit started in August 2010 and the project will be realized until mid 2013;
- PLN 210,000 thousand to be used for the construction and start-up of a new 50 MWe and 45 MWt biomass-fired boiler in the Jaworzno III Power Plant, which is planned to be made available in 2012, as well as the repair of the steam turbine.

As at the balance sheet date, the Company has not applied for the payment of funds under any of the above-mentioned loans.

Debentures issued

On 16 December 2010, agreements were signed between the Company and Bank Handlowy w Warszawie S.A., ING Bank Śląski S.A., Bank Polska Kasa Opieki S.A., BRE Bank S.A., Powszechna Kasa Oszczędności Bank Polski S.A. and Nordea Bank Polska S.A., with respect to the program of issue of TAURON Polska Energia S.A.'s debentures for an amount of PLN 1,300,000 thousand. Under these agreements, the Company was entitled to issue debentures in two tranches, A and B.

Under Tranche A, on 29 December 2010 Tauron Polska Energia S.A. issued 5-year corporate debentures with a nominal value of PLN 848,200 thousand in order to refinance the existing debt of Południowy Koncern Energetyczny S.A. (currently TAURON Wytwarzanie S.A.), ENION S.A. (currently TAURON Dystrybucja S.A.) and Południowy Koncern Węglowy S.A. Under Tranche B, the Company is entitled to issue a number of next series of debentures during the term of the program as well as to redeem and reissue debentures up to the amount of Tranche B i.e. PLN 400,000 thousand, with a proviso that any unused amount of Tranche A not exceeding PLN 50,000 thousand can be added to Tranche B up to the total amount not exceeding PLN 450,000 thousand.

On 28 October 2011, annexes to the agreements dated 16 December 2010 were signed between the Company and Bank Handlowy w Warszawie S.A., ING Bank Śląski S.A., Bank Polska Kasa Opieki S.A., BRE Bank S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Nordea Bank Polska S.A. and Nordea Bank AB under which the value of the debenture issue program was increased by Tranche C with a value of PLN 3,000,000 thousand, up to the total amount of PLN 4,300,000 thousand. The purpose of this increase was to acquire funds for the purchase of Górnośląski Zakład Elektroenergetyczny S.A. or implementation of investments in the TAURON Group.

On 12 December 2011, the Company issued debentures with a total value of PLN 3,300,000 thousand. Debentures were issued in two tranches (B and C). Tranche B included debentures with a total nominal value of PLN 300,000 thousand and maturity of 12 December 2015. Tranche C included debentures with a total nominal value of PLN 3,000,000 thousand and maturity of 12 December 2016.

Debentures are issued in a dematerialized form. These are unsecured coupon debentures with a floating interest rate of WIBOR 6M plus a fixed margin. Interest on these debentures is payable on a semi-annual basis. The Company provided a declaration of submission to enforcement up to PLN 5,160,000 thousand as a security for the debenture issue program.

The agreements signed by the Company with banks include legal and financial commitments (covenants), which are commonly used in such transactions. As at 31 December 2011, none of these covenants has been breached.

As at 31 December 2011 and 31 December 2010, the liabilities of the TAURON Group arising from debt securities were solely comprised of the liability of TAURON Polska Energia S.A. under issued debentures. Under the central financing model implemented by the Group, the subsidiaries only issue intercompany debentures which are acquired by the parent, while external funding is acquired at the level of the parent.

Consequently, on 30 December 2010 Południowy Koncern Energetyczny S.A., currently TAURON Wytwarzanie S.A., redeemed external debentures with a value of PLN 41,308 thousand and paid the accrued interest of PLN 18,462 thousand in accordance with the repayment schedule, and additionally used the amount of PLN 782,940 thousand obtained from the issue of intercompany debentures to early redeem the entire outstanding balance of debentures issued to external parties, amounting to PLN 526,076 thousand, and to pay the commission on early redemption of PLN 15,952 thousand.

The tables below present the balances of the Group's liability under issued debentures, together with accrued interest, as at 31 December 2011 and 31 December 2010.

Carrying amount of debentures issued as at 31 December 2011

Company	Tranche	Interest rate	Currency	As at balance sheet date		of which maturing within (from the balance sheet date)					
				Interest accrued	Principal at amortised cost	Less than 3 months	3-12 months	1-2 years	2-3 years	3-5 years	Over 5 years
TAURON Polska Energia S.A.	Tranche A	floating	PLN	412	846 106	-	-	-	-	846 106	-
TAURON Polska Energia S.A.	Tranche B	floating	PLN	968	298 920	-	-	-	-	298 920	-
TAURON Polska Energia S.A.	Tranche C	floating	PLN	9 682	2 991 086	-	-	-	-	2 991 086	-
Total debentures				11 062	4 136 112	-	-	-	-	4 136 112	-

Carrying amount of debentures issued as at 31 December 2010

Company	Tranche	Interest rate	Currency	As at balance sheet date		of which maturing within (from the balance sheet date)					
				Interest accrued	Principal at amortised cost	Less than 3 months	3-12 months	1-2 years	2-3 years	3-5 years	Over 5 years
TAURON Polska Energia S.A.	Tranche A	floating	PLN	357	845 650	-	-	-	-	845 650	-
Total debentures				357	845 650	-	-	-	-	845 650	-

37.3.6. Assets pledged as security

The Group uses various forms of security to secure payment of liabilities. The most frequently used ones include mortgages, registered pledges, liens and lease agreements relating to real estate and other items of property, plant and equipment as well as inventories, receivables, or frozen cash in bank accounts.

The carrying amounts of assets pledged as security for liabilities at particular balance sheet dates are presented in the table below.

Carrying amount of assets pledged as security for liabilities

	As at 31 December 2011	As at 31 December 2010
Real estate	730 416	3 313 463
Plant and equipment	136 201	275 467
Motor vehicles	2 439	4 241
Assets under construction	75	224
Cash	663	3 772
Other financial and non-financial receivables	5 771	16 850
Total assets pledged as security for liabilities	875 565	3 614 017

The significant decrease in the carrying amount of assets pledged as security for liabilities is due to the restructuring of debt within the Group. Using the funds obtained from the issue of intercompany debentures that were acquired by TAURON Polska Energia S.A. in December 2010 and in January 2011, Południowy Koncern Energetyczny S.A., currently TAURON Wytwarzanie S.A., redeemed the debentures previously issued and repaid its investment loans. As a result, the following mortgages and registered pledges were deleted from the registers: in respect of real estate – for an amount of PLN 2,540,281 thousand, plant and machinery – PLN 26,721 thousand, and other financial and non-financial receivables – PLN 15,001 thousand. Likewise, Południowy Koncern Węglowy S.A. deleted mortgages (PLN 32,640 thousand) and registered pledges on plant and machinery (PLN 89,873 thousand) from the registers due to the repayment of loans.

Description of other forms of security

In addition to the collaterals listed above, the Group also uses other forms of security, of which the most significant ones as at 31 December 2011 relate to loans taken out by TAURON Wytwarzanie S.A. and include: assignment of receivables amounting to PLN 88,000 thousand, authorizations to bank accounts – PLN 138,000 thousand and blank promissory notes for PLN 163,000 thousand. Loans taken out by TAURON Dystrybucja S.A. have been secured by granting authorizations to dispose of the funds in the borrowers' bank accounts up to the balance of the outstanding loan plus interest and other amounts due to the bank – a total of PLN 107,786 thousand as at 31 December 2011. Elektrociepłownia Tychy S.A. issued a blank promissory note for an amount of PLN 92,383 thousand to secure a sale and leaseback agreement signed in 2007. This agreement is additionally secured by the assignment of receivables, assignment of rights under insurance policies, mortgage on real estate and plant and machinery (in the table above) and authorization to dispose of bank accounts.

Under the debentures issue program, the parent signed a declaration of submission to enforcement for the following amounts:

- up to PLN 1,560,000 thousand – valid until 31 December 2016,
- up to PLN 3,600,000 thousand – valid until 31 December 2018.

In order to secure two agreements for bank guarantees from PKO Bank Polski S.A., TAURON Polska Energia S.A. provided declarations of submission to enforcement under Article 97 of the Banking Law up to the amount of PLN 48,000 thousand and PLN 62,000 thousand, valid until 31 December 2012 and 31 December 2015, respectively.

In order to secure the transactions made by TAURON Polska Energia S.A. in electricity markets through Towarowa Gielda Energii S.A. and its participation in the system securing the liquidity of settlements, restrictions were placed on the EUAs of TAURON Wytwarzanie S.A. entered in the National Register of Emission Allowances (KRUE). In addition, TAURON Wytwarzanie S.A. issued a suretyship to Izba Rozliczeniowa Gield Towarowych S.A. (IRGIT S.A.) for the settlement of the Company's future transactions up to the amount of PLN 145,000 thousand. It was agreed that the Company would pay a consideration to TAURON Wytwarzanie S.A. for setting up collateral in the form of a suretyship.

In addition, on 28 December 2011, TAURON Polska Energia S.A. entered into a collateral transfer of ownership agreement with IRGIT S.A., under which restrictions were placed on 6,000,000 EUAs of TAURON Polska Energia S.A. in order to secure transactions made on Towarowa Gielda Energii S.A. The agreement came into force on 29 December 2011 i.e. the date of registration of additional emission allowances subject to the transfer of ownership, and it is valid until 16 March 2012. The collateral was established on the emission allowances purchased from the subsidiary, TAURON Wytwarzanie S.A., with a commitment to sell them back on 20 March 2012.

In order to secure funds for future decommissioning costs, the mining companies that are part of the Group have recognized a Mine Decommissioning Fund. Details are presented in Note 15.

38. Financial risk management objectives and policies

The Group companies manage financial risk in a mindful and responsible manner, based on the developed and adopted Policy for Specific Risk Management in the Area of Finance, which includes a set of principles and standards consistent with best practices in this respect. A comprehensive risk management framework that is consistent with business processes allows for identification and management of correlations between the risk incurred and the level of income that can be earned. The intention of those managing risk at the Group companies is to keep the exposure within the pre-agreed and authorized safety levels rather than to fully eliminate the exposure arising from changes in the identified and monitored risk factors.

The primary objective of financial risk management is to manage the risk so as to reduce as much as possible the sensitivity of the Group's cash flows to changing financial risks and to minimize finance costs and hedging expenses incurred under derivative transactions.

Apart from derivatives, the key financial instruments used by the Group include bank and other loans, debentures, finance leases and hire purchase contracts, cash and deposits. The main purpose of using these financial instruments is to provide funds for the operations of the Group companies. Due to the nature of its business processes, the Group also holds and uses other financial instruments, such as trade receivables and payables, which arise directly in the course of the Group's business activities.

The Group's current policy and the policy in place during the entire period covered by these consolidated financial statements has been not to engage in trading in financial instruments.

The key risks arising from the Group's financial instruments are interest rate risk, liquidity risk, currency risk and credit risk.

On 10 May 2011, the Board of Directors of the parent passed a resolution implementing in the Group a policy for specific risk management in the area of finance, the objectives of which are as follows:

- Defining the financial risk management strategy and principles in the Group;
- Defining acceptable tools for hedging financial risk;
- Defining the decision-making process in the area of financial risk management in the Group,

- Implementation of general standards in the area of financial risk management, in line with the Group's requirements and the related best practices;
- Defining the general rules for organization of activities relating to financial risk in the Group, including delegation of duties to enable proper control of the activities relating to financial risk management;
- Defining general principles of hedge accounting in the Group which define the principles and types of hedge accounting and the accounting treatment of hedging instruments and hedged items to be applied as part of hedge accounting under IFRS.

The policy for specific risk management in the area of finance defines the strategy of financial risk management in the area of currency and interest rate risks.

The aim of the currency risk management is to reduce the negative impact of changes in foreign exchange rates on the Group's cash flows to an acceptable level. The aim of the interest rate risk management is to reduce, to an acceptable level, the negative impact of fluctuations in market interest rates on cash flows and the annual net interest expense being part of finance income and costs presented in the Group's consolidated financial statements.

The policy for specific risk management in the area of finance and hedge accounting policies refer to the cash flow risk and do not include fair value risk due to its low significance for the Group.

As a result of the implementation of the policy for specific risk management in the area of finance, the financial risk management function was centralized in order to optimize the financial risk management process, including minimization of the Group's costs in this area. From the perspective of financial risk management in the Group, the individual companies are responsible for identifying, measuring and reporting the financial risk associated with their activities to the parent company.

In 2011, the Group did not enter into any derivative transactions falling under hedge accounting. However, in accordance with its financial risk management policy, TAURON Polska Energia S.A., which, in accordance with the policy, is the only one in the Group to enter into transactions with external entities, plans to make use of derivative instruments which, due to their nature, will enable it to apply hedge accounting in the future.

In addition, in the second half of 2011, the Group companies implemented a Policy for Management of Financial Liquidity in the TAURON Group. Owing to this policy, which includes, among others, precise weekly updates of financial plans, scenario analyses and comparative analyses, management of the liquidity position of the TAURON Group is optimized and the risk of loss of liquidity is reduced. Based on the adopted policy, TAURON Polska Energia S.A. sets the optimum amount and structure of the liquidity reserve and performs measurements and assessments of the liquidity risk at the level of the TAURON Group.

It has been assumed that each employee is responsible for risk management. Employees are aware of the risks arising in their areas of operations and feel responsible for risk management. The Group companies also monitor the market price risk arising from all financial instruments held by the Group. The Group companies' accounting policies relating to derivatives are set out in Note 11.

38.1. Interest rate risk

The Group is exposed to the risk of changes in interest rates due to acquiring financing subject to variable interest rates and investing in assets that are subject to variable and fixed interest rates. The Group companies are additionally exposed to the risk of lost benefits in respect of their fixed interest debt due to declines in the interest rates.

The tables below present the carrying amounts of the Group's financial instruments exposed to interest rate risk, analyzed by maturity.

31 December 2011 – fixed interest rate						
Financial instruments	<1 year	1–2 years	2–3 years	3–5 years	>5 years	Total
Financial assets						
Deposits	2 604	20 991	–	–	–	23 595
Bonds, T-bills and other debt securities	99 507	–	–	–	–	99 507
Financial liabilities						
Preferential loans	1 996	1 903	1 359	2 717	4 076	12 051

31 December 2011 – floating interest rate						
Financial instruments	<1 year	1–2 years	2–3 years	3–5 years	>5 years	Total
Financial assets						
Deposits	607	–	–	–	1 048	1 655
Loans granted	–	–	–	–	–	–
Cash and cash equivalents	505 670	–	–	–	–	505 670
Financial liabilities						
Issued debentures and other debt securities	11 062	–	–	4 136 112	–	4 147 174
Bank overdrafts	–	–	–	–	–	–
Preferential loans	116 704	25 517	5 632	8 062	9 000	164 915
Arm's length loans	84 405	29 706	27 862	–	–	141 973

31 December 2010 – fixed interest rate						
Financial instruments	<1 year	1–2 years	2–3 years	3–5 years	>5 years	Total
Financial assets						
Deposits	2 603	17 170	–	–	–	19 773
Bonds, T-bills and other debt securities	–	–	–	–	–	–
Financial liabilities						
Preferential loans	210	–	–	–	–	210

31 December 2010 – floating interest rate						
Financial instruments	<1 year	1–2 years	2–3 years	3–5 years	>5 years	Total
Financial assets						
Deposits	14 815	–	–	–	905	15 720
Loans granted	60	60	60	60	–	240
Cash and cash equivalents	1 473 981	–	–	–	–	1 473 981
Financial liabilities						
Issued debentures and other debt securities	357	–	–	845 650	–	846 007
Bank overdrafts	2 464	–	–	–	–	2 464
Preferential loans	103 335	106 890	25 217	7 649	22	243 113
Arm's length loans	218 661	64 047	13 796	12 907	–	309 411

Interest on financial instruments with floating interest rates is updated in periods of less than 1 year. Interest on financial instruments with fixed interest rates is fixed over the entire period to maturity of these instruments. Other financial instruments of the Group, which have not been included in the tables above, are non-interest bearing and are therefore not exposed to interest rate risk.

38.2. Currency risk

The Group companies are exposed to changes in EUR/PLN, USD/PLN and CZK/PLN exchange rates due to their operational and financial activities. The tables below present the Group's exposure to currency risk, analyzed by the particular classes of financial instruments in the years 2010 and 2011.

Currency position as at 31 December 2011

	Total carrying amount in PLN	EUR		USD		CZK	
		in currency	in PLN	in currency	in PLN	in currency	in PLN
Financial assets							
Trade receivables and other financial receivables	2 753 140	1 388	6 131	–	–	96 885	16 577
Cash and cash equivalents	505 670	7 052	31 146	–	–	20 298	3 473
Total		8 440	37 277	–	–	117 183	20 050
Financial liabilities							
Arm's length loans	141 973	1 900	8 394	18	60	–	–
Trade payables	1 471 434	5 136	22 684	1	5	21 303	3 645
Commitments resulting from purchases of fixed and intangible assets	630 295	263	1 161	–	–	–	–
Finance lease and hire purchase commitments	70 993	2 448	10 813	–	–	–	–
Total		9 747	43 052	19	65	21 303	3 645
Net currency position		(1 307)	(5 775)	(19)	(65)	95 880	16 405

Currency position as at 31 December 2010

	Total carrying amount in PLN	EUR		USD		CZK	
		in currency	in PLN	in currency	in PLN	in currency	in PLN
Financial assets							
Trade receivables and other financial receivables	2 279 310	2 023	8 012	–	–	57 271	9 049
Cash and cash equivalents	1 473 981	2 782	11 018	–	–	13 759	2 174
Total		4 805	19 030	–	–	71 030	11 223
Financial liabilities							
Arm's length loans	309 411	2 461	9 748	3 649	10 817	–	–
Trade payables	945 457	2 181	8 638	–	–	19 354	3 058
Commitments resulting from purchases of fixed and intangible assets	388 467	–	–	–	–	–	–
Finance lease and hire purchase commitments	91 262	2 970	11 762	–	–	–	–
Total		7 612	30 148	3 649	10 817	19 354	3 058
Net currency position		(2 807)	(11 118)	(3 649)	(10 817)	51 676	8 165

In 2011, the TAURON Group, as part of its financial risk management, hedged the exposure to currency risk arising in the course of trading activities of the Group companies, by entering into forward contracts. The aim of these transactions was to hedge the Group companies against cash flows variability arising from fluctuations in currency rates. As at 31 December 2011, the TAURON Group had one open derivative transaction amounting to PLN 80 thousand (liability).

38.3. Commodity price risk

The TAURON Polska Energia S.A. Group companies are exposed to unfavorable impact of risks associated with changes in cash flows and financial results denominated in Polish currency due to changes in prices of commodities. The Group's exposure to commodity price risk is reflected in the volume of purchases of basic raw materials and goods for resale, which include hard coal, gas and energy. The volumes and purchase costs of basic raw materials from external suppliers are presented in the table below.

Fuel type	Unit	2011		2010	
		Volume	Purchase cost	Volume	Purchase cost
Coal	tonne	8 919 257	2 175 352	7 839 301	1 777 636
Gas	thousand m ³	3 180 555	199 619	3 001 016	192 025
Electricity	MWh	44 940 029	8 920 476	17 774 911	3 422 567
Heat energy	GJ	5 807 432	166 867	7 081 741	188 693
Total			11 462 314		5 580 921

The increase in the volume and purchase cost of electricity in the year ended 31 December 2011 in relation to the comparative period is mainly due to the amended Energy Law which came into force on 9 August 2010 and imposed an obligation on generators to sell electricity to the public, as discussed in detail in Note 13.1.

38.4. Credit risk

Credit risk arises from a potential credit event which may take the form of the following: contractor's insolvency, payment of part of a receivable, a significant delay in payment of a receivable or other unexpected departure from contractual terms.

Apart from individual customers, the Group companies trade only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. Where necessary, the contractor is required to submit proper collateral in the form of bank, insurance or corporate guarantees as well as clauses providing for the withholding of power supplies in the case of late payment of liabilities. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

The TAURON Polska Energia S.A. Group companies are exposed to credit risk arising in the following areas:

- core activities – credit risk arises mainly from purchases and sales of electricity and heat energy, purchases and sales of fossil fuels etc.;
- investment activities – credit risk arises from transactions relating to implementation of investment projects, the success of which depends on the financial position of the Group's suppliers;
- business activities (market risk management) – credit risk arises from possible default of the counterparty in a derivative transaction if the fair value of the derivative transaction is positive for the Group;
- investing available cash – credit risk arises from the Group companies investing available cash in securities subject to credit risk i.e. financial instruments other than those issued by the State Treasury.

Classes of financial instruments giving rise to exposure to credit risk, which have different characteristics of credit risk include:

- deposits;
- bonds, Treasury bills and other debt securities;
- trade receivables;
- loans granted;
- other financial receivables;
- other financial assets;
- cash and cash equivalents;
- derivative instruments.

There is no significant concentration of credit risk within the Group's core activities, except as listed in Note 38.4.2.

With respect to credit risk arising from financial assets of the Group, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

38.4.1. Bonds, Treasury bills and other debt securities held by the Group

Debt securities held by the Group are described in detail in Note 37.3.1.

38.4.2. Trade receivables

Trade receivables mainly include receivables from sale of energy and additional services. Due to on-going monitoring of trade receivables there is no additional credit risk that would exceed the doubtful debts allowance recognized for trade receivables of the Group.

In managing credit risk, the Group uses mainly the following mechanisms and techniques:

- assessment of contractors' financial standing and assignment of credit limits;
- requesting specific collateral from clients with poor financial standing;
- use of standard contractual provisions for credit risk and standard collateral for transactions made on credit terms;
- on-going monitoring of payments and early debt collection system;
- systematic measurement of credit risk arising in trading activities; and
- on-going monitoring of the client's financial standing; cooperation with credit bureaus and debt collection companies.

As at 31 December 2011, the Group's largest trade receivables were due from Kompania Węglowa S.A.: PLN 71,406 thousand, PSE Operator S.A.: PLN 57,180 thousand, ArcelorMittal Poland S.A.: PLN 49,397 thousand.

As at 31 December 2010, the Group's largest trade receivables were due from PSE Operator S.A.: PLN 105,353 thousand, ArcelorMittal Poland S.A.: PLN 103,116 thousand, KGHM Polska Miedź S.A.: PLN 94,369 thousand and Kompania Węglowa S.A.: PLN 65,255 thousand.

38.4.3. Deposits, cash and cash equivalents

The Group manages credit risk related to cash and cash equivalents by diversifying the banks in which surplus cash is invested. All of the entities with which the Group enters into deposit transactions operate in the financial sector. They only include banks with a high rating and an appropriate level of equity as well as strong and stable market position.

The share of three banks with which the Group holds the largest cash balances as at 31 December 2011 accounted for 65% of all cash balances.

38.4.4. Derivative instruments

All the entities with which the Group enters into derivative transactions operate in the financial sector. They include Polish banks with a high financial rating and an appropriate level of equity as well as a strong and stable market position.

38.4.5. Impairment write-downs/allowances and ageing of financial assets

As at 31 December 2011 and 31 December 2010, impairment write-downs/allowances were recognized against trade receivables, other receivables and other financial assets.

In determining the impairment of these assets, the Group considered the factors that are discussed in detail in Note 11 of these consolidated financial statements. The Group has no material items that were non-recoverable at the balance sheet date and for which no allowance was recognized.

38.4.5.1. Impairment write-downs/allowances and ageing analysis of trade and other receivables

Impairment write-downs/allowances for trade and other receivables

	Year ended 31 December 2011	Year ended 31 December 2010
Allowance/write-down at the beginning of period	(154 882)	(158 024)
Recognised	(73 802)	(73 691)
Utilized	31 098	24 487
Reversed	24 127	52 376
Cancelled	59	40
Other movements	(464)	(70)
Allowance/write-down at the end of period	(173 864)	(154 882)
Value of item before allowance	2 917 208	2 428 027
Value of item net of allowance (carrying amount)	2 743 344	2 273 145

Ageing analysis of trade and other receivables as at 31 December 2011

	Not past due	Past due					Total
		<30 days	30–90 days	90–180 days	180–360 days	>360 days	
Before allowance/write-down	2 411 143	239 598	75 789	33 887	42 288	114 503	2 917 208
Allowance/write-down	(18 208)	(1 697)	(3 213)	(6 160)	(33 233)	(111 353)	(173 864)
After allowance/write-down	2 392 935	237 901	72 576	27 727	9 055	3 150	2 743 344

Ageing analysis of trade and other receivables as at 31 December 2010

	Not past due	Past due					Total
		<30 days	30–90 days	90–180 days	180–360 days	>360 days	
Before allowance/write-down	2 011 581	171 716	69 364	33 741	39 171	102 454	2 428 027
Allowance/write-down	(18 862)	(1 167)	(2 300)	(4 555)	(27 184)	(100 814)	(154 882)
After allowance/write-down	1 992 719	170 549	67 064	29 186	11 987	1 640	2 273 145

38.4.5.2. Impairment allowances/write downs for other financial assets

Impairment allowances/write downs for other financial assets as at 31 December 2011

	Other long-term receivables	Shares of non-consolidated entities	Bonds, T-bills and other debt securities	Deposits	Other	Total
Allowance/write-down as at 1 January 2011	–	(3 263)	(3 700)	–	403	(6 560)
Recognised	–	(501)	–	–	–	(501)
Utilized	–	7	–	–	–	7
Reversed	–	513	733	–	(1 507)	(261)
Cancelled	–	–	–	–	–	–
Other movements	–	–	–	–	(834)	(834)
Allowance/write-down as at 31 December 2011	–	(3 244)	(2 967)	–	(1 938)	(8 149)
Value of item before allowance	9 796	169 834	104 699	25 250	4 064	313 643
Value of item net of allowance (carrying amount), of which:	9 796	166 590	101 732	25 250	2 126	305 494
non-current	9 796	166 590	–	21 084	–	197 470
current	–	–	101 732	4 166	2 126	108 024

Impairment allowances/write downs for other financial assets as at 31 December 2010

	Other long-term receivables	Shares of non-consolidated entities	Bonds, T-bills and other debt securities	Deposits	Other	Total
Allowance/write-down as at 1 January 2010	–	(2 707)	(3 295)	–	362	(5 640)
Recognised	–	(1 104)	(405)	–	(293)	(1 802)
Utilized	–	2	–	–	–	2
Reversed	–	304	–	–	–	304
Cancelled	–	71	–	–	–	71
Other movements	–	171	–	–	334	505
Allowance/write-down as at 31 December 2010	–	(3 263)	(3 700)	–	403	(6 560)
Value of item before allowance	6 405	153 388	5 200	35 493	11 719	212 205
Value of item net of allowance (carrying amount), of which:	6 405	150 125	1 500	35 493	12 122	205 645
non-current	6 405	148 515	1 500	18 074	2 958	177 452
current	–	1 610	–	17 419	9 164	28 193

38.5. Liquidity risk

The Group maintains a balance between continuity of funding and flexibility through the use of various sources of financing, such as bank overdrafts, bank loans, debentures, finance leases and hire purchase contracts. The use of such sources of financing enables management of liquidity risk and successfully minimizes any negative effects following from realization of such risk.

In order to minimize any cash flow disturbances and the risk of loss of liquidity, the TAURON Group applied the cash pooling mechanism, as it was the case in the previous year. Cash pooling, irrespective of the funds gathered by the particular participants, is linked to a flexible credit facility in the form of an overdraft in current account, the amount of which has been increased from 100,000 thousand in 2011 to 300,000 thousand in 2012–2014.

The tables below summarize the maturity profile of the Group's financial liabilities as at 31 December 2011 and 31 December 2010 based on contractual undiscounted payments.

Financial liabilities as at 31 December 2011

	less than 3 months	3–12 months	1–2 years	2–3 years	3–5 years	more than 5 years	Total
Interest-bearing loans and issued debentures	38 984	422 312	301 943	275 952	4 552 548	14 256	5 605 995
Trade payables	1 468 200	400	2 434	400	–	–	1 471 434
Commitments resulting from purchases of fixed and intangible assets	630 295	–	–	–	–	–	630 295
Derivative instruments	80	–	–	–	–	–	80
Other financial liabilities	200 822	46 570	5 416	1 359	745	448	255 360
Obligations under finance leases and hire purchase contracts	5 249	9 510	14 353	23 783	18 098	–	70 993
Guarantees granted and similar items	4 306	–	–	–	–	–	4 306
Total	2 347 936	478 792	324 146	301 494	4 571 391	14 704	8 038 463

Financial liabilities as at 31 December 2010

	less than 3 months	3–12 months	1–2 years	2–3 years	3–5 years	more than 5 years	Total
Interest-bearing loans and issued debentures	153 814	214 049	213 769	81 847	954 424	22	1 617 925
Trade payables	943 255	1 002	400	400	400	–	945 457
Commitments resulting from purchases of fixed and intangible assets	388 108	359	–	–	–	–	388 467
Derivative instruments	6 917	–	–	–	–	–	6 917
Other financial liabilities	249 399	39 484	5 243	316	541	809	295 792
Obligations under finance leases and hire purchase contracts	8 578	14 877	14 887	13 085	24 050	15 785	91 262
Guarantees granted and similar items	5 773	–	–	–	–	–	5 773
Total	1 755 844	269 771	234 299	95 648	979 415	16 616	3 351 593

38.6. Derivatives

As at 31 December 2011, the Group recognized a liability arising from derivative instruments in the amount of PLN 80 thousand. The liability in question was recognized as a result of the measurement of a forward currency contract held by TAURON Polska Energia S.A. as at 31 December 2011. The parent hedges against the risk of changes in foreign exchange rates due to entering into transactions in foreign currencies.

As at 31 December 2010, the Group recognized liabilities arising from derivative instruments, amounting to PLN 6,917 thousand. These included interest rate swaps (IRS) which were entered into by Południowy Koncern Energetyczny S.A. (now TAURON Wytwarzanie S.A.) in order to hedge against the interest rate risk arising from:

- issued debentures, amounting to PLN 4,443 thousand,
- investment loans, amounting to PLN 2,474 thousand.

On 30 December 2010, Południowy Koncern Energetyczny S.A. (now TAURON Wytwarzanie S.A.) repaid the full amount of the liability arising from debentures issued to external parties. As a result, the cumulative loss on the measurement of derivative instruments, which up until that date had been recognized in other comprehensive income, was transferred from the revaluation reserve resulting from valuation of

hedging instruments to the net profit. After the balance sheet date, those derivative instruments were settled with an effect of PLN (616) thousand. As at 31 December 2010, the Company held one interest rate swap maturing in January 2011, which had been entered into in order to hedge against the interest rate risk arising from the investment loan. This interest rate swap was settled on 10 January 2011 with a profit of PLN 83 thousand. No hedge accounting was applied with respect to derivatives held at the 2010 year-end.

38.7. Market risk – sensitivity analysis

The Group identifies the following main types of market risk to which it is exposed:

- interest rate risk,
- currency risk,
- electricity price risk,
- risk of changes in the prices of CO₂ emission allowances and energy certificates and
- risk of changes in the prices of commodities (e.g. coal).

Currently, the Group is mainly exposed to the risk of changes in the EUR/PLN, USD/PLN and CZK/PLN exchange rates. In addition, the Group is exposed to changes in reference interest rates for PLN, EUR and USD.

The Group uses scenario analysis in analyzing sensitivity to changes in market risk factors. The Group uses expert scenarios reflecting its subjective assessments with respect to individual market risk factors in the future.

The aim of the scenario analyses presented in this section is to analyze the effect of changes in market risk factors on the Group's results. Only those items which meet the definition of financial instruments in accordance with IFRS were included in the analysis.

The potential changes in foreign exchange rates are determined within a time horizon up until the date of the next financial statements and were calculated based on annual implied volatilities for currency options quoted on the interbank market for a given currency pair at the balance sheet date or – if no market quotations were available – based on historical volatilities for a period of one year preceding the balance sheet date.

In the interest rate risk sensitivity analysis, the Group makes use of a parallel shift in the interest rate curve for a potential change in reference interest rates within a time horizon up until the date of the next financial statements. For the purpose of interest rate risk sensitivity analysis, the Group used the average levels of the reference interest rates in a given year. The magnitude of potential changes in the interest rates was estimated based on the implied volatilities of the ATMF interest rate options quoted on the interbank market for the currencies for which the Group had an interest rate risk exposure at the balance sheet date.

In the case of the interest rate risk sensitivity analysis, the effect of changes in risk factors has been included in interest income/expense for financial instruments measured at amortized cost and in the fair value at the balance sheet date for financial instruments with variable interest rates carried at fair value.

Presented below is a sensitivity analysis for each type of market risk the Group was exposed to at the balance sheet date, indicating the effect that the potential changes in the individual risk factors would have on profit before taxation, by class of financial assets and liabilities.

38.7.1. Currency risk sensitivity analysis

The Group identifies its exposure to the risk of changes in the EUR/PLN, USD/PLN and CZK/PLN exchange rates. The tables below present sensitivity of profit before taxation to potential reasonable changes in foreign exchange rates within a time horizon up until the date of the next financial statements, assuming there are no changes in other risk factors:

Year ended 31 December 2011

The risk exposure as at 31 December 2011 is representative of the Group's risk exposure within the 1-year period preceding that date.

Classes of financial instruments	Sensitivity analysis for currency risk as at 31 December 2011									
	31 December 2011		EUR/PLN			USD/PLN			CZK/PLN	
	Carrying amount	Value at Risk	exchange rate EUR/PLN +14.05%	exchange rate EUR/PLN -14.05%	exchange rate USD/PLN +23.35%	exchange rate USD/PLN -23.35%	exchange rate CZK/PLN +11.33%	exchange rate CZK/PLN -11.33%	In PLN thousand	Profit/(Loss)
Trade receivables and other financial receivables	2 753 140	22 708	862	(862)	-	-	1 878	(1 878)		
Cash and cash equivalents	505 670	34 619	4 376	(4 376)	-	-	393	(393)		
Arm's length loans	141 973	8 454	(1 179)	1 179	(14)	14	-	-		
Trade payables	1 471 434	26 334	(3 188)	3 188	-	-	(413)	413		
Obligations under finance leases and hire purchase contracts	70 993	10 813	(1 520)	1 520	-	-	-	-		
Commitments resulting from purchases of fixed and intangible assets	630 295	1 161	(163)	163	-	-	-	-		
Total			(812)	812	(14)	14	1 858	(1 858)		

Year ended 31 December 2010

The risk exposure as at 31 December 2010 is representative of the Group's risk exposure within the 1-year period preceding that date.

Classes of financial instruments	Sensitivity analysis for currency risk as at 31 December 2010									
	31 December 2010		EUR/PLN			USD/PLN			CZK/PLN	
	Carrying amount	Value at Risk	exchange rate EUR/PLN +12.3%	exchange rate EUR/PLN -12.3%	exchange rate USD/PLN +20.3%	exchange rate USD/PLN -20.3%	exchange rate CZK/PLN +9.6%	exchange rate CZK/PLN -9.6%	In PLN thousand	Profit/(Loss)
Trade receivables and other financial receivables	2 279 310	17 061	985	(985)	-	-	869	(869)		
Cash and cash equivalents	1 473 981	13 192	1 355	(1 355)	-	-	209	(209)		
Arm's length loans	309 411	20 565	(1 199)	1 199	(2 196)	2 196	-	-		
Trade payables	945 457	11 696	(1 062)	1 062	-	-	(294)	294		
Obligations under finance leases and hire purchase contracts	91 262	11 762	(1 447)	1 447	-	-	-	-		
Commitments resulting from purchases of fixed and intangible assets	388 467	-	-	-	-	-	-	-		
Total			(1 368)	1 368	(2 196)	2 196	784	(784)		

38.7.2. Interest rate risk sensitivity analysis

The Group identifies its exposure to the risk of changes in WIBOR, EURIBOR and in 2010 LIBOR USD. The tables below present sensitivity of profit before taxation to reasonable potential changes in interest rates within a time horizon up until the date of the next financial statements, assuming there are no changes in other risk factors:

Year ended 31 December 2011

Classes of financial instruments	31 December 2011		Sensitivity analysis for interest rate risk as at 31 December 2011			
	Carrying amount	Value at Risk	WIBOR		EURIBOR	
			WIBOR + 84 bp	WIBOR - 84 bp	EURIBOR + 72 bp	EURIBOR - 72 bp
	In PLN thousand	In PLN thousand	Profit/(loss)		Profit/(loss)	
Deposits	25 250	1 655	14	(14)	–	–
Cash and cash equivalents	505 670	505 670	3 957	(3 957)	224	(224)
Preferential loans	176 966	164 915	(1 385)	1 385	–	–
Arm's length loans	141 973	141 973	(1 122)	1 122	(60)	60
Issued debentures and debt securities	4 147 174	4 147 174	(34 836)	34 836	–	–
Total			(33 372)	33 372	164	(164)

Year ended 31 December 2010

Classes of financial instruments	31 December 2010		Sensitivity analysis for interest rate risk as at 31 December 2010					
	Carrying amount	Value at Risk	WIBOR		EURIBOR		LIBOR USD	
			WIBOR + 60 bp	WIBOR - 60 bp	EURIBOR + 33 bp	EURIBOR - 33 bp	LIBOR USD + 36 bp	LIBOR USD - 36 bp
	In PLN thousand	In PLN thousand	Profit/(loss)		Profit/(loss)		Profit/(loss)	
Deposits	35 493	15 720	94	(94)	–	–	–	–
Loans granted	240	240	1	(1)	–	–	–	–
Cash and cash equivalents	1 473 981	1 473 981	8 765	(8 765)	36	(36)	–	–
Preferential loans	243 323	243 113	(1 459)	1 459	–	–	–	–
Arm's length loans	309 411	309 411	(1 733)	1 733	(32)	32	(39)	39
Bank overdrafts	2 464	2 464	(15)	15	–	–	–	–
Issued debentures and debt securities	846 007	846 007	(5 076)	5 076	–	–	–	–
Total			577	(577)	4	(4)	(39)	39

39. Capital management

In accordance with the adopted strategy, the parent centralized the finance management function in the TAURON Group and thus maximized its ability to discharge the liabilities incurred. The key instruments ensuring effective management of financial resources include the central financing model implemented in 2010 and the policy for management of financial liquidity implemented in the second half of 2011 together with the cash pooling mechanism being in use from 2010. In addition, the finance management system is supported by the central policy for financial risk management implemented in 2011 and the Group's central insurance policy, whereby TAURON Polska Energia S.A. is the one to manage and set the directions for the activities undertaken, thus enabling the setting of appropriate exposure limits.

In accordance with the central financing model, TAURON is responsible for acquisition of funding for the Group companies. This model enables reduction of borrowing costs, increases funding opportunities, reduces the number and forms of collaterals set up on the assets of the TAURON Group and the number of covenants required by financial institutions, and also reduces administrative expenses. In addition, the central financing model enables access to funding which is not available to individual companies. The implementation of the central financing model effectively changed the approach to the funding of investment projects in the Group. Funding is acquired based on the consolidated balance sheet of the whole TAURON Group and is incurred in order to cover the financial gap at the level of the Group rather than being assigned to specific investment projects.

The second important factor affecting the effectiveness of finance management is the liquidity management policy. The implementation of proper forecasting standards makes it possible to determine the precise liquidity position, which allows for optimization of the selection of the moment of acquiring funding and the maturities and types of investment instruments as well as the proper level of the liquidity reserve. This results in both the reduction of costs and the improvement of safety. Day-to-day liquidity management is supported by the cash pooling mechanism implemented in 2010. Its primary objective is to ensure financial liquidity in the TAURON Group while reducing the costs of short-term external borrowings and maximizing the amount of finance income generated using surplus cash.

In the course of their day-to-day financing activities, the TAURON Group companies effectively managed cash flows by matching the maturities of their liabilities and receivables. In addition, in 2011 the Group implemented a uniform program of bank guarantees that can be used by all of the Group companies.

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value.

The Group manages its capital structure and adjusts it to reflect changes in economic conditions. To maintain or adjust its capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders, issue new shares or adjust the level of its external debt.

The Group monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. Within net debt, the Group includes interest-bearing loans and borrowings (including debt securities), trade and other payables, less cash and cash equivalents. Capital includes equity attributable to the equity holders of the parent less the net unrealized gains reserve.

	As at 31 December 2011	As at 31 December 2010
Interest-bearing loans and borrowings	4 466 113	1 401 205
Trade and other payables and finance lease and hire purchase commitments	2 428 162	1 727 895
Less cash and cash equivalents	505 670	1 473 981
Net debt	6 388 605	1 655 119
Equity attributable to equity holders of the parent	15 677 721	14 704 825
Revaluation reserve from valuation of hedging instruments	-	-
Total capital	15 677 721	14 704 825
Capital and net debt	22 066 326	16 359 944
Leverage ratio	29%	10%

The increase of the leverage ratio to 29% as at 31 December 2011 compared with 10% as at 31 December 2010 results from the increase of the liability arising from issued debentures due to the issue of debentures with a nominal value of PLN 3,300,000 thousand in December 2011.

40. Employment structure

The average employment in the Group in the reporting periods covered by these financial statements was as follows:

	Year ended 31 December 2011	Year ended 31 December 2010
Management of the parent	5	5
Managements of subsidiaries	53	49
Administration	4 098	4 098
Sales department	1 962	2 059
Manufacturing	20 139	21 326
Others	1 247	943
Total	27 504	28 480

The level of employment in the acquired GZE S.A. Group companies during the period from the date of acquiring control to the balance sheet date amounted on average to 1,627 FTEs. In addition, as a result of the voluntary redundancy scheme carried out by the Group in 2011, employment contracts were terminated mainly with the employees of TAURON Wytwarzanie S.A. and TAURON Dystrybucja S.A., as discussed in Note 27.

41. Auditor's fees

These consolidated financial statements of the TAURON Polska Energia S.A. Group were audited by Ernst & Young Audit Sp. z o.o. with its registered office in Warsaw, Rondo ONZ 1. The audit contract between TAURON Polska Energia S.A. and Ernst & Young Audit Sp. z o.o. was concluded on 19 November 2010 and covers the audit of the Company's separate and consolidated financial statements for the years 2010–2012. The amount of the auditor's fees is presented in the table below.

	Year ended 31 December 2011	Year ended 31 December 2010
Statutory audit, of which:	1 088	719
– consolidated financial statements	36	37
– separate financial statements	34	64
– separate financial statements of subsidiaries	1 018	618
Other assurance services rendered for the Group	163	86
Other services (including training) rendered for the Group	382	266
Total	1 633	1 071

The fees paid by the Company to Ernst & Young Audit Sp. z o.o. in 2010 due to the preparation of a prospectus amounted to PLN 1,469 thousand.

42. Events after the balance sheet date

On 19 January 2012, the Company filed an application for payment of a tranche of PLN 210,000 thousand of the loan granted by the European Investment Bank under the agreement dated 24 October 2011 (as described in detail in Note 37.3.5). The purpose of this loan is to provide funding for the construction and start-up of a new biomass boiler in the Jaworzno III Power Plant. The loan will be repaid in ten equal annual installments, the last one payable on 15 December 2021. The funds were received by the Company into its bank account on 30 January 2012.

In addition, on 30 January 2012 the Company issued 1,500 Tranche B debentures with an issue price and nominal value of the debenture equal to PLN 100 thousand, i.e. the total value of the debentures equal to PLN 150,000 thousand. The maturity date of those debentures is 30 January 2015, and interest is payable on a semi-annual basis. At the date of authorization of these financial statements, the total nominal value of the Company's debt under issued debentures (without accrued interest) is PLN 4,298,200 thousand, including PLN 848,200 thousand under tranche A, PLN 450,000 thousand under tranche B and PLN 3,000,000 thousand under tranche C.

Board of Directors of the Company

Katowice, 6 March 2012

Dariusz Lubera	– President	.....
Joanna Schmid	– Vice President	.....
Dariusz Stolarczyk	– Vice President	.....
Krzysztof Zamasz	– Vice President	.....
Krzysztof Zawadzki	– Vice President	.....

**REPORT OF THE MANAGEMENT BOARD
ON OPERATIONS OF
TAURON POLSKA ENERGIA S.A.
CAPITAL GROUP
FOR THE FINANCIAL YEAR 2011**

MARCH 2012

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1. ORGANISATION OF TAURON CAPITAL GROUP

1.1. Basic Information on TAURON Capital Group

Key companies of TAURON Capital Group, besides the parent company, TAURON Polska Energia S.A. (hereinafter referred to as the Company or TAURON) also include 21 subsidiaries listed in item 1.2.2. of this report.

Moreover, the Capital Group consists of 27 other subsidiaries as well as 14 affiliates with the capital interest between 50%–20% and 31 companies with the capital interest below 20%. It should be mentioned that the value of shares in these companies constitutes about 0.5% of assets of TAURON Capital Group.

The parent company TAURON Polska Energia Spółka Akcyjna was established on 6 December 2006 under the implementation of the *Programme for Power Engineering*. The founders of the Company included: State Treasury represented by the Minister of Treasury, EnergiaPro S.A. (EnergiaPro) with the seat in Wrocław, ENION S.A. (ENION) with the seat in Kraków and Elektrownia Stalowa Wola S.A. (ESW) with the seat in Stalowa Wola. The Company was registered in the National Court Register on 8 January 2007 under the name of enterprise Energetyka Południe S.A. The change of the enterprise to its current name, i.e. TAURON Polska Energia S.A., was registered on 16 November 2007. It should be mentioned that the company does not have any branches (plants).

Among the companies of TAURON Capital Group subject to consolidation, the most important subsidiaries include:

- 1) TAURON Wytwarzanie S.A. (TAURON Wytwarzanie) – dealing with generation of power from conventional sources and biomass co-burning,
- 2) TAURON EKOENERGIA sp. z o.o. (TAURON EKOENERGIA) – dealing with generation of power from renewable sources,
- 3) TAURON Dystrybucja S.A. (TAURON Dystrybucja) – providing electric energy distribution services,
- 4) TAURON Sprzedaż sp. z o.o. (TAURON Sprzedaż) – dealing with supply of electric energy to retail customers,
- 5) TAURON Obsługa Klienta sp. z o.o. (TAURON Obsługa Klienta) – dealing with customer service,
- 6) TAURON Ciepło S.A. (TAURON Ciepło) – dealing with heat generation, distribution and sales,
- 7) Południowy Koncern Węglowy S.A. (PKW) – dealing with hard coal mining.

The consolidation covered also the company Górnośląski Zakład Elektroenergetyczny S.A. (GZE) and its subsidiaries which have become the indirect subsidiaries of the Company as of the day the agreement on sales of shares of GZE by Vattenfall AB in favour of TAURON was concluded, i.e. as of 13 December 2011:

- 1) Vattenfall Distribution Poland S.A. (Vattenfall Distribution Poland)¹ – providing electric energy distribution services,
- 2) Vattenfall Network Services Poland sp. z o.o. (Vattenfall Network Services Poland)² – dealing with maintenance of facilities included in the distribution grid of Vattenfall Distribution Poland,
- 3) Vattenfall Wolin-North sp. z o.o. (Vattenfall Wolin-North)³ – dealing with generation of power from renewable sources,
- 4) Vattenfall Sales Poland sp. z o.o. (Vattenfall Sales Poland) – dealing with sales of electric energy,
- 5) Vattenfall Business Services Poland sp. z o.o. (Vattenfall Business Services Poland) – dealing with customer service.

Moreover, TAURON Capital Group consists of eight other subsidiaries subject to consolidation, involved, among others, in generation of electric energy and heat, trade of electricity and heat, extraction of limestone and stone for construction purposes.

¹ On 20 February 2012, the District Court in Gliwice registered the change of company name to TAURON Dystrybucja GZE S.A. in the National Court Register.

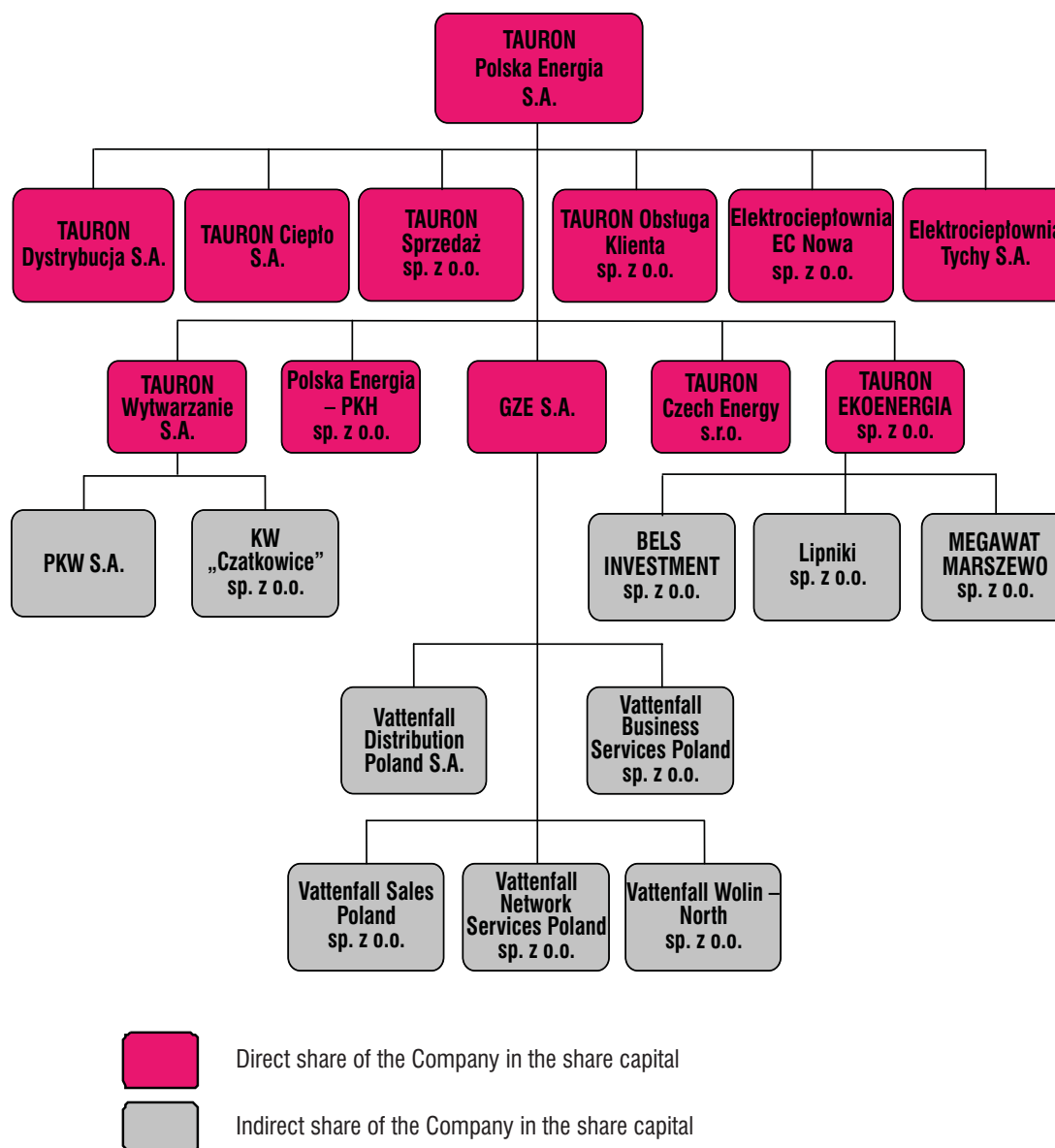
² On 15 February 2012, the District Court in Gliwice registered the change of company name to TAURON Service GZE S.A. in the National Court Register.

³ On 27 February 2012, the District Court in Gliwice registered the change of company name to TAURON Ekoenergia GZE S.A. in the National Court Register.

1.2. Structure of TAURON Capital Group

The chart below presents the structure of TAURON Capital Group, including companies subject to consolidation, as of 31 December 2011 and as of the day of this report.

Figure No. 1 Structure of TAURON Capital Group – status as of 31 December 2011 and as of the date of this report



Information concerning the level of capital interest in the share capital and in the governing body of individual companies is included in item 1.4 of this report.

1.2.1. Changes in organisation of TAURON Capital Group

In 2011 the following changes in proprietary structure of TAURON Capital Group subsidiaries took place:

Purchase of shares or stocks of other companies

- On 13 December 2011, the Company acquired 1,249,693 shares from Vattenfall AB at par value of PLN 100.00 for each share, constituting 99.98% of the GZE company share capital. Before concluding of the aforementioned agreement, the Company did not hold any GZE shares whereas after their acquisition, it holds 99.98% of shares in the GZE company share capital and it is authorised to

execute 99.98% of votes for at the General Meeting (GM) of GZE. As a result of acquisition of the shares, the Company has indirectly become the owner of shares or stocks, respectively, of the following GZE subsidiaries:

- 1) Vattenfall Distribution Poland,
- 2) Vattenfall Sales Poland,
- 3) Vattenfall Network Services Poland,
- 4) Vattenfall Wolin-North,
- 5) Vattenfall Generation Poland,
- 6) Vattenfall Business Services Poland.

The aforementioned acquisition is compliant with the Corporate Strategy for TAURON Group for 2011–2015, with estimates up to the year 2020 (Corporate Strategy) and it has contributed to the strengthening of the Company position in the area of electric energy distribution and sales.

2. On 28 September 2011 TAURON EKOENERGIA company acquired 400,000 shares of Lipniki sp. z o.o. company (Lipniki) from the German energy corporation WSB Neue Energien GmbH (i.e. 100% of shares), at par value of PLN 50.00 for each share, including the Lipniki wind farm. The entity acquired is a special purpose vehicle that was established to construct and operate the wind park Lipniki including 15 wind turbines of the total capacity of 30.75 MW, launched in July 2011.

The purchase is compliant with implementation of the Corporate Strategy in the area of investment in generating capacity in wind energy and biogas energy. As a result, the generating capacity held by the group has been increased by wind-based renewable energy sources, which will contribute both to the competitiveness of electric energy sales offer as well as to enhancement of the TAURON Capital Group image.

3. On 26 July 2011 between the Company and Południowy Koncern Energetyczny S.A. (PKE), the agreement was concluded concerning disposal of shares of the company Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. (PEPKH), pursuant to which, the Company purchased 700 of PEPKH company shares at par value of PLN 6,000.00 each, held by PKE. As a result of the aforementioned actions, the Company increased its direct share in the capital and in the governing body of PEPKH.

The objective of this acquisition was to adjust the proprietary structure of TAURON Capital Group.

4. In connection with agreements concluded in August 2011 concerning purchase of shares of companies PKE and ENION, held by minority shareholders, the Company purchased 9,447 PKE shares at par value of PLN 10.00 each, constituting 0.0061% of the company share capital, at the price of PLN 235 thousand as well as 6,149,541 of ENION shares at par value of PLN each, at the price of PLN 676 thousand, constituting 0.0245% of the company share capital. The compensation for the shares purchased was paid in August 2011.

The objective of the aforementioned acquisition was to adjust the proprietary structure of TAURON Capital Group.

5. On 31 August 2011, the Company established the following single-person limited liability companies:

- a) Enpower sp. z o.o. with the seat in Katowice,
- b) Enpower Service sp. z o.o. with the seat in Katowice,
- c) Energopower sp. z o.o. with the seat in Stalowa Wola,
- d) Poen sp. z o.o. with the seat in Katowice,

In each of the aforementioned companies, the Company took over 100 shares at par value of PLN 50 each.

The aforementioned actions were connected with the expected restructuring processes in TAURON Capital Group as well as with establishment of the Tax Capital Group (PGK) for tax optimisation and reduction of tax risk in TAURON Capital Group. All the companies indicated above are included in the PGK. Detailed information on PGK is presented in item 2.7.1 of this report.

Merger and division of companies

1. On 31 August 2011, the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register issued its decision on merger of PKE company (acquiring company) and ESW company (acquired company). Accordingly, the share capital of the acquiring company was increased from PLN 1,559,231,860.00 to PLN 1,662,622,990.00, i.e. by PLN 103,391,130.00. As a result of the aforementioned process, the share of the Company in the share capital and in the governing body of the acquiring company was increased from 99.46% to 99.49%. Simultaneously, as of 1 September 2011, the change of name of the acquiring company to TAURON Wytwarzanie took place.
2. On 1 September 2011 the District Court for Wrocław–Fabryczna in Wrocław, 6th Commercial Division of the National Court Register issued its decision on incorporation of the merger of the companies EnergiaPro (acquiring company) and ENION (acquired company). Accordingly, the share capital of the acquiring company was increased from PLN 82,081,118.70 to PLN 167,748,363.81, i.e. by PLN 85,667,245.11. As a result of the aforementioned process, the share of the Company in the share capital and

in the governing body of the acquiring company was increased from 99.00% to 99.38%. Simultaneously, as of 1 September 2011, the change of name of the acquiring company to TAURON Dystrybucja took place.

- On 1 September 2011 the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register issued its decision on incorporation of the merger of the companies Przedsiębiorstwo Energetyki Ciepłej Katowice S.A. (PEC Katowice) (acquiring company) and Przedsiębiorstwo Energetyki Ciepłej in Dąbrowa Górnicza S.A. (PEC in Dąbrowa Górnicza) (acquired company). Consequently, the share capital of the acquiring company was increased from PLN 211,000,000.00 to PLN 444,663,500.00, i.e. by PLN 233,663,500.00. As a result of the aforementioned process, the share of the Company in the share capital and in the governing body of the acquiring company was decreased from 95.66% to 90.06%. Simultaneously, as of 1 September 2011, the change of name of the acquiring company to TAURON Ciepło took place.

The mergers of companies referred to in items 1–3 above were mergers through acquisition, i.e. pursuant to Article 492 § 1 item 1 of the Act of 15 September 2000, Code of Commercial Companies, by transfer of the whole assets of the acquired company to the acquiring company in exchange for the shares of the acquiring company, which were issued to the shareholders of the acquired company. As a result of the merger, the acquired companies were dissolved without performing of the liquidation.

As a result of the aforementioned actions, the number of entities operating within the individual Business Area was decreased. Moreover, the activities listed above, being part of the Corporate Strategy, allowed for implementation of the process of reorganization of TAURON Capital Group structure in individual Business Areas.

- During the reporting period, registration of the division of the company TAURON Obsługa Klienta took place, through transfer of a part of assets of this company, constituting the organised part of the enterprise, consisting of tangible and intangible assets as well as liabilities associated with the supply of electric energy, to TAURON Sprzedaż. The division was performed pursuant to Article 529 § 1 item 4 of the Act of 15 September 2000 Code of Commercial Companies. On 3 January 2011, the increase of the share capital of the TAURON Sprzedaż company, associated with the acquisition of a part of assets of TAURON Obsługa Klienta, was incorporated by the Regional Court in Kraków.

The aforementioned division was performed within the implementation of the strategic project in TAURON Capital Group, the major objective of which in 2010 was the improvement of the quality and effectiveness of performance through focussing and development of particular competence within the mass customer service and supply of electric energy to end customers within one entity of TAURON Capital Group, and the competence in the area of electric energy sales – within another entity.

Decrease in share capital of the companies

Within the process of forced repurchase of shares from minority shareholders, executed pursuant to Article 418¹ § 4 of the Act of 15 September 2000 Code of Commercial Companies, the value of share capital took place in three companies.

- On 8 February 2011, the decrease in share capital of ENION company occurred – from the amount of PLN 252,961,720.56 to the amount of PLN 252,897,508.08, as a result of redemption of 6,421,248 of treasury stocks with a par value PLN 0.01 for each share. Accordingly, the share of the Company in the share capital and in the governing body of ENION company was increased from 99.68% to 99.70%.
- On 7 April 2011, the decrease in share capital of EnergiaPro company occurred – from the amount of PLN 82,282,436.18 to the amount of PLN 82,081,118.70, as a result of redemption of 20,131,748 of treasury stocks with a par value PLN 0.01 for each share. Accordingly, the share of the Company in the share capital and in the governing body was increased from 98.76% to 99.00%.
- On 23 December 2011, the decrease in share capital of TAURON Wytwarzanie company occurred – from the amount of PLN 1,662,622,990.00 to the amount of PLN 1,658,793,390.00, as a result of redemption of 382,960 of treasury stocks with a par value PLN 10.00 for each share. Accordingly, the share of the Company in the share capital and in the governing body was increased from 99.49% to 99.72%.

Redemption of shares

On 31 March 2011 redemption of 200 of treasury shares with a par value of PLN 6,000.00 per share was performed, held by the previous shareholders of the PEPKH company, i.e.: Katowicki Holding Węglowy S.A and KWK Kazimierz Juliusz sp. z o.o., as a result of which the aforementioned entities lost the status of PEPKH shareholders.

As a result of the above transaction:

- share of the Company in the share capital of PEPKH increased from 10.00% to 12.50%, and in the governing body – from 27.78% to 31.25%,
- share of PKE in the share capital of PEPKH increased from 70.00% to 87.50%, and in the governing body – from 61.11% to 68.75%.

Simultaneously, considering usufruct by the Company of the total shares in PEPKH held by PKE, the actual share of the Company in the PEPKH capital increased from 80.00% to 100.00%, and in its governing body – from 88.88% to 100.00%.

The action referred to above resulted in TAURON Capital Group having taken full control over PEPKH company, which subsequently allowed for acquisition of PEPKH shares by the Company.

Cancellation of privileged votes

On 28 June 2011, amendments to the PEPKH company Articles of Association were registered, among others, in the scope of cancellation of privileged shares in terms of votes, consequently:

- a) the Company share in the governing body of PEPKH decreased from 31.25% to 12.50%,
- b) the share of PKE in the governing body of PEPKH increased from 68.75% to 87.50%.

Establishment of the usufruct of shares

On 30 August 2011 between the Company and ENION, PKE as well as PKW, agreements were concluded concerning usufruct of shares of the company Przedsiębiorstwo Świadczeń Zdrowotnych i Promocji Zdrowia (Enterprise of Health Services and Promotion) Elvita – Jaworzno III sp. z o.o. (PŚZiPZ Elvita – Jaworzno III). Pursuant to the said agreements, the Company has become the user of the total of 14,984 shares, of the par value of PLN 500.00 for each share, constituting 99.74% of shares of the company PŚZiPZ Elvita – Jaworzno III and providing for 99.74% shares at the Shareholders' Meeting (GM) of the company PŚZiPZ Elvita – Jaworzno III.

The aforementioned activity allows for direct supervision over performance of the company PŚZiPZ Elvita – Jaworzno III, including influencing the strategic and business decisions of the company as well as determination of goals to be implemented.

1.2.2. Entities subject to consolidation

As of 31 December 2011, within the TAURON Capital Group, financial statements of the following subsidiaries have been covered by consolidation with the financial statement of the Company, by applying the full consolidation method:

1. TAURON Wytwarzanie S.A. (TAURON Wytwarzanie),
2. TAURON Dystrybucja S.A. (TAURON Dystrybucja),
3. TAURON Sprzedaż sp. z o.o. (TAURON Sprzedaż),
4. TAURON Obsługa Klienta sp. z o.o. (TAURON Obsługa Klienta),
5. TAURON Ciepło S.A. (TAURON Ciepło),
6. TAURON EKOENERGIA sp. z o.o. (TAURON EKOENERGIA),
7. TAURON Czech Energy s.r.o. (TAURON Czech Energy),
8. Elektrociepłownia Tychy S.A. (EC Tychy),
9. Elektrociepłownia EC Nowa sp. z o.o. (EC Nowa),
10. Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. (PEPKH),
11. Południowy Koncern Węglowy S.A. (PKW),
12. Kopalnia Wapienia Czatkowice sp. z o.o. (KW Czatkowice),
13. BELS INVESTMENT sp. z o.o. (BELS INVESTMENT),
14. MEGAWAT MARSZEWO sp. z o.o. (MEGAWAT MARSZEWO),
15. Lipniki sp. z o.o. (Lipniki),
16. Górnośląski Zakład Elektroenergetyczny S.A. (GZE),
17. Vattenfall Business Services Poland sp. z o.o. (Vattenfall Business Services Poland),
18. Vattenfall Distribution Poland S.A. (Vattenfall Distribution Poland),
19. Vattenfall Network Services Poland sp. z o.o. (Vattenfall Network Services Poland),
20. Vattenfall Sales Poland sp. z o.o. (Vattenfall Sales Poland),
21. Vattenfall Wolin-North sp. z o.o. (Vattenfall Wolin-North).

Detailed information on companies covered by consolidation as well as on the Company's share in their issued capital and in their governing body, is presented in item 1.4 of this report.

1.3. TAURON and TAURON Capital Group management concept

1.3.1. TAURON and TAURON Capital Group management principles

TAURON management principles

In accordance with the provisions of TAURON Polska Energia S.A. By-laws (By-laws), the Company is managed directly by the Management Board of the Company as well as by proxies, Directors of Departments, attorneys.

The President of the Management Board manages business as usual of the Company and takes decisions on all issues concerning the Company, which are not subject to decisions of the Management Board or other governing bodies of the Company, and supervises the performance of the division which reports to him directly. In particular, the President of the Management Board:

- 1) manages the internal business of the Company and represents it in the external contacts,
- 2) coordinates all the issues connected with the performance of the Management Board,
- 3) acts as the employer within the meaning of labour law regulations,
- 4) supervises the performance of the division which reports to him directly,
- 5) issues the internal regulatory acts and intra-corporate regulatory acts in accordance with the binding regulations,
- 6) takes decisions related to managing of the Company business as usual,
- 7) performs all the real functions and legal acts, taking into consideration implementation of the Company's goals and targets,
- 8) undertakes any other activities providing for effective and efficient performance of the Company.

Vice-Presidents of the Management Board:

- 1) manage the internal business of the Company and represent it within the external contacts,
- 2) manage the current business operations of the Company within the scope delegated as well as supervise the performance of the divisions which report to them directly,
- 3) take decisions on issues which are not subject to decisions of the Management Board, within the functions delegated to the subordinated business units as well as other decisions within the powers of attorney and authorisations granted to them by the Management Board or the President of the Management Board,
- 4) perform all the real functions and legal acts, taking into consideration implementation of the Company's goals and targets,
- 5) undertake any other activities providing for effective and efficient performance of the Company.

Directors of Departments:

- 1) manage the departments which report to them, being responsible for their performance results,
- 2) determine the goals, targets and tasks of individual business units included in the department they manage, within their subjective competence,
- 3) coordinate the structures subordinated to them, in accordance with the Company's interest and in compliance with the legal regulations,
- 4) implement the guidelines and recommendations of the Management Board members and keep them informed of the performance of the subordinated department,
- 5) undertake any other necessary activities providing for effective and efficient performance of the subordinated department.

"TAURON Group" management principles

In 2011, the development of the management process of "TAURON Group", understood as consolidated economic body consisting of autonomous commercial law companies, led by the Company, established by the Management Board was continued.

The main internal regulatory act of "TAURON Group" is the Code of TAURON Group (Code) adopted by the Management Board of the Company, which regulates its operations, providing for implementation of the goals through the particular tailored solutions in the area of management of "TAURON Group" entities, including, in particular, determining of the operating objectives of the companies, providing for achievement of the adopted effects.

Simultaneously, in 2011, within "TAURON Group", Business Areas were operating, established by the Company Management Board based on the Code, comprising the companies of "TAURON Group" as well as the established Management Areas within which the relevant cooperation rules are implemented.

The table below presents the list of companies included in "TAURON Group" as of 31 December 2011.

Table No. 1 List of companies of TAURON Capital Group included in “TAURON Group” as of 31 December 2011

No.	Company enterprise
1.	TAURON Polska Energia S.A. (parent company)
2.	TAURON Sprzedaż
3.	TAURON Obsługa Klienta
4.	TAURON EKOENERGIA
5.	TAURON Wytwarzanie
6.	EC Nowa
7.	TAURON Czech Energy
8.	EC Tychy
9.	PEPKH
10.	TAURON Dystrybucja
11.	TAURON Ciepło
12.	KW Czatkowice
13.	PKW

Due to acquisition of shares of GZE company, described in detail in item 1.2.1 and 1.5.1 of this report and taking of indirect control over the GZE subsidiaries by the Company, including:

- 1) Vattenfall Distribution Poland,
- 2) Vattenfall Business Services Poland,
- 3) Vattenfall Generation Poland,
- 4) Vattenfall Network Services Poland,
- 5) Vattenfall Sales Poland,
- 6) Vattenfall Wolin-North,

actions have been undertaken aimed at incorporation of the aforementioned GZE subsidiaries to “TAURON Group”. This occurred on 18 January 2012 when the Management Board of the Company passed the resolution on including of the above companies in “TAURON Group”. The companies listed above received the status of “TAURON Group” member as of 24 January 2012, i.e. at the moment the GM adopted the resolution on entering of the aforementioned companies to “TAURON Group”. Within the aforementioned meetings, amendments to the Articles of Association and Agreements of the above companies were also introduced, in connection with their entering to “TAURON Group”.

Owing to the adoption of the Code, the next key element providing for taking of operating decisions within the “TAURON Group” was the establishment of four Committees of “TAURON Group”:

- 1) Project Assessment Committee
- 2) TAURON Group Management Committee,
- 3) TAURON Group Compliance Committee,
- 4) Committee on TAURON Group Corporate Strategy Implementation.

The Committees were established to provide for performance of “TAURON Group” in accordance with the principles of operating coherence, in accordance with law and the common interest of “TAURON Group” and its stakeholders. The Committees, among others, play the opinion-making and decision-making role for the Management Board of the Company.

The underlying task of the committees is to supervise implementation of the adopted coherent actions by all the participants of “TAURON Group”, compliant with the Code and for the common interest of “TAURON Group” members. The specific functions of the Committees have been specified in the by-laws of their operations adopted by the Company Management Board.

Due to the implementation of the “TAURON Group” management model, the management agreements were terminated, concluded with individual subsidiaries of TAURON Capital Group, within the meaning of art. 7 of the Act of 15 September 2000 Code of Commercial Companies (this process was concluded on 12 April 2011).

1.3.2. Changes in TAURON and TAURON Capital Group management principles

Changes in TAURON management principles

In the financial year 2011, changes in the Company management rules and in the Company organisational structure, provided in the by-laws, were introduced, covering, in particular:

- 1) adjustment of names of divisions and positions of the President of the Management Board and Vice-Presidents of the Management Board, in accordance with resolutions of the Supervisory Board of the Company, as well as execution of changes in reference numbers of business units,
- 2) modification of tasks executed by members of the Management Board through specification of operations related to supervision, coordination, creating and management in accordance with the scope indicated by the Supervisory Board during the recruitment procedure,
- 3) regulating of issues connected with preparation, publication and archiving of intra-corporate regulatory acts, issued based on the Code, binding both in the Company and in companies – members of the “TAURON Group” (competence of the President of the Management Board was supplemented by adding the powers to issue the intra-corporate regulatory acts other than Cooperation Rules in the Management Areas),
- 4) establishment of Reorganisation Department in the division supervised by the Vice-President of the Management Board for Corporate Affairs (with simultaneous extension of competence of the Reorganisation Department previously operating within the division supervised by the Vice-President of the Management Board for Strategy and Business Development by issues related to reorganisation of TAURON Capital Group), as well as rearrangement of the organisational structure of the Division of Vice-President of the Board for Commercial Affairs, in accordance with the process model (Department of Sales and Customer Service, Department of Energy Trading, Department of Fuel – *Front Office*, Department of Portfolio Management – *Middle Office*, Department of Market Operator and Trading Service – *Back Office*).

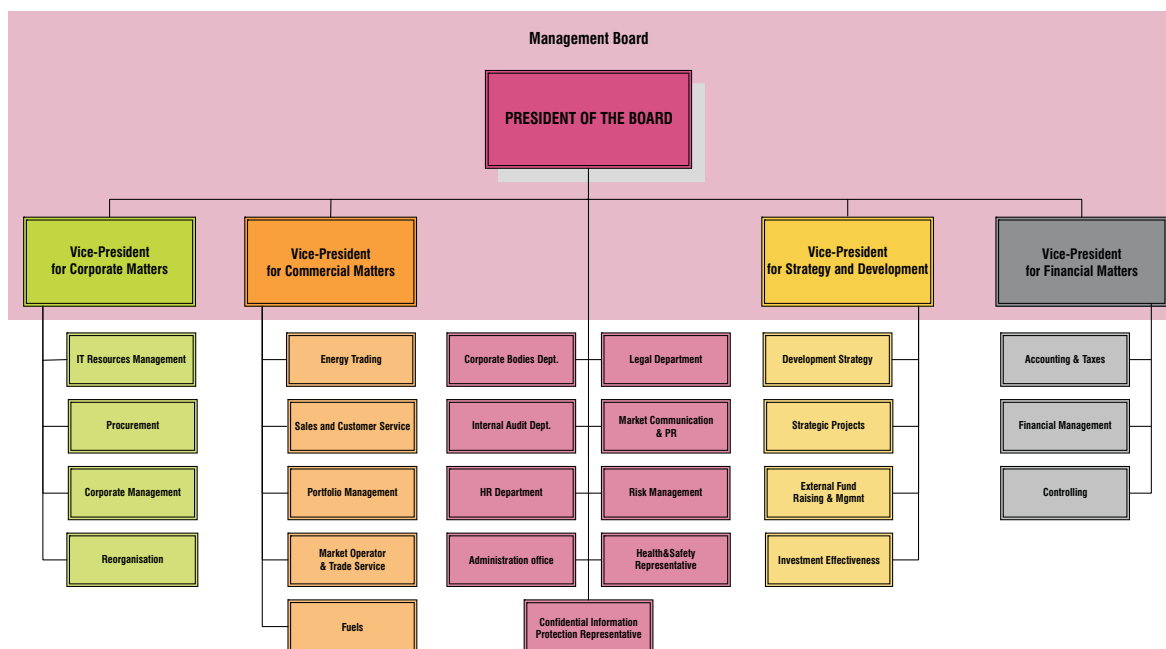
Amendments to the By-laws were adopted by the resolution of the Supervisory Board of 28 April 2011.

The organisational chart below presents the structure of divisions reporting to Board members, to the level of business units – offices reporting directly to the members of the Management Board, effective as of 31 December 2011.

**Figure No. 2 Organisational Chart of TAURON Polska Energia S.A.
as of 31 December 2011**



Organisational Chart of TAURON Polska Energia S.A.



Since 31 December 2011 until the day of this report, no amendments or modifications have been introduced to the aforementioned organisational structure of the Company.

Changes in "TAURON Group" management principles

Changes in Business Areas and allocation of the companies to specific Business Area

Considering the changes in organisation of the TAURON Capital Group, in 2011 the Management Board of the Company updated the allocation of "TAURON Group" companies to particular Business Area or Business Areas. It should be indicated that the aforementioned update was also performed in January 2012, in connection with incorporation of GZE subsidiaries to "TAURON Group", and the resulting need to determine their allocation to particular Business Areas.

Development and implementation of Cooperation Principles in Management Areas

In connection with implementation of the Code, in 2011 the process of development and implementation of Cooperation Principles in Management Areas was performed in the companies of "TAURON Group", as a result of which the Cooperation Principles have been implemented in the following Management Areas:

- 1) designing of strategy and development methods;
- 2) trading of fuel, energy and related products;
- 3) strategic investment projects;
- 4) management of stock exchange information and investor relations;
- 5) international cooperation;
- 6) research and development projects, including projects in the area of new technologies and environmental protection;
- 7) external and internal communication;
- 8) management of information and communication technology systems;
- 9) financial management;
- 10) controlling and management reporting;
- 11) accounting and taxes;
- 12) image marketing;
- 13) management of project implementation;
- 14) proceedings, legal counselling and internal regulations.

1.4. Organisational or capital relationships

As of 31 December 2011, the Company held shares and stocks directly in the following significant subsidiaries:

Table No. 2 List of significant subsidiaries in which the Company holds direct share

No.	Company name	Address	Core business area	Direct share in the company equity	Entity holding stocks/shares as of 31 December 2011	Direct share in the company governing body	Entity holding stocks/shares as of 31 December 2011
1.	TAURON Wytwarzanie	40-389 Katowice ul. Lwowska 23	Generation, transmission and distribution of electric energy and heat	99.72%	Company – 99.72%	99.72%	Company – 99.72%
2.	TAURON Dystrybucja	30-390 Kraków ul. Zawila 65 L	Distribution of electric energy	99.38%	Company – 99.38%	99.51%	Company – 99.51%
3.	TAURON Sales	30-417 Kraków ul. Łagiewnicka 60	Sales of electric energy	100.00%	Company – 100.00%	100.00%	Company – 100.00%
4.	TAURON Customer Service	53-128 Wrocław ul. Sudecka 95-97	Services (customer service)	100.00%	Company – 100.00%	100.00%	Company – 100.00%
5.	TAURON EKOENERGIA	58-500 Jelenia Góra ul. Obrońców Pokoju 2B	Generation and trading of electric energy	100.00%	Company – 100.00%	100.00%	Company – 100.00%
6.	EC Tychy	43-100 Tychy ul. Przemysłowa 47	Generation of electric energy, production and distribution of heat	95.47%	Company – 95.47%	99.05%	Company – 99.05%

No.	Company name	Address	Core business area	Direct share in the company equity	Entity holding stocks/shares as of 31 December 2011	Direct share in the company governing body	Entity holding stocks/shares as of 31 December 2011
7.	PEPKH	40-389 Katowice ul. Lwowska 23	Electric energy trading	100.00%	Company – 100.00%	100.00%	Company – 100.00%
8.	TAURON Heat	40-126 Katowice ul. Grażyńskiego 49	Production and distribution of heat	90.06%	Company – 90.06%	91.76%	Company – 91.76%
9.	EC Nowa	41-308 Dąbrowa Górnicza al. J. Piłsudskiego 92	Generation of electric energy, production of heat and technical gases	84.00%	Company – 84.00%	84.00%	Company – 84.00%
10.	TAURON Czech Energy	720 00 Ostrava Na Rovince 879/C Czech Republic	Electric energy trading	100.00%	Company – 100.00%	100.00%	Company – 100.00%
11.	GZE	44-100 Gliwice ul. Barlickiego 2	Activity of financial holdings	99.98%	Company – 99.98%	99.98%	Company – 99.98%

As of 31 December 2011, the Company indirectly held shares and stocks in the following significant subsidiaries covered by consolidation:

Table No. 3 List of significant subsidiaries in which the Company holds indirect share

No.	Company name	Address	Core business area	Indirect share in the company equity	Entity holding stocks/shares as of 31 December 2011	Indirect share in the company governing body	Entity holding stocks/shares as of 31 December 2011
1.	KW Czatkowice ¹	32-063 Krzeszowice 3 os. Czatkowice 248	Mining, crushing and granulation of limestone rocks and stone mining for construction needs	99.72%	TAURON Wytwarzanie – 100.00%	99.72%	TAURON Wytwarzanie – 100.00%
2.	PKW ¹	43-600 Jaworzno ul. Grunwaldzka 37	Hard coal mining	52.33%	TAURON Wytwarzanie – 52.48%	67.82%	TAURON Wytwarzanie – 68.01%
3.	(BELS INVESTMENT)	58-500 Jelenia Góra ul. Obrońców Pokoju 2B	Generation of electric energy	100.00%	TAURON EKOENERGIA – 100.00%	100.00%	TAURON EKOENERGIA – 100.00%
4.	MEGAWAT MARSZEWO	58-500 Jelenia Góra ul. Obrońców Pokoju 2B	Generation of electric energy	100.00%	TAURON EKOENERGIA – 100.00%	100.00%	TAURON EKOENERGIA – 100.00%
5.	Lipniki	52-420 Wrocław ul. Tadeusza Mikulskiego 5	Generation of electric energy	100.00%	TAURON EKOENERGIA – 100.00%	100.00%	TAURON EKOENERGIA – 100.00%
6.	Vattenfall Distribution Poland	44-100 Gliwice ul. Portowa 14a	Distribution of electric energy	99.98%	GZE – 100%	99.98%	GZE – 100%
7.	Vattenfall Sales Poland	44-100 Gliwice ul. Barlickiego 2a	Electric energy trading	99.98%	GZE – 99.998%, Vattenfall Network Services Poland – 0.002%	99.98%	GZE – 99.998% Vattenfall Network Services Poland – 0.002%
8.	Vattenfall Network Services Poland	44-100 Gliwice ul. Myśliwska 6	Repairs and maintenance of machines and electric equipment, electric installations, construction of electric power lines	99.98%	GZE – 99.8%, Vattenfall Sales Poland – 0.2%	99.98%	GZE – 99.8%, Vattenfall Sales Poland – 0.2%
9.	Vattenfall Wolin-North	44-100 Gliwice ul. Barlickiego 2a	Generation of electric energy	99.98%	GZE – 100%	99.98%	GZE – 100%
10.	Vattenfall Business Services Poland	44-100 Gliwice ul. Wybrzeże Armii Krajowej 19b	Services	99.98%	GZE – 100%	99.98%	GZE – 100%

¹ The Company is the user of shares/stocks owned by TAURON Wytwarzanie. As a result of signing of agreements on shares usufruct, the Company holds 100% shares in the share capital and the governing body of KW Czatkowice as well as 52.48% shares in the share capital of PKW company, providing 68.01% of votes at GM.

In the consolidated financial report of TAURON Capital Group for the year ended on 31 December 2011, the investment in the joint venture Elektrociepłownia Stalowa Wola S.A. has also been recognised. (EC Stalowa Wola), which was evaluated by application of the ownership rights method. TAURON Wytwarzanie and PGNiG Energia S.A. – each holds 50% each of shares in the equity and in the governing company of EC Stalowa Wola company (indirect share of the Company is 49.86%).

1.5. Major domestic and foreign investment

1.5.1. Purchase of shareholding securities

In the area of purchase of shares and stocks in companies, the main investment included:

Purchase of GZE shares

Based on preliminary purchase contract of 23 August 2011 concluded with Vattenfall AB and following the unconditional approval of the President of UOKiK (Office of Competition and Consumer Protection) on taking the control over GZE, on 13 December 2011 the Company purchased 1,249,693 shares in the GZE share capital with a par value of PLN 100.00 each and the total par value of PLN 124,969.3 thousand, constituting 99.98% of the GZE share capital. The total value of the transaction amounted to PLN 4,625,955 thousand, whereas the amount of PLN 3,623,517 thousand was paid on the day the transaction was concluded (the amount includes the deposit of PLN 120,000 thousand transferred to Vattenfall AB based on the preliminary purchase agreement, including the accrued interest) while the amount of PLN 1,002,438 thousand constitutes Vattenfall AB debt towards GZE and its subsidiaries, taken over by the Company as part of the transaction.

Purchase of the special purpose vehicle Lipniki

On 28 September 2011 TAURON EKOENERGIA company acquired 100% shares of Lipniki company from the German energy corporation WSB Neue Energien GmbH, including the wind farm. Lipniki company is a special purpose vehicle which was established to construct and operate the wind park Lipniki including 15 wind turbines of the total capacity of 30.75 MW. The Lipniki wind farm was commissioned in July 2011. The sales price was established at PLN 93,317 thousand. The Lipniki wind farm is the first wind park within the structures of TAURON Capital Group.

Increase of share in PEPKH company

On 26 July 2011 a contract was concluded between PKE and the Company concerning disposal of shares of PEPKH company as the benefit to fulfil part of the liability of PKE to disburse the dividend payable to the Company for the financial year ended on 31 December 2010. PKE disposed of all the shares held in PEPKH, i.e. 700 shares with total par value of PLN 4,200, for the total amount of PLN 42,170 thousand. On 26 July 2011 the transfer of shares to the Company was performed. As a result of this transaction, the Company increased its direct share in the capital and governing body of PEPKH to 100%.

1.5.2. Purchase of debt securities and other securities

Within TAURON Capital Group, acting on the basis of the implemented model of central financing as well as in accordance with the conditions of the operating programme of issue of internal bonds, in 2011 the Company was purchasing bonds issued by TAURON Capital Group. The major objective of bond issue was acquisition of funds by companies of TAURON Capital Group for implementation of the investment programme, refinancing of the hitherto debt or purchase of shares/stocks. The total value of issues taken over in 2011 amounted to PLN 1,147,040.

The table below shows the value of issues taken over, divided into individual companies of TAURON Capital Group (issuers) as of 31 December 2011.

Table No. 4 Value of issues taken over, divided into individual companies of TAURON Capital Group (issuers)

No.	Company name (issuer)	Value of issues taken over, in PLN thousand
1.	EC Tychy	45,300
2.	PEPKH	10,000
3.	TAURON Dystrybucja	65,800
4.	TAURON EKOENERGIA	150,000
5.	TAURON Wytwarzanie	875,940
TOTAL		1,147,040

Moreover, in connection with acquisition of the part of Vattenfall AB assets, in the period from the day of taking over the control to the balance sheet day, the companies of GZE group invested in State Treasury bonds. As of the balance sheet day, companies of GZE group held the following bonds:

Table No. 5 Investment of companies of GZE group in State Treasury bonds

No.	Company	Par value, in PLN thousand	Date of redemption
1.	Vattenfall Distribution Poland	8,999	02.01.2012
2.	Vattenfall Sales Poland	90,499	02.01.2012

In addition, in 2011 the Company was investing available funds acquired within the cash pooling operating in TAURON Capital Group, exclusively in safe money market instruments, i.e. bank deposits and participation units of investment funds of the money market. At the end of the year, the total cash surplus was invested only in bank deposits (the participation units of investment funds of the money market were purchased and redeemed in the third quarter of 2011).

1.5.3. Implementation of strategic investment

In 2011, the following strategic investment projects were continued in TAURON Capital Group:

- 1) construction of steam and gas fired unit, including the heat generation component at Stalowa Wola – the investment is implemented with participation of the strategic partner – PGNiG S.A. The investment is aimed at construction and commissioning of the new steam and gas fired unit of 400 MWe power capacity and 240 MWt heating capacity. On 15 April 2010 the Implementation Agreement was signed between the Company, PGNiG S.A., PGNiG Energia S.A. and ESW, which specifies, in particular, the rules of preparation and execution of the investment process. Delivery of the project is scheduled in 2015;
- 2) construction of 50 MW_e/182 MW_t power unit, adjusted to electric energy and heat generation within the area of Zespół Elektrociepłowni Bielsko-Biała (ZEC in Bielsko-Biała) belonging to TAURON Wytwarzanie. The investment is aimed at replacement of exploited generation units of low capacity by a high performance unit, complying with all environmental protection requirements concerning emissions of NO_x, SO₂ and dust. Delivery of the investment is planned in mid-2013;
- 3) construction of a 40 MW wind farm in the location of Wicko. The investment has already been approved by relevant corporate bodies. The process of selection of the General Contractor is underway. Concluding of the agreement is scheduled at the end of the first quarter of 2012, and completing of the investment is scheduled in 2013;
- 4) construction of an 82 MW wind farm in the location of Marszewo. On 19 January 2012, the agreement with the General Contractor was signed. The delivery of the Site to the Contractor is scheduled in March. Commissioning is planned in 2014;
- 5) construction of steam and gas fired unit at EC Katowice, including the 135 MW_e/90 MW_t capacity unit. In January 2012, the utilities contract concerning implementation of the above investment was published. Delivery of the project has been planned at the turn of 2015/2016;
- 6) construction of the 50 MW_e/45 MW_t co-generating biomass-fuelled unit at Elektrownia Jaworzno III belonging to TAURON Wytwarzanie. The investment is under implementation. Completion of construction works is scheduled at the end of 2012;
- 7) modernisation of one of the boilers at Elektrownia Stalowa Wola belonging to TAURON Wytwarzanie, in order to adjust it to biomass burning. The investment has been commenced and completion of construction works is scheduled in 2012;
- 8) construction of new generating capacity in co-generation at the level of 50 MW_e and 86 MW_t in EC Tychy and modernisation of the existing unit in order to adjust it to biomass burning. This investment has already been approved by competent corporate bodies, and delivery of this investment is scheduled at the beginning of 2016;
- 9) construction of the new 910 MW power unit with supercritical parameters at Elektrownia Jaworzno III belonging to TAURON Wytwarzanie. It is expected that the new unit will demonstrate high performance and availability as well as low levels of emissions of NO_x, SO₂, CO₂, and dust. Completing of this investment project has been planned at the turn of 2016/2017;
- 10) construction of installation for denitrification of combustion gases in 6 units at Elektrownia Jaworzno III and 4 units at Elektrownia Łaziska belonging to TAURON Wytwarzanie. This investment will enable to reduce the NO_x emission in these units to the levels which will be binding for Poland from 2018. The construction works have already been commenced and they will be continued until 2015;
- 11) construction of the new 850 MW steam and gas fired unit, natural gas burning, at Elektrownia Blachownia – within the actions undertaken by the Company and TAURON Wytwarzanie in the scope of the project on reconstruction of generating capacity at Elektrownia Blachownia, with participation of the strategic partner KGHM Polska Miedź S.A. Commissioning of the project has been planned at the turn of 2015/2016.

In 2011, the investment expenditure of TAURON Capital Group amounted to about PLN 2,504 M and it was higher by approximately 56.2% as compared to expenditure incurred in 2010, which amounted to about PLN 1,603 M. This results mainly from intensification of strategic investment in the Business Areas of Generation and Distribution. In terms of value, the main investment outlays in 2011 was incurred for:

- construction of new generating capacity (PLN 528 M),
- construction of installations for reduction of NOx emission (PLN 185 M),
- construction of new junctions in the Business Area of Distribution (PLN 386 M),
- modernisation of existing distribution grids (PLN 556 M).

Moreover, expenses were incurred for construction of underground excavations in the Business Area of Mining (PLN 55 M).

2. OPERATIONS OF TAURON CAPITAL GROUP

2.1. Timeline of key events

The below timeline of key events presents the most important events related to operations of TAURON Capital Group which occurred in 2011.

Table No. 6 Timeline of key events

Month	Events
January	<ul style="list-style-type: none"> Incorporation of PKW and KW Czatkowice to "TAURON Group" established by the Management Board of the Company based on the Code.
February	<ul style="list-style-type: none"> Appointment of members of the Management Board for the third term by the Supervisory Board.
March	<ul style="list-style-type: none"> Signing of Agreements by the Company concerning the project of construction of the steam and gas fired unit at Stalowa Wola (for operation of the EC Stalowa Wola, supply of electric energy, supply of gas fuel). Registration of the decrease in share capital of the Company by the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register performed through decrease in par value of the shares in order to restructure the equity of the Company. Signing of loan agreement between EC Tychy and the Regional Fund for Environmental Protection and Water Management (WFOŚiGW) involving reconstruction of the fluidized bed boiler and construction of installation of biomass-fuelled boilers.
April	<ul style="list-style-type: none"> Signing of agreement by the Company, based on which the decision has been taken that further construction works of the unit of 800–910 MW at Elektrownia Blachownia in Kędzierzyn-Koźle will be conducted based on the assumption of selection of the gas fuel. Adopting of updated Corporate Strategy.
May	<ul style="list-style-type: none"> Appointment of members of the Supervisory Board for the third term by the GM. Convening of Ordinary General Meeting of the Company for the financial year 2010.
June	<ul style="list-style-type: none"> Withdrawal of Kompania Węglowa from the Agreement on Joint Venture of 8 April 2010, based on which the Company and Kompania Węglowa S.A. (Kompania Węglowa) undertook the commitment to commence actions aimed at contribution of the enterprise KWK "Bolesław Śmiały" by Kompania Węglowa to the special purpose vehicle and, subsequently, contribution of shares in this special purpose vehicle as well as all PKW shares held by Kompania Węglowa to the Company, in exchange for new in-kind contribution of stocks at the increased share capital of the Company addressed to Kompania Węglowa.
July	<ul style="list-style-type: none"> Confirmation of the long-term foreign and local currency ratings for the Company at BBB level, with stable outlooks by the Fitch Rating Agency. Signing of agreement of CC Poland Plus sp. z o.o. (CC Poland Plus) by the Company, in order to conduct research and coordinate activities in the area of the so-called clean coal technologies. Signing of agreement on purchase of PEPKH shares by the Company. Signing of agreement between EC Nowa and ArcelorMittal Poland S.A. on sales of energy media, purchase of gas fuel, implementation of investment involving modernisation of the OPG 430 boiler and construction of turbo generator of 50 MW capacity, and establishing the principles of settlements between EC Nowa and ArcelorMittal concerning the CO₂ emission.
August	<ul style="list-style-type: none"> Signing of preliminary agreement between the Company and Vattenfall AB on sales of GZE stocks in favour of the Company. Confirmation of maintenance of the long-term foreign and local currency ratings for the Company at BBB level, with stable outlooks by the Fitch Rating Agency, in connection with GZE acquisition from Vattenfall AB. Establishment of TAURON Wytwarzanie, as a result of registration by the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register, of the merger of PKE and ESW companies.
September	<ul style="list-style-type: none"> Signing of agreement on establishment of Tax Capital Group. Establishment of TAURON Dystrybucja, as a result registration by the District Court Wrocław–Fabryczna in Wrocław, 6th Commercial Division of the National Court Register, of the merger of EnergiaPro and ENION companies. Establishment of TAURON Ciepło, as a result registration by the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register, of the merger of PEC Katowice oraz PEC in Dąbrowa Górnicza. Purchase of the whole shares of Lipniki company holding the wind farm by TAURON EKOENERGIA.

Month	Events
October	<ul style="list-style-type: none"> Signing of the agreement by the Company, on the basis of which the value of bond programme of the Company was increased by tranche C at the value of PLN 3,000,000 thousand, i.e. to the total amount of PLN 4,300,000 thousand. Entering of the Company into the agreement on cooperation under the form of a special purpose vehicle holding the name of Pierwiastki i Surowce Krytyczne sp. z o.o. providing the platform for cooperation in the scope of research on optimum technology for production of solar panels.
November	<ul style="list-style-type: none"> Registration of the Tax Capital Group by the Head of Tax Office in Sosnowiec. Registration of significant amendment to the Subject of Company Operations by the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register.
December	<ul style="list-style-type: none"> Issue of bonds by the Company at the total value of PLN 3,300,000 thousand. Signing of agreement on sales of GZE stocks in favour of the Company.

2.2. Core business areas

TAURON Capital Group is a vertically integrated energy utility enterprise holding the leading position in generation, distribution and supply of electric energy in Poland and in Central and Eastern Europe. TAURON Capital Group conducts its operations within the following Core Business Areas (hereinafter also referred to as Segments):

Mining, comprising mainly mining, preparation and sales of hard coal in Poland, the activity provided by PKW.

Generation, comprising mainly generating of electric energy and heat from conventional sources, as well as generating of electric power and heat using biomass co-burning, the activity provided by TAURON Wytwarzanie, EC Tychy and EC Nowa.

Renewable Energy Sources (RES), comprising generating electric energy from renewable sources (excluding generation of electric energy using biomass co-burning attributed to the Generation Segment), as well as managing of the TAURON Capital Group projects in the area of energy generating from other renewable energy sources. This activity is provided by TAURON EKOENERGIA as well as companies acquired in 2010: BELS INVESTMENT and MEGAWAT MARSZEWO, as well as companies acquired in 2011: Lipniki and GZE subsidiary – Vattenfall Wolin-North.

Distribution, covering distribution of electric energy using distribution networks located in southern Poland, the activity provided by TAURON Dystrybucja and the subsidiary of GZE acquired in 2011: Vattenfall Distribution Poland. This area also covers the company Vattenfall Network Services Poland and GZE – jointly presented as Business Unit Distribution.

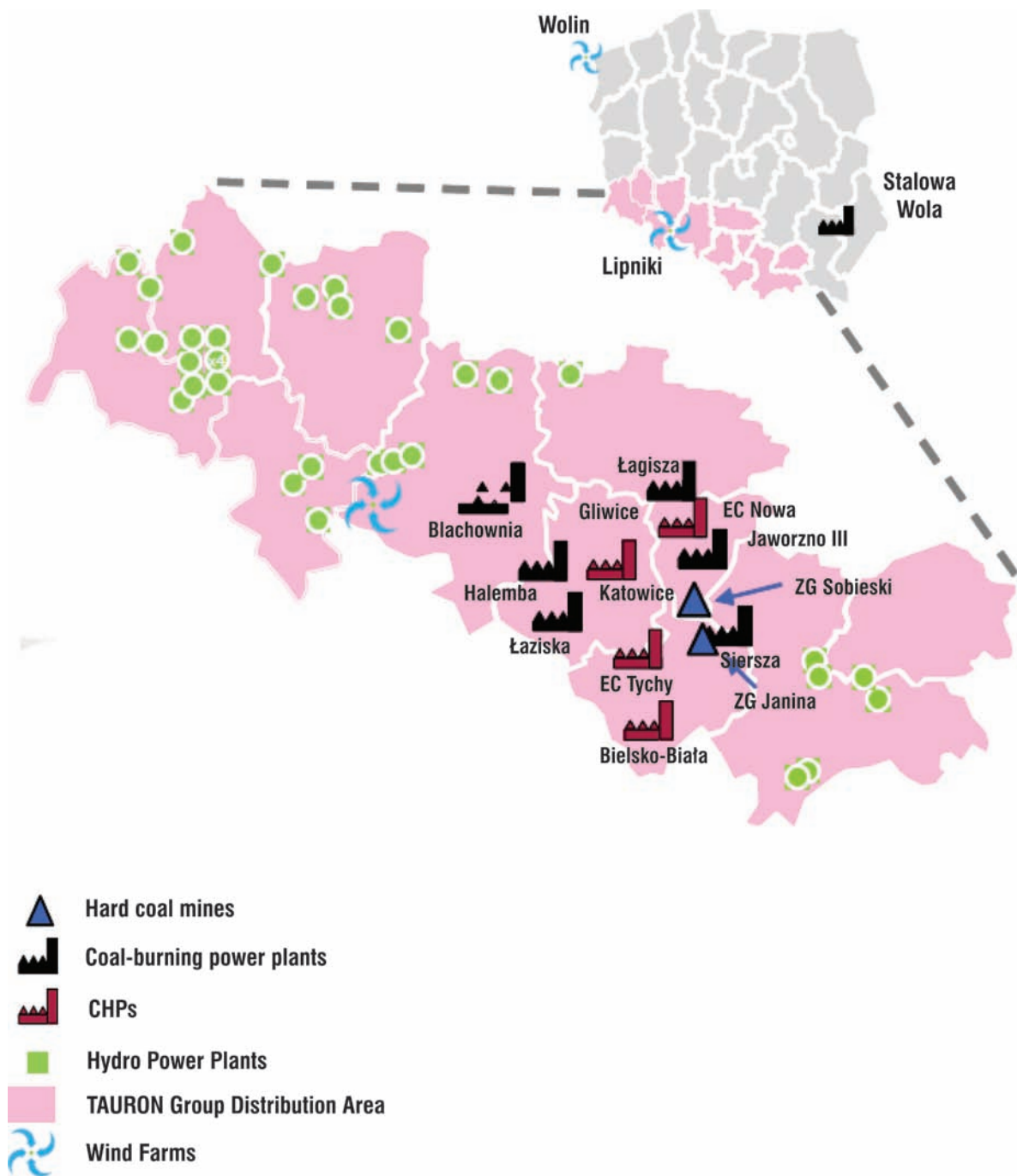
Trading, comprising sales of electric energy to end-customers and wholesale trading of electric energy, as well as trading and management of CO₂ emission allowances and the proprietary rights arising from the energy certificates of origin. Operations in this area are provided by the companies: TAURON Polska Energia S.A., TAURON Sprzedaż, PEPKH, TAURON Czech Energy and the GZE subsidiary acquired in 2011: Vattenfall Sales Poland. The company dealing with customer service of the companies is also included in this Core Business Area: TAURON Sprzedaż and TAURON Dystrybucja, i.e. TAURON Obsługa Klienta.

Other, comprising mainly distribution and sales of heat (provided by the company TAURON Ciepło) as well as other activities in the area of extraction of stone, including limestone, for power industry, metallurgy, construction and road building as well as production of sorbents for flue gas desulphurization installations using the wet method and for the use in the fluidized bed boilers (provided by the company KW Czatkowice). The GZE subsidiary company acquired in 2011 is also allocated to this Core Business Area: Vattenfall Business Services Poland.

TAURON Capital Group conducts its operations and acquires its revenues mainly from generating, sales and distribution of electric energy and heat as well as from sales of hard coal.

The map below shows the location of key assets of TAURON Capital Group as well as areas within which the companies of TAURON Capital Group (TAURON Dystrybucja, Vattenfall Distribution Poland) have been appointed as Distribution System Operators (DSOs).

Figure No. 3 Location of key assets of TAURON Capital Group



2.3. Financial results by business areas

The table below shows the results of TAURON Capital Group by individual Core Business Areas (Segments) for the years 2011 and 2010. Data for individual Business Areas do not cover consolidation exclusions.

Table No. 7 The table below shows the results of TAURON Capital Group by Business Areas (Segments) for the years 2011 and 2010

Specification (PLN thousand)	Year 2011	Year 2010	Dynamics (2011/2010)
Coal mining			
Revenue on sales	1,171,213	1,081,398	108.3%
Operating profit	4,805	5,908	81.3%
Amortisation	99,840	104,706	95.4%
EBITDA	104,645	110,614	94.6%
Generating electric energy and heat from conventional sources			
Revenue on sales	6,435,851	5,863,208	109.8%
Operating profit	621,061	656,169	94.6%
Amortisation	565,973	541,778	104.5%
EBITDA	1,187,034	1,197,947	99.1%
Generating electric energy and heat from renewable sources			
Revenue on sales	180,674	167,202	108.1%
Operating profit	100,578	89,407	112.5%
Amortisation	25,414	25,538	99.5%
EBITDA	125,992	114,945	109.6%
Distribution of electric energy			
Revenue on sales	4,668,237	4,509,033	103.5%
Operating profit	614,205	509,281	120.6%
Amortisation	665,611	628,523	105.9%
EBITDA	1,279,816	1,137,804	112.5%
Supply of energy and other products of the energy market			
Revenue on sales	13,841,745	12,093,842	114.5%
Operating profit	278,835	183,934	151.6%
Amortisation	9,819	8,095	121.3%
EBITDA	288,654	192,029	150.3%
Other			
Revenue on sales	594,162	597,963	99.4%
Operating profit	71,692	35,445	202.3%
Amortisation	44,890	50,587	88.7%
EBITDA	116,582	86,032	135.5%
Non-attributable items and exemptions			
Revenue on sales	(6,136,660)	(8,883,767)	69.1%
Operating profit	(79,687)	(80,885)	98.5%
Amortisation	0	0	–
EBITDA	(79,687)	(80,885)	98.5%
Total EBITDA	3,023,036	2,758,486	109.6%

Coal mining

In 2011 revenue on sales from the Mining Segment increased by about 8.3% as compared to 2010 which results from the increase in average price of the coal sold as well as the increase in sales volume. Decrease in EBIT (Earnings Before Interest and Taxes) by about 18.7% in relation to 2010 results mainly from higher costs of material consumption, caused by increase of market prices above the inflation rate as well as unfavourable mining and geological conditions (increased deposit of sandstone, inflow of groundwater and lengthening of ventilation ducts).

In 2011, the total production of commercial coal amounted to about 4.6 million t, i.e. by about 1.8% more in relation to 2010. In spite of the growth of production year to year, in 2011 the risks of unfavourable geological and mining conditions materialised as well as the natural hazards which were difficult to foresee. In order to prevent that, available geological data is analysed on on-going basis. Moreover, the planning process in the mining sector is mainly based on forecast of deposit composition, covering, among others, tectonic parameters,

level of formation and slope of the deposits, physical and chemical parameters of the fossil and the rocks, expected natural hazards and their intensity level. Research is also conducted – surface and underground drilling, as well as preparatory works.

Generating electric energy and heat from conventional sources

In 2011 revenue on sales from the Generation Segment increased by about 9.8% as compared to 2010 which results from the increase in sales volume of electric energy, in particular within trades concluded at the Polish Power Exchange (Towarowa Gielda Energii S.A.) (TGE). Moreover, as compared to the previous year, the price trends at TGE were favourable. This business area has also reached higher revenue on sales of proprietary rights arising from energy certificates (irrespective of significant decrease of prices of red certificates in 2011 from about 27 PLN/MWh to about 9 PLN/MWh), revenue of sales of RUS and power reserves, in connection with the increasing demand of the Electric Power National System (KSE) as well as increasing demand of the Transmission System Operator in the scope of commissioning of units which were not classified for emergency shutdown before. The lower level of revenue on sales of heat was caused by unfavourable atmospheric conditions in 2011.

The operating result EBIT of the Generation Area reached almost 96% of the level achieved a year before, EBIDTA (Earnings before Interest, Taxes, Depreciation, and Amortization) in 2011 reached the level close to 2010. The results achieved were positively influenced by higher volume of sales of electric energy from own production as well as higher sales price of electric energy, while the negative impact was mainly attributed to the increased unit floating generation costs (mainly costs of consumption and purchase of production fuel, including the biomass). The increased costs in this area were also influenced by the extended down time of the 460 MW unit in Elektrownia Łagisza, which has enforced the necessity to relocate the production of electric energy from this unit to generating units of worse indicators of emission and unit fuel consumption.

The margin on floating costs on sales of heat has slightly increased, while the margin on sales of wind of blast furnace and compressed air stayed at the level comparable to 2010. The revenue on compensation to cover stranded costs resulting from termination of long-term contracts (LTC) was lower, which is mainly attributed to the change of result set in accordance with the provisions of the Act of 29 June 2007 on principles of covering of the costs incurred by producers due to the premature termination of long-term contracts for sales of power and electric energy, i.e. with excluding of revenue-cost streamline related to activities other than production and sales of electric energy and RUS. The mechanism for calculating and disbursement of funds to cover the stranded costs occurring in connection with termination of LTC assumes that in case of deterioration of market conditions, the amount of compensation will grow (with the limitation of the maximum ceiling), and if the result is better than forecasted, the level of compensation will decrease. Therefore, this mechanism has a neutralising impact on potential negative market events. Year 2012 is the last year of participation of the company TAURON Wytwarzanie in the programme of compensation of stranded costs.

The implementation of transactions of exchange of EUA (European Union Allowances) to the CER units Certified Emission Reduction, had positive impact on the results achieved. Within such transactions, companies of the Generation Segment sold the emission allowances EUA, granted within KPRUII (National Plan of Allowances Distribution), to the Company, simultaneously repurchasing the units of certified emission CER/ERU (Emission Reduction Unit). In the second settlement period (2008–2012), the Polish legislation permits individual installations included in the Community system of CO₂ emission trading to cover 10% of the emission with the CER units. The value of these units at European markets is lower than the value of emission allowances EUA, and the difference in price allows the companies participating in the emission trade system to gain profit. On the other hand, the decreased results may be attributed to higher fixed costs, mainly costs of outsourced services (including renovations and repairs).

Generating electric energy and heat from renewable sources

In 2011 revenue on sales in the RES Segment increased by about 8.1% as compared to 2010 which results mainly from the increase in electric energy sales.

The operating result EBIT and EBITDA result of RES Business in 2011 reached higher level than in 2010 (by about 12.5% and 9.6%, respectively). Results of this Segment are significantly determined by the electric energy production volume. Due to unfavourable atmospheric conditions which occurred mainly in the 2nd and 3rd quarter of 2011 (long periods without rain), the production volume of electric energy was by about 0.1 TWh lower than in 2010, which was reflected in the lower sales of electric energy and proprietary rights arising from energy certificates. Other factors positively influencing the result included higher sales price of proprietary rights arising from energy certificates as well as including of results of the following companies in the results of RES Segment in 2011: Lipniki and Vattenfall Wolin-North (since the moment of their acquisition).

Distribution of electric energy

In 2011, as compared to 2010, the Distribution Segment of electric energy reached the increase in revenue by about 3.5%, increase of results at the operating level by about 20.6%, and EBITDA result by about 12.5%. The improved result of EBIT in 2011 may be mainly attributed to the following reasons of changes in the revenue and cost levels.

The total revenue reached in 2011 is higher than in 2010 due to the increase in revenue on sales of distribution services to end consumers (growth of sales volume at the decreased unit rate for distribution services), increased export sales (growth of price and volume) as well as increased value of other revenue related to distribution activities, including mainly connection fees and

excessive reactive power intake. In terms of value, sales to end consumers in 2011 increased in relation to 2010 in tariff groups B and C, while it decreased quantitatively in group G. In terms of sales to other DSO, the value balance of energy transits in 2011 is positive, which means profit on purchase and sales operations of distribution services from/to other DSO, however, this result is lower than in 2010.

In addition, higher value of sales in 2011, as compared to 2010, was influenced by acquisition of GZE companies in the middle of December 2011, and recognising of result of GZE distribution companies in the result of the Distribution Business Area.

The level of EBIT operating profit achieved by Distribution Business Area in 2011 was higher by about 20.6% than a year ago, and EBIDTA result was higher by about 12.5%. Besides higher revenue, lower operating costs had positive impact on increased results of this Business Area. Floating costs of the Business Area decreased in 2011 mainly due to lower level of energy purchase for the needs of balance differences. The decrease in purchase costs due to reduced level of grid losses indicator, totally levelled off the effect of growth in electric energy prices which occurred in 2011. Within fixed costs, their level was minimally increased in relation to 2010, however, main growths involved amortisation and costs of outsources services which include costs of customer service since 2011. The level of EBIT was also positively influenced by results on other operating activity as well as other statutory activity (unrelated to distribution activities, covering, among others, street lighting).

Supply of energy and other products of the energy market

In 2011 the Trading Segment reached revenue on sales at the level higher by 14.5% y/y, which mainly resulted from the growth of retail sales volume of electric energy (by about 3.4%). The revenue of the Segment was also increased due to gaining the revenue on the services of comprehensive customer service provided in favour of TAURON Dystrybucja. Year 2011 was the first year when actions related to comprehensive customer service of appointed companies of TAURON Capital Group were concentrated in the company TAURON Obsluga Klienta.

The operating result (EBIT) in 2011 reached significantly higher level than in 2010 (increase by about 51.6%). EBIDTA result of the Trading Business Area increased by about 50.3% as compared to the previous year. The Segment achieved higher margin on electric energy sales, which was positively influenced mainly by the increased volume of sales and increased sales prices, while the negative impact may be attributed to the increased wholesale price of electric energy purchase.

Revenue on other operations

In 2011, revenue on other operations reached the level of 99.4% of revenue of the previous year. It is the result of lower revenue reached by the heat generation companies (by about 4.8%) – due to sales of heat generated and purchased, as well as heat transmission. In every case, the factor decreasing revenue was the decreased volume of sales caused by higher average ambient temperatures in 2011, as compared to 2010. The decrease in sales was partly compensated by the increase in average sales price of trading heat, which also referred to heat purchase price.

On the other hand, in 2011, in relation to 2010, revenues of the company attributed to this Segment (KW Czatkowice) increased significantly, which was mainly related to the aggregate and resulted from the increased demand connected with implementation of the governmental programme of development of roads and motorways.

The above changes in levels of revenues and costs influenced the increase in EBITDA level in 2011 by about 35.5% in relation to 2010. In addition, the EBIT result was positively influenced by results of other statutory activities (increase by about 102.3% y/y) (unrelated to heat sales) as well as other operating activity, including the reversal of impairment losses of fixed assets in the area of operations of one of the companies. As of 31 December 2011, considering the assumptions effective on that day, including those resulting from effects of merger of the aforementioned companies within TAURON Ciepło, the analysis conducted has confirmed the lack of necessity to recognise the impairment losses.

2.4. Basic products, goods and services

The table below presents volumes of production and sales in TAURON Capital Group for 2011 and 2010.

Table No. 8 Volumes of production and sales for 2011 and 2010

Volumes of production and sales	Unit	Year 2011	Year 2010	Change
Commercial coal production	M Mg	4.58	4.50	1.8%
Generation of electric energy (net production of the Group), including:	TWh	21.38	21.33	0.2%
<i>Net production of Generation Area</i>	<i>TWh</i>	<i>21.00</i>	<i>20.85</i>	<i>0.7%</i>
<i>Net production of RES Area</i>	<i>TWh</i>	<i>0.37</i>	<i>0.48</i>	<i>-22.9%</i>
Generation of electric energy from renewable sources of the Group, including:	TWh	0.99	1.10	-10.0%
<i>Production of biomass from Generation Area</i>	<i>TWh</i>	<i>0.61</i>	<i>0.62</i>	<i>-1.6%</i>
<i>Production of hydro plants and wind farms of the RES Area</i>	<i>TWh</i>	<i>0.38</i>	<i>0.48</i>	<i>-20.8%</i>

Volumes of production and sales	Unit	Year 2011	Year 2010	Change
Heat generation by the Group, including:	PJ	15.96	18.29	-12.7%
<i>Production of heat from Generation Area</i>	<i>PJ</i>	15.08	17.25	-12.6%
<i>Production of heat from Area: Other</i>	<i>PJ</i>	0.88	1.04	-15.4%
Distribution of electric energy	TWh	38.24	37.52	1.9%
Retail sales of electric energy	TWh	35.52	34.34	3.4%
Number of clients – Distribution	thou.	4,143	4,115	0.7%

Volumes indicated in items distribution and sales of electric energy do not contain sales volumes of GZE companies taken over in December 2011, conducting operations in the area of distribution and sales of electric energy, in order to provide for comparability of the data for TAURON Capital Group for 2011 and 2010.

Data concerning volumes of supply and sales of electric energy and number of clients for the whole 2011 for GZE companies (thus, also for the period when the companies belonged to Vattenfall group) are presented in the table below.

Table No. 9 Volumes of sales of GZE companies in 2011

Volumes of production and sales	Unit	2011
Distribution of electric energy	TWh	14.6
Sales of electric energy	TWh	9.5
Number of clients – Distribution	thou.	1,133

2.5. Potential customers market and sources of supply

TAURON Capital Group is a vertically integrated energy enterprise controlling the whole value chain from coal mining to supplying of electric energy to end consumers. Therefore, TAURON Capital Group performs its operations within all key segments of the energy market (excluding electric energy transmission which is the exclusive responsibility of the Transmission System Operator), i.e. in the area of coal mining, generation, distribution as well as sales and trading of electric energy and heat. Vertical integration of TAURON Capital Group allows for decreasing of dependence of TAURON Capital Group on external suppliers of hard coal, increasing the stability of the revenue and margins achieved by TAURON Capital Group.

In 2011, about 27% of the current demand of TAURON Capital Group for fuel required for generation of electric energy and heat was satisfied by hard coal coming from own mining plants of TAURON Capital Group.

Business Area: Mining

The PKW company acting within the Mining Business Area is a producer of power coal, type 31.2, offered for sale on the market in thick and medium coal sizes and power fine coal. Depending on the coal size, the coal has the following trade parameters:

- energy value from 19 MJ/kg to 23 MJ/kg,
- ash content from 9% to 16%,
- sulphur content from 1.0% to 1.4%.

PKW conducts the sales of coal in two directions:

- sales of fine coal and coal sludge to power plants and cogeneration plants,
- sales of thick, medium and small amount of fine coal sizes through the organized sales network all over the country.

Sales of coal from PKW is mainly provided in the region of southern and central Poland in particular the following provinces: Śląskie, Małopolskie, Podkarpackie, Świętokrzyskie and Dolnośląskie.

In 2011, sales of hard coal by PKW amounted to 4.6 million Mg, including 3.1 million Mg (69%) – to companies of Generation Segment of TAURON Capital Group.

Business Area: Generation

Generation of electric energy and heat by TAURON Capital Group generation units depends on the supplies of hard coal. The main suppliers of hard coal for producers of TAURON Capital Group include: Kompania Węglowa (about 50% of the demand) and PKW (about 27% of the demand).

In 2011, the substantial majority of electric energy production of the Generation Area was sold based on transactions concluded at TGE, in accordance with the provisions of art. 49a, of the Act of 10 April 1997: *Energy Law*, effective as of 9 August 2010. This Act has bound the energy enterprises dealing with generation of electric energy and entitled to receive funds to cover stranded costs to sell the electric

energy generated (after taking into consideration contracts concluded before the introduction of amendments to the aforementioned Act as well as energy excluded from this obligation pursuant to legal regulations), in the manner providing for equal, public access to this energy, i.e. through open tender, on Internet trading platform on the regulated market or at TGE.

Due to the revision of the aforementioned Energy Law, sales of electric energy produced by Generation Area in 2011 to the Company was reduced and amounted to about 1.4 TWh. Limited volume of the generated electric energy is also sold to independent consumers connected in the past to the power plant and cogeneration plant installations of the TAURON Capital Group.

Heat produced by Generation Business Area is sold to TAURON Capital Group companies which deal with distribution and sales of heat, as well as to external consumers.

Moreover, companies of Generation Area obtain, due to electric energy generation from RES as well as from cogeneration, certificates of origin, which are purchased and submitted to the President of the Energy Regulatory Office (URE) to be redeemed by the companies of the Trading Business Area.

Business Area: RES

Electric energy generated in 2011 by the RES Area was sold to TAURON Sprzedaż (about 92%) and to the Company (about 8%). The proprietary rights obtained due to production of electric energy in RES Area were sold completely to TAURON Sprzedaż, in order to redeem them.

Business Area: Distribution

Within the Distribution Area, the companies TAURON Dystrybucja and Vattenfall Distribution Poland operate as DSO, on the basis of decision of the Regulator.

TAURON Dystrybucja provides services to about 4.1 million end consumers, to whom it supplied 33.6 TWh of electric energy in 2011, of the total volume of energy of 38.2 TWh, supplied by the company in 2011. TAURON Dystrybucja covers with its operations the area of about 53 thousand km², located mainly in the provinces of Śląskie, Małopolskie, Dolnośląskie and Opolskie and, in addition, in the provinces of Podkarpackie, Łódzkie and Świętokrzyskie. The operating functions are carried out by five branches of the company, located in: Bielsko-Biała, Będzin, Częstochowa, Jelenia Góra, Kraków, Legnica, Opole, Tarnów, Wałbrzych and Wrocław.

Vattenfall Distribution Poland provides services to about 1.1 million of end consumers, to whom during the whole 2011, including the period when it was still the property of Vattenfall AB, it provided about 11.3 TWh of electric energy, of the total volume of electric energy supplied in 2011, amounting to about 14.6 TWh. This company covers with its operations the area of about 4.2 thousand km² located in Śląskie province.

Electric energy is supplied to consumers classified to the following tariff groups:

- A Group – consumers connected to high-voltage power grid,
- B Group – consumers connected to medium-voltage power grid,
- C, D and R Groups – consumers connected to low-voltage power grid,
- G Group – consumers using energy for household needs, irrespective of the voltage of the power grid.

Sales of distribution services is carried out on the basis of comprehensive agreements as well as agreements on provision of distribution services concluded with consumers. The first of the aforementioned types of agreements covers both sales of electric energy by the companies of the Trading Area (in 2011 they included TAURON Sprzedaż and Vattenfall Sales Poland) as well as supply of the energy by DSO companies (TAURON Dystrybucja and Vattenfall Distribution Poland, respectively). The second type of the agreements is the so-called split agreements, which refer only to the sales of distribution service. Under this type of agreements, consumers purchase electric energy in a selected individual sales company, on the basis of a separate agreement.

Sales value share as a part of the comprehensive agreements, within the total value of distribution services sales to end consumers fluctuates around 75%. On the other hand, the volume of supply as a part of comprehensive agreements within the total volume of supply to end consumers is about 50%.

Business Area: Trading

Companies which operate in the area of electric energy sale are mainly responsible for sales of electric energy via two channels.

- through TAURON Sprzedaż – to consumers from all tariff groups, including end consumers (since the middle of December 2011, also through the company Vattenfall Sales Poland),
- through the Company – to the biggest clients of TAURON Capital Group, the so-called strategic clients.

In 2011, the total sales of electric energy carried out by these companies for over 4.1 million end consumers amounted to 34.5 TWh (value without the company Vattenfall Sales Poland). TAURON Sprzedaż Group buys electric energy mainly from the Company (about 95%).

The company Vattenfall Sales Poland in the whole 2011, i.e. also at the time when it belonged to Vattenfall AB, sold about 9.5 TWh of electric energy. The company provides services to about 1.1 million clients.

Income generated from sales of electric energy depends, to certain extent, on the electric energy tariff approved by the President of Energy Regulatory Office for electric energy sold to clients in households (the so-called tariff group G). Whereas, prices of electric energy for the remaining tariff groups, i.e. A, B and C, do not require approval of the President of Energy Regulatory Office.

In the past, companies conducting operations in the scope of electric energy sales to end business consumers used the so-called A tariff group for consumers connected to the high-voltage power grid (WN), B tariff group for consumers connected to the medium-voltage power grid (SN) and C tariff group for consumers other than households, connected to the low-voltage power grid (nN). In connection with energy market liberation and the need to offer prices and products tailored to the end consumers' individual needs, TAURON Capital Group negotiates conditions of electric energy sales agreements individually with the clients. The client segmentation used, allocates them to the strategic, business and mass segment, depending on the level of electric energy consumption. Simultaneously, parallel classification of clients into three categories is applied, depending on the type of power grids they are connected to, i.e.:

- WN consumers, covering consumers of A tariff group as well as TPA (Third-party Access) consumers connected to high-voltage power grids,
- SN consumers, covering consumers of B tariff group as well as TPA consumers connected to medium-voltage power grids, and
- nN consumers, covering consumers of C tariff group as well as TPA consumers connected to low-voltage power grids.

In this way, companies carrying out operations in the scope of electric energy sales gradually withdraw from offering their consumers electric energy prices which are based on tariff groups applied to consumers charged for the electric energy distribution service.

Currently, end consumers, except for households, negotiate prices of electric energy sales. In case of households, the default G tariff, approved by the President of ERO is applied. Simultaneously, there is a possibility to resign from tariff G in favour of the price list offered by the vendor. An example of such actions include the promotion "Guarantee of lower price" addressed to persons being the shareholders of the Company as a result of purchase of stocks under public offering, or price lists applied in case of change of electric energy seller by a household. Each consumer category is offered a different range of products and for each of them TAURON Capital Group adopts a different marketing approach.

The table below presents categories of TAURON Capital Group end consumers, depending on voltage type and specific nature of their business:

Table No. 10 Categories of end consumers of TAURON Capital Group

Group of clients	Description of clients
WN Clients	Consumers representing sectors of heavy industry, metallurgical industry, chemical industry, mining industry, automotive industry
SN Clients	Clients representing other sectors of industry, producers of equipment, consumers from food industry, public sector, construction sector and public utilities sector
nN Clients	Clients dealing with sales, services, banking, catering and small businessmen
Tariff Group G	Households
Other clients	TPA consumers not connected to TAURON Capital Group distribution network

The table below presents information on the volume of electric energy sold by companies operating in the area of electric energy sales to end consumers, as well as numbers of clients of these companies, divided into individual consumers' categories in 2011.

Table No. 11 Volume of electric energy sold and number of clients in 2011

Kind of clients	Volume of sold electric energy in TWh	Percentage of sold electric energy in total sales	Number of clients in thousand
WN Clients	5.40	15.2%	0.05
SN Clients	9.49	26.7%	7.39
nN Clients	5.04	14.2%	361.86
Tariff Group G	7.68	21.6%	3,743.55
Other clients	7.91	22.3%	0.01
Total	35.52	100.0%	4,112.86

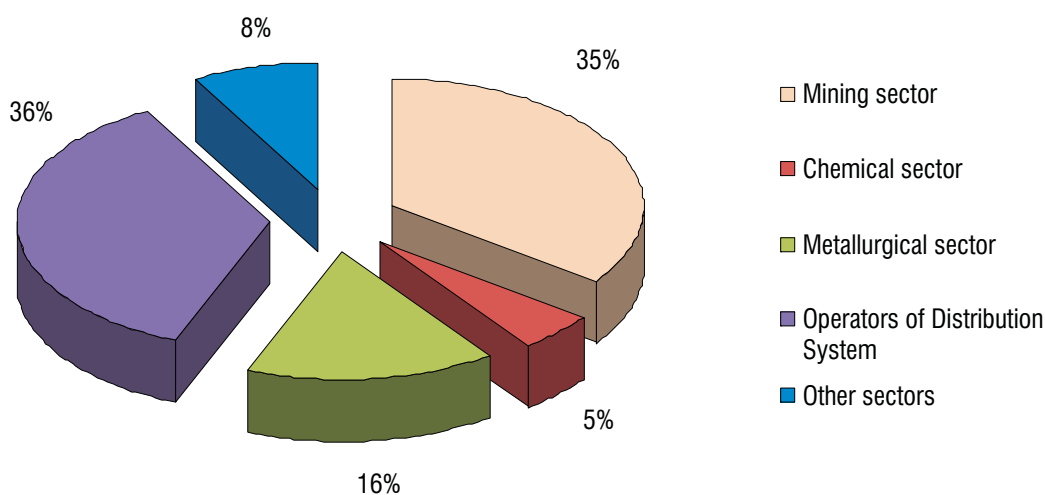
TAURON Group retail sales went up by about 1.2 TWh, i.e. by 3.4%, from 34.4 TWh in 2010 to 35.5 TWh in 2011.

The highest growth in sales, amounting to 4.11 TWh in relation to 2010, was observed by TAURON Capital Group in the category of other clients, i.e. TPA clients in DSO area outside TAURON Capital Group. This increase makes about 12% of the total sales of 2011 and it resulted from the conducted intensive sales activities. During this time, TAURON Capital Group noted decrease of sales in WN clients group by 3.26 TWh, as compared to 2010, which was the result of competition at the retail sales market. The above-mentioned decrease in volume corresponds to about 9.2% of sales reached in 2011. Simultaneously, growth of sales to SN clients by 0.67 TWh and to nN clients by 0.12 TWh was recorded, constituting, respectively, 1.9% and 0.3% of total sales in 2011. The above situation resulted from increased consumption connected with the improved economic conditions as well as from the implemented sales actions focussing on maintenance of the hitherto clients and regaining of previously lost clients. Decrease of sales in the G tariff group by 0.21 TWh, i.e. by about 0.6% of total sales, results from lower average consumption per client in this tariff group.

In 2011, the value and volume of electric energy sales for the biggest client of TAURON Capital Group did not exceed, respectively, 10% of total electric energy sales value and 10% of total volume of the electric energy sold. Only the share of two biggest clients of TAURON Capital Group in electric energy sales exceeded 5% of total value and 5% of total volume of the electric energy sold. The biggest clients of TAURON Capital Group are ArcelorMittal Poland S.A., CMC Zawiercie S.A., Góraźdże Cement S.A., ISD Huta Częstochowa sp. z o.o., KGHM Polska Miedź S.A., Kompania Węglowa S.A., Zakłady Azotowe in Tarnów-Mościce S.A.

The volume of sales to strategic clients, reached by the Company in 2011 amounted to about 7.9 TWh, and sales according to individual sectors is shown in the figure below.

Figure No. 4 Structure of Sales of the Company in 2011, according to sectors



Electric energy sales market is competitive and the consumers have the opportunity of choosing electric energy supplier among many suppliers of electric energy. As a result, on one hand, TAURON Capital Group sells electric energy also to consumers in areas other than the area covered by TAURON Capital Group distribution network, and on the other hand, it competes with other electric energy suppliers for clients who are located within the area covered by TAURON Capital Group distribution network. In 2011, TAURON Capital Group undertook intensive actions in order to maintain its hitherto clients and to acquire new clients. New product offers were launched for sales and loyalty programmes for clients were implemented. In 2011, widespread sales action was undertaken, related to acquisition of small and medium-sized enterprises (Tariff Groups C). Promotional actions were also conducted for the hitherto clients, which allowed for reaching the coverage of limited time contracts with clients at the level of 84% of the volume of sales in tariff groups A, B and C according to the status at the end of 2011, accordingly, reducing the risk of losing the sales margin and sales volume.

In connection with the stock exchange debut of the Company in 2010, in the previous year, promotion of "Guarantee of lower price" for individual clients group was continued in the previous financial year. The promotion was addressed to shareholders of the Company who purchased shares in public offering. Within the promotion, over 8 thousand clients were acquired in total, including 800 clients so far supplied with electricity by other vendors.

Business Area: Other

The core activity of TAURON Ciepło in the Business Area: Other, carried out on the basis of concessions granted by the President of ERO covers:

- heat generation,

- heat trading,
- heat transmission and distribution.

The activity is performed within the area of Śląskie and Małopolskie provinces. TAURON Ciepło holds its own heat sources of the total installed heat capacity of 195.9 MW. The share of heat produced by own sources in the total volume of heat sales is about 14%. Other heat sold by this company is purchased from the following entities: TAURON Wytwarzanie, EC Nowa and heating – energy company – Spółka Ciepłowniczo-Energetyczna Jaworzno III sp. z o.o. as well as from heat generating companies outside TAURON Capital Group, including mainly the following entities:

- Elektrociepłownia “Będzin” S.A.,
- Fortum Częstochowa S.A. in Częstochowa,
- Elektrociepłownia EC Wojkowice sp. z o.o.,
- Elektrociepłownia Chorzów “ELCHO” sp. z o.o.,
- Zakłady Energetyki Ciepłej sp. z o.o.,
- Elektrociepłownia “Szopienice” sp. z o.o.,
- Ciepłownia Siemianowice sp. z o.o.

In 2011, the company TAURON Ciepło sold, together with the heat generated, produced, 9.4 PJ of heat and 1,626 MW of heat energy.

The core activity of KW Czatkowice, included in the Business Area: Other is extraction, crushing and pulverising of limestone, as well as extraction of stone for construction industry. In 2011 the company sold 550.6 thousand Mg of stone, 1,016.3 thousand Mg of aggregate (grits and mixed stone) and 708.9 thousand Mg of limestone dust and sand. The main consumers of stone and aggregate are the companies from construction sector (including road building), metallurgical and chemical sector, and the main consumers of ground products of this company (limestone dust and sand) – are the companies of Generation Segment of TAURON Capital Group included in TAURON Wytwarzanie: Elektrownia Jaworzno III, Elektrownia Łagisza, Elektrownia Łaziska, EC Katowice) and outside the Group: Knauf-Jaworzno III sp. z o.o., VG ORTH Polska sp. z o.o., Elektrownia Bełchatów.

TAURON Group conducts its operations mainly on the territory of Poland. In 2011 and 2010, the value of sales for foreign clients reached PLN 665,279 thousand and PLN 228,867 thousand, respectively.

2.6. Significant events and achievements of TAURON Capital Group influencing its operations

The most important events of significant impact on operations of TAURON Capital Group, which occurred during the financial year 2011, and until the day of this report are as follows:

Appointment of the Management Board of the Company for the new term

On 24 February 2011, the Supervisory Board of the Company passed the resolution on appointment of the following persons for the third term of the Management Board of the Company: Mr. Dariusz Lubera (as the President of the Management Board), Ms. Joanna Schmid (as Vice President for Strategy and Business Development), Mr. Dariusz Stolarczyk (as Vice President of Corporate Matters), Mr. Krzysztof Zamasz (as Vice President for Commercial Matters), Mr. Krzysztof Zawadzki (as Vice-President for Economic and Financial Matters). Resolutions of the Supervisory Board to appoint the above persons to the Management Board of the Company entered into force on the day of their adoption, becoming effective as of the date of the Ordinary General Meeting of the Company approving the financial statements for the financial year 2010, i.e. as of 6 May 2011.

The Company informed of this event in the current report No. 8/2011 of 24 February 2011.

Appointment of the Supervisory Board of the Company for the new term

In connection with termination of the second joint term of office of the Supervisory Board, on 6 May 2011, the following persons were appointed as members of the Supervisory Board of the Company:

- Representatives of the State Treasury, namely: Antoni Tajduś, Agnieszka Trzaskalska, Włodzimierz Luty, Marek Ściążko and Michał Michalewski were appointed under the personal authorities of the State Treasury, pursuant to § 23 item 1 point 3) of the Company Articles of Association (The Company informed of this event in the current report current report No. 27/2011 of 5 May 2011),
- Other members of the Supervisory Board, namely: Leszek Koziorowski, Jacek Kuciński and Jacek Szyke, were appointed according to the resolution of the Ordinary General Meeting of the Company (The Company informed of this event in the current report No. 29/2011 of 6 May 2011).

Reduction of the share capital and par value of the Company shares

On 25 March 2011, the District Court Katowice–Wschód in Katowice, 8th Commercial Division of the National Court Register, issued a decision on entering of reduction of the share capital of the Company by the amount of PLN 7,010,197,576.00, from the amount of

PLN 15,772,944,546.00 to the amount of PLN 8,762,746,970.00 through reducing of the par value of each share by PLN 4, i.e. from the amount of PLN 9 to the amount of PLN 5. The above event was the consequence of the resolution adopted by the Extraordinary General Meeting of the Company of 10 November 2010. The reduction of the Company share capital was executed following the procedure of notifying the creditors, with the purpose of restructuring of the Company equity, through removal of discrepancies between the share capital and the supplementary capital as well as between the par value of shares and their market value.

The Company informed of this event in the current report No. 15/2011 of 29 March 2011.

Payment of dividend by the Company

In accordance with the resolution of the Ordinary General Meeting of the Company of 6 May 2011, the total amount of PLN 262,882,409.10 was allocated for payment of dividend to the shareholders for 2010. The amount of dividend allocated for one share amounted to PLN 0.15. The total number of shares covered by the dividend was 1,752,549,394 of shares. The day of dividend was established on 30 June 2011, and the day of payment of the dividend – on 20 July 2011.

The Company informed of this event in the current report No. 31/2011 of 6 May 2011.

Construction of a new cogeneration unit at EC Tychy – obtaining a loan from WFOŚiGW.

On 29 March 2011, WFOŚiGW and EC Tychy) signed a preferential loan contract at the level of PLN 30,000 thousand for the project involving reconstruction of the fluidized bed boiler and construction of installation of biomass supply. In EC the new power unit with heating – condensation turbine, of the nominal electric power (at condensing work) of 50 MWe and maximum heat capacity of about 86 MWT shall be constructed. To provide for operating of the existing unit BC-35, after implementation of the new, stricter emission standards, modernisation of the existing fluidised bed boiler has been planned, in order to adapt it to combustion of biomass.

The Company informed of this event in the consolidated interim report for the first half of 2011.

Selection of technology for the new power unit at Elektrownia Blachownia

On 13 April 2011, the management boards of: the Company, KGHM Polska Miedź S.A. and PKE signed the agreement pursuant to which they had decided that further design work concerning construction of the 800–910 MW unit at the Elektrownia Blachownia in Kędzierzyn-Koźle would be conducted with the assumption of the choice of the gas fuel.

The Company informed of this event in the consolidated interim report for the first half of 2011.

Withdrawal of Kompania Węglowa from Contract of 8 April 2011 on the Joint Venture

On 10 June the Company received a letter from Kompania Węglowa concerning the contract on the Joint Venture, described in the prospectus of the Company of 8 April 2011. Pertaining to this agreement, the Company and Kompania Węglowa made a commitment to undertake actions aimed at contributing of the enterprise KWK “Bolesław Śmiały” by Kompania Węglowa to the special purpose vehicle, and to contribute all the shares held by Kompania Węglowa in PKW to the company, in exchange for contribution of new apportionment shares in the increased share capital of the Company, addressed to Kompania Węglowa. In the said letter, the Management Board of Kompania Węglowa stated that they did not accept the value of the organised part of the enterprise of Kompania Węglowa – Oddział KWK “Bolesław Śmiały” as well as the value of shares held by Kompania Węglowa S.A. in PKW, resulting from the performed valuation of assets. Furthermore, the Management Board of Kompania Węglowa stated that they had decided to withdraw from the Contract on the Joint Venture of 8 April 2011, with the consequent expiration of the Contract.

The Company informed of this event in the current report No. 36/2011 of 10 June 2011.

Maintenance of the BBB rating for the Company

On 1 July 2011, the Fitch rating agency informed of their decision to sustain the rating for the Company in foreign and local currency at the BBB level, with stable perspective. According to Fitch agency, the ratings reflect the strong position of the Company at the Polish electric energy market as well as its prudent financial policy.

The Company informed of this event in the current report No. 40/2011 of 01 July 2011.

Incorporation of ESW by PKE

On 31 August 2011, the District Court for Katowice–East in Katowice, 8th Commercial Division of the National Court Register issued its decision on registration of the merger of PKE company (acquiring company) and ESW company (acquired company). Simultaneously, as of 1 September 2011, the change of enterprise of the acquiring company to TAURON Wytwarzanie took place. Detailed information on incorporation of ESW by PKE is included in item 1.2.1 of this report.

Incorporation of ENION by EnergiaPro

On 1 September 2011 the District Court for Wrocław–Fabryczna in Wrocław, 6th Commercial Division of the National Court Register issued its decision on incorporation of registration of the merger of the companies EnergiaPro (acquiring company) and ENION (acquired company). Simultaneously, as of 1 September 2011, the change of enterprise of the acquiring company to TAURON Dystrybucja took place. Detailed information on incorporation of ENION by Energiapro is included in item 1.2.1 of this report.

Incorporation of PEC in Dąbrowa Górnicza by PEC Katowice

On 1 September 2011, the District Court for Katowice–East in Katowice, 8th Commercial Division of the National Court Register issued its decision on registration of the merger of PEC Katowice company (acquiring company) and PEC in Dąbrowa Górnicza company (acquired company). Simultaneously, as of 1 September 2011, the change of enterprise of the acquiring company to TAURON Ciepło took place. Detailed information on incorporation of PEC in Dąbrowa Górnicza by PEC Katowice is included in item 1.2.1 of this report.

Purchase of the special purpose vehicle Lipniki

On 28 September 2011 TAURON EKOENERGIA company acquired 100% shares of Lipniki company from the German energy corporation WSB Neue Energien GmbH, including the wind farm. Lipniki company is the special purpose vehicle which was established to construct and operate the wind park Lipniki, including 15 wind turbines of the total capacity of 30.75 MW. Detailed information on purchase of the special purpose vehicle Lipniki is included in items 1.2.1 and 1.5 of this report.

Issue of bonds under the adopted programme on issue of the Company bonds

On 12 December 2011, within the programme of issue of the Company bonds, tranches B and C of bonds at total value of PLN 3,300,000 thousand were issued. The issue was aimed at raising of financial resources to fund acquisition of GZE from Vattenfall AB.

The Company informed of this event in the current report No. 60/2011 of 12 December 2011.

Raising of subsidiary funds

TAURON Capital Group acquires financial resources for many investments within the *Operational Programme Infrastructure and Environment 2007–2013*, and it also applies for financing of the National Fund of Environmental Protection and Water Management (NFOŚiGW) and from *Operational Programme Human Capital* (training projects). Two projects – construction of the biomass boiler of the capacity of 50 MW in Elektrownia Jaworzno III and the biomass boiler of the capacity of 20 MW in Elektrownia Stalowa Wola – received support at the level of about PLN 40 M for each project. The first contract on subsidy, concerning the investment in Stalowa Wola, was signed on 29 November 2011. the other one – for investment in Jaworzno – on 19 January 2012. Moreover, TAURON Capital Group received the co-financing from NFOŚiGW for construction of the installation of denitrification of combustion gases in Elektrownia Jaworzno III and Elektrownia Łaziska. The total value of funds acquired within the public assistance programmes, which will be allocated for investment in power generation assets, amounts to about PLN 116 million.

Exceeding of the 10% equity threshold of the Company within the trading turnover between TAURON Capital Group companies and Polskie Sieci Energetyczne S.A. (PSE Operator)

On 5 January 2012 the Company received data from PSE Operator concerning transmission services provided for the companies of TAURON Capital Group, enabling clearing with PSE Operator for December 2011. The net value of turnover generated during the last twelve months between the companies of TAURON Group and PSE Operator reached about PLN 1,758 M (including: PLN 1,508 M of costs for the companies of TAURON Capital Group, and PLN about 250 M of income), accordingly, the value of turnover has reached the material amount. Turnover of the highest value, i.e. about PLN 636.6 M net, was generated under the agreement of 15 January 2008, concluded between ENION and PSE Operator.

The Company informed of this event in the current report No. 1/2012 of 5 January 2012.

Other

In addition, events resulting from the concluded contracts and agreements significant for the operations, described in item 2.7.1 of this report should also be considered as important events of substantial impact on operations of TAURON Capital Group in the financial year 2011.

Information on significant events occurring after the balance sheet day until the day of this report has also been provided in note 42 of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group for the year ended on 31 December 2011.

2.7. Information on agreements concluded by companies of TAURON Capital Group

2.7.1. Agreements significant for operations of TAURON Capital Group

In the financial year 2011 Companies of TAURON Capital Group concluded the following agreements significant for operations of TAURON Capital Group:

Concluding of significant contracts within the project *Construction of the gas and steam unit in Stalowa Wola*

On 11 March 2011, due to implementation of the project: *Construction of the gas and steam unit in Stalowa Wola*, the following significant agreements were signed:

1. Agreement on Operations of the EC Stalowa Wola, concluded between the Company, PGNiG S.A., PGNiG Energia S.A., ESW and EC Stalowa Wola. This project specifies the procedure of preparation and execution of the investment process of construction of the gas and steam unit in Stalowa Wola as well as rules of exploitation of the unit and trading of products of this exploitation. The Agreement was concluded for 25 years following the date of commissioning of the gas and steam unit. The value of the agreement was determined at the amount of PLN 1,95 billion net.
2. The Agreement on sales of electric energy concluded between PGNiG Energia S.A., the Company and EC Stalowa Wola, concerning the many years' sales of electric energy generated by EC Stalowa Wola in the steam and gas fired unit in Stalowa Wola to the Company and to PGNiG Energia S.A. The estimated value of the agreement during its whole effective period (14 years) will amount to PLN 6.78 billion net.
3. Agreement on supply of gas fuel concluded between PGNiG S.A. and EC Stalowa Wola, the subject of which is the supply of the gas fuel. The estimated value of the agreement during its whole effective period (14 years) will amount to PLN 9.66 billion net.

The Company informed of the aforementioned events in the current reports No. 9/2011 of 11 March 2011, No. 14/2011 of 25 March 2011 and No. 41/2011 of 8 July 2011.

Concluding of significant contract with ArcelorMittal Poland S.A.

On 25 July 2011 the significant agreement was concluded between EC Nowa and ArcelorMittal Poland S.A., the subject of which is the sales of energy carriers by EC Nowa to ArcelorMittal, purchase of gas fuel by EC Nowa from ArcelorMittal, establishment of the principles of settlements between EC Nowa and ArcelorMittal concerning the CO₂ emission, and implementation of investment by EC Nowa involving modernisation of the OPG 430 boiler and construction of turbo generator of 50 MW capacity. The contract was concluded for the period of 65 months. The estimated value of this contract during its entire effective period was determined at the level of about PLN 2.13 billion.

The Company informed of this event in the current report No. 42/2011 of 25 July 2011.

Concluding of preliminary contract with Vattenfall AB on purchase of GZE shares

On 23 August 2011, the Company and Vattenfall AB signed preliminary contract on purchase of 1,249,693 of shares of GZE company, constituting 99.98% of the share capital of GZE. Closing of the transaction has been assumed as dependable on the Company obtaining the approval of the President of UOKiK (Office of Competition and Consumer Protection) on concluding of the concentration.

The Company informed of this event in the current report No. 44/2011 of 23 August 2011.

Signing of the Annex to Agreement concluded between PKE and Kompania Węglowa

On 14 October 2011 between TAURON Wytwarzanie and Kompania Węglowa, Annex was signed to the agreement of 1 December 2010, concluded between PKE (currently TAURON Wytwarzanie) and Kompania Węglowa, the subject of which is sales of coal for energy generation purposes, coming from coals and mining plants of Kompania Węglowa, designed for consumption in power plants and cogeneration plants belonging to TAURON Wytwarzanie. Pursuant to the said annex, the parties undertook, among others, to launch actions enabling purchasing of coal by TAURON Wytwarzanie within the procedure of excise tax exemptions, pursuant to the Act of 6 December 2008 on excise tax, as well as assumed that supplies of coal performed after 1 January 2012 would be performed applying the excise tax exemption, provided that application of such exemption is possible in compliance with the binding regulations. Moreover, the provision has been waived that "parties foresee the possibility to terminate the contract by giving a notice, in case if no agreement is reached resulting in concluding of the annex until 15 October 2011, concerning the price of coal, considering the final legal status in scope of excise tax".

The Company informed of this event in the current report No. 49/2011 of 14 October 2011.

Concluding of agreement increasing the value of the bond issue programme

On 28 October 2011, between the Company and Bank Handlowy w Warszawie S.A., ING Bank Śląski S.A., Bank Polska Kasa Opieki S.A., BRE Bank S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Nordea Bank Polska S.A., Nordea Bank AB, the annex was concluded to

the Guarantee Agreement, Agency Agreement and Deposit Agreement and the Conversion Agreement, on the basis of which the value of bond issue programme of the Company was increased within tranche C by PLN 3,000,000 thousand, i.e. to the total amount of PLN 4,300,000 thousand.

The Company informed of this event in the current report No. 53/2011 of 28 October 2011.

Concluding of agreement on establishment of PGK

On 26 September 2011 the PGK agreement was signed, entered by the Company as the representing entity, as well as the selected companies of TAURON Capital Group, i.e.:

- 1) TAURON Wytwarzanie,
- 2) TAURON Dystrybucja
- 3) TAURON Sprzedaż,
- 4) TAURON Obsługa Klienta
- 5) TAURON EKOENERGIA
- 6) PEPKH
- 7) POEN sp. z o.o.,
- 8) ENPOWER sp. z o.o.,
- 9) ENPOWER Service sp. z o.o.,
- 10) ENERGOPOWER sp. z o.o.

The Agreement was concluded for the period of three fiscal years, i.e. from 1 January 2012 to 31 December 2014. The Head of the First Tax Office in Sosnowiec registered the Capital Tax Group on 28 November 2011.

PGK was established in order to optimise execution of the obligations connected with clearing of the corporate income tax by the key companies of TAURON Capital Group, and it enables, among others:

- acceleration of settlement of tax losses, i.e. compensation of tax losses of one of the companies is executed through tax profit of other company over the same fiscal year,
- common application at the level of PGK for individual interpretation of tax law within the scope of corporate income tax which, in case of favourable interpretation, will result in relevant protection for all entities included in PGK.

Concluding of significant agreement with Electrabel NV/SA

On 30 November 2011 between the Company and Electrabel NV/SA of the GDF SUEZ Group, the agreement was signed, the subject of which is the settlement of any transactions to be concluded between the parties in connection with the purchase, sales, supply and consumption of electric energy, including options related to purchase, sales, supply and consumption of electric energy. The agreement has been concluded for indefinite period of time. The estimated value of the agreement during the period of 5 years has been determined at PLN 2.23 billion net.

The Company informed of this event in the current report No. 58/2011 of 30 November 2011.

Purchase of GZE stocks

On 13 December 2011 ING Securities S.A., acting on account of the Company, concluded the sales disposal contract as a buyer, with Vattenfall AB as the seller, concerning sales of 1,249,693 shares in the GZE share capital at par value of PLN 100.00 each and at the total par value of PLN 124,969.3 thousand, constituting 99.98% of GZE share capital. The total value of the transaction amounted to PLN 4,625,955 thousand. Detailed information on purchase of GZE shares is included in items 1.2.1 and 1.5 of this report.

The Company informed of this event in the current report No. 61/2011 of 13 December 2011.

2.7.2. Material transactions with affiliated entities under conditions other than market conditions

All transactions of TAURON Capital Group with affiliated entities are concluded under market conditions. Information on significant transactions with affiliated entities has been provided in note 36 of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group for the year ended on 31 December 2011.

2.7.3. Information on agreements on credits and loans raised and terminated

On 24 October 2011 the Company concluded two financial agreements with the European Investment Bank for the period not longer than 10 years following release of each tranche of the loan, for the purpose of co-financing of investment projects implemented in:

- ZEC in Bielsko-Biała – the loan at the level of PLN 300,000 thousand to finance the construction of high performance coal-fired unit in cogeneration, with the accompanying infrastructure, and
- Elektrownia Jaworzno III – the loan at the level of PLN 210,000 thousand, allocated for construction of the new biomass-fuelled boiler of 50 MW_g and 45 MW_t as well as renovation of the steam turbine.

Interest rate of the financing acquired under the aforementioned contracts is determined on individual basis, as fixed or floating interest rate, and its ultimate level is set before the tranche is released and it will be correlated with the current market rates.

Moreover, in 2011 the hitherto agreement on overdraft facility was extended (functionally combined with the cash pooling operating in TAURON Capital Group), the maturity of which was May 2011. Under the annex concluded, the agreement was extended till 31 December 2011 and it included the credit limit of PLN 100,000 thousand, to be allocated for financing of business as usual.

Simultaneously, due to the expiring term of the aforementioned overdraft facility agreement, 31 December 2011, the public procurement procedure was performed, as a result of which, in December 2011, the Company concluded the agreement on overdraft facility at the amount of PLN 300,000 thousand, with the effective period from 1 January 2012 to 31 December 2014.

Detailed specification of loan agreements concluded in 2011, related to cash pooling, is presented in the table below:

Table No. 12 Specification of credit agreements related to cash pooling, concluded by the Company in 2011

Kind of agreement	Kind and level of interest rate	Amount of credit/loan in thou. PLN	Effective term
Overdraft	WIBOR 1M + fixed margin	100,000	28.05.2011 – 31.12.2011
Overdraft	WIBOR O/N + fixed margin	300,000	01.01.2012 – 31.12.2014

The central financing model binding in TAURON Capital Group, assumes acquisition of financial resources by the Company and their re-distribution to subsidiaries. The subsidiaries acquire funds from NFOŚiGW and WFOŚiGW exclusively. The consequence of the approach adopted is the lack of new bank credits and loans raised by subsidiaries and the limited level of subordinated debts.

In 2011 companies of TAURON Capital Group concluded loan agreements with WFOŚiGW as specified in the table below:

Table No. 13 Specification of loan agreements with WFOŚiGW concluded in 2011

No.	Company	Amount of the loan	Currency	Date of agreement	Date of repayment	Interest rate
1.	PEC Katowice	18,929	PLN	08.04.2011	15.01.2013	Ratio*bill rediscount rate, not lower than 3%
2.	PEC in Dąbrowa Górnicza	773,116	PLN	25.02.2011	30.11.2013	Ratio*bill rediscount rate, not lower than 3%
3.	EC Tychy	30,000,000	PLN	29.03.2011	15.12.2022	Ratio*bill rediscount rate, not lower than 3%

Due to implementation of the central model of financing as well as refinancing of part of the debt of subsidiary companies by the Company, in 2011 EnergiaPro (currently TAURON Dystrybucja) repaid its investment loan before the maturity date, at the initial value of PLN 80,000 thousand, raised at Bank Zachodni WBK S.A., with the maturity date on 1 August 2013, with the interest rate based on WIBOR 1M and fixed margin during the term of the agreement.

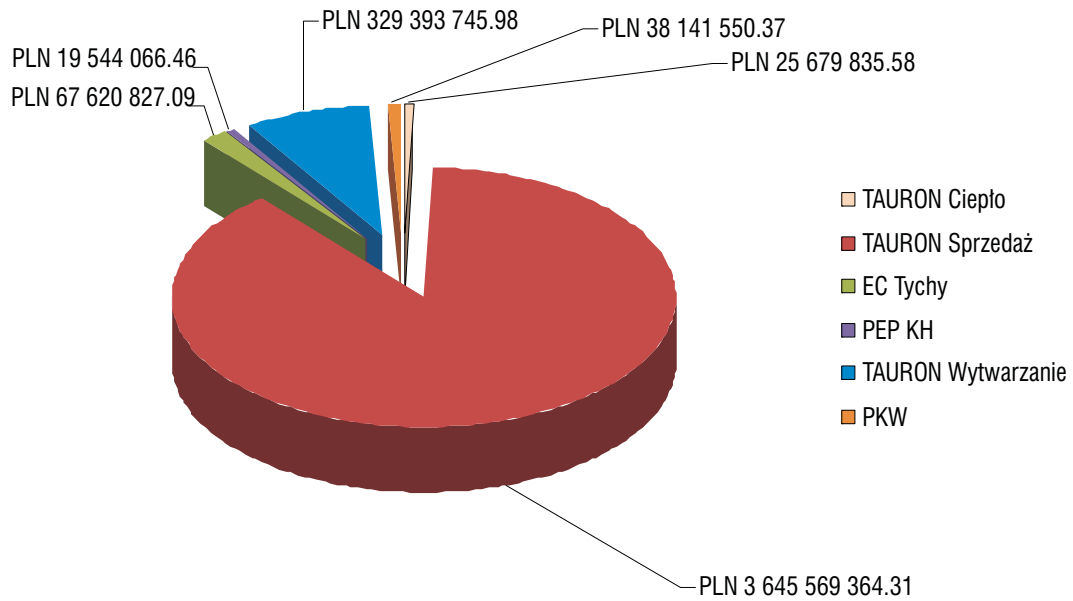
It should be stressed that in connection with the transaction of taking over part of the assets of Vattenfall AB, on 12 December 2011, GZE granted a loan of PLN 10,000 thousand to the company Vattenfall Wolin-North, of maturity date falling on 30 June 2012, at interest rate based on WIBOR 3M plus fixed margin.

2.7.4. Information on granted loans and sureties as well as sureties and guarantees received

In 2011 the Company continued the intra group management of financial resources through the cash pooling system implemented in 2010, whose structure is based on loans granted between its members. At the end of 2011, 12 companies of TAURON Capital Group participated in the cash pooling structure, and the Company continued to act as the entity managing its structure.

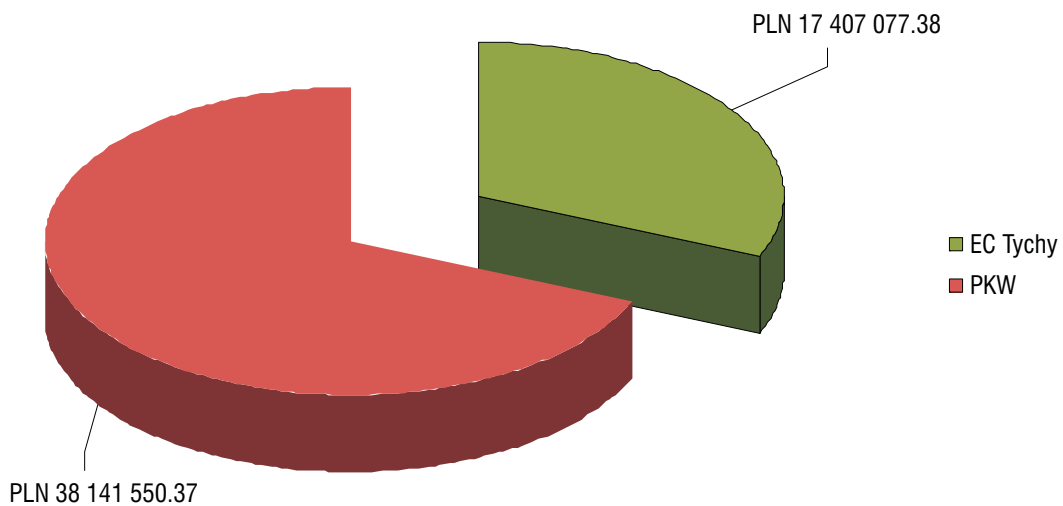
The total amounts of loans granted by the Company in 2011, within the cash pooling structure, i.e. the aggregate amount of all multiple loans granted during the year, subjected to multiple repayment – arising from the applied cash pooling model, in favour of individual companies of TAURON Capital Group, are presented in the figure below.

Figure No. 5 Total amounts of loans granted by the Company in 2011 within the cash pooling structure



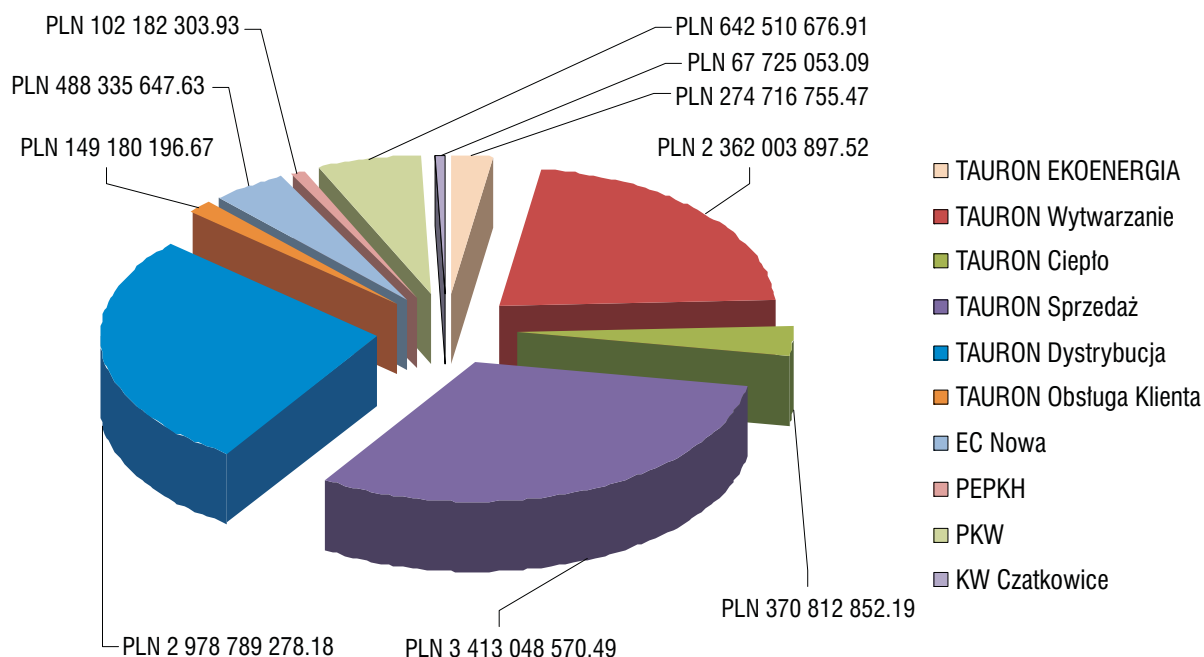
As of 31 December 2011, the balance of loans granted by the Company amounted to PLN 55,548,627.75 and it involved the companies presented in the figure below.

Figure No. 6 Balance of loans granted by the Company as of 31 December 2011



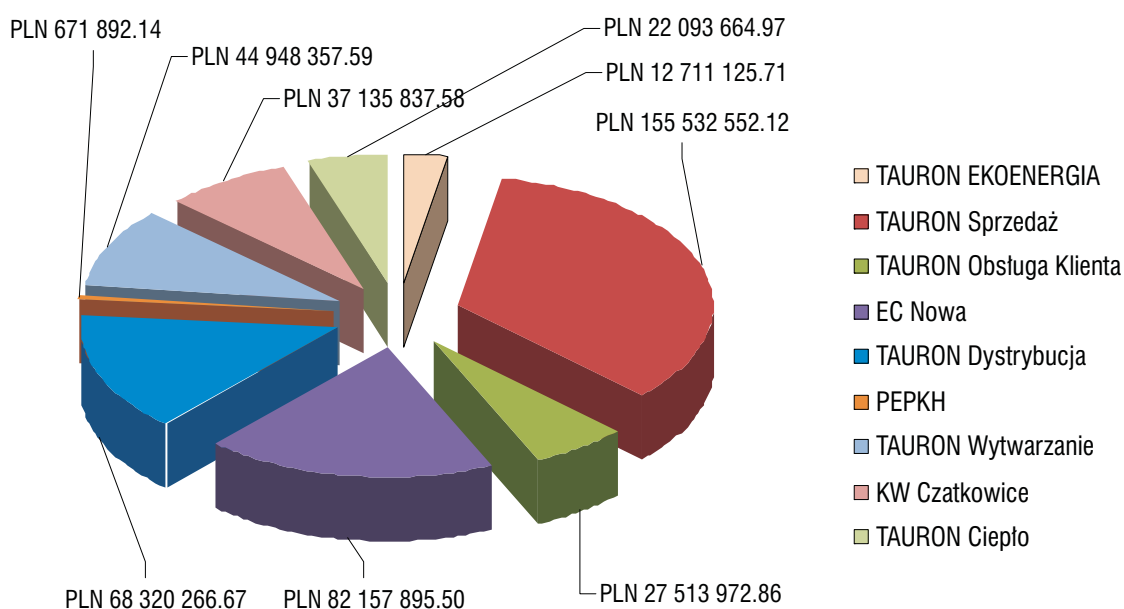
On the other hand, the total amount of loans granted to the Company by its subsidiaries, i.e. the aggregate amount of all multiple loans granted during the year, subjected to multiple repayment within the cash pooling, is presented in the figure below.

Figure No. 7 Total amounts of loans granted to the Company by the subsidiaries in 2011 within the cash pooling structure



As of 31 December 2011, the balance of loans granted to the Company by the subsidiaries within the cash pooling amounted to PLN 451,085,565.14 (interest excluded), according to the subject according to structure of entities is presented in the figure below.

Figure No. 8 Balance of loans granted to the Company by subsidiaries as of 31 December 2011



Loans granted as a part of cash pooling are of short-term nature to be used for financing of business as usual, and at the same time, they have no defined maturity date. The loans granted are repaid automatically in case the financial resources are kept on the bank account of the company covered by the cash pooling system. The definite date for repayment of any liabilities is the maturity date of the currently binding intra group loan agreement, i.e. 31 December 2014.

Loans granted by companies of TAURON Capital Group within the cash pooling are expressed in Polish zloty and in 2011 their interest rate was based on WIBOR 1M plus the fixed margin. In 2011 companies of TAURON Capital Group did not grant any loans to entities outside TAURON Capital Group.

The guaranties, sureties and commitments granted in 2011 arise from the adopted financing model of TAURON Capital Group and they were provided on account of the conducted trading operations and as the collateral for repayment of loans granted, among others by WFOŚiGW.

Detailed specification of guaranties, sureties and commitments granted by the Company in 2011 is presented in the table below:

Table No. 14 Specification of guaranties, sureties and commitments binding in 2011

No.	Beneficiary	Agreement	Party to the agreement	Amount in thousand PLN	Currency	Effective term
1.	(PSE Operator)	Agreement on collateral	TAURON Wytwarzanie	4,000	PLN	Indefinite time
2.	WFOŚiGW	Agreement on financing commitment	EC Tychy	87,040	PLN	24.02.2012
3.	UniCredit Bank Czech Republic	Guarantee Agreement	TAURON Czech Energy	20,000	CZK	08.06.2012
4.	Ministry of Economy	Agreement on financing surety	TAURON Wytwarzanie	200,000	PLN	31.12.2012
5.	WFOŚiGW	Aval agreement	EC Tychy	30,000	PLN	15.12.2022
6.	CEZ a.s.	Guarantee Agreement (annex No. 3)*	TAURON Czech Energy	500	EUR	31.12.2012
7.	Nordea Bank Polska	Collateral Agreement	Vattenfall Network Services Poland	672.1	PLN	31.03.2014
8.	Nordea Bank Polska	Collateral Agreement	Vattenfall Sales Poland	4,000	PLN	31.12.2011

* Guarantee issued on 14.12.2011 effective from 01.01.2012.

In 2011, the framework agreement on bank guarantee was effective, within the limit set up to the amount of PLN 40,000 thousand, under which the Company launched the bank guarantees for the beneficiaries listed in the table below.

Table No. 15 List of guarantees raised under the limit

No.	Beneficiary	Agreement	Guarantee amount in thousand PLN	Currency	Effective term
1.	Commodity Clearing House (Izba Rozliczeniowa Gield Towarowych S.A.) (IRGIT)	payment guarantee	40,000	PLN	11.03.2011
2.	Central Allocation Office GmbH (CAO)	payment guarantee	500	EUR	31.12.2011
3.	PSE Operator	bid bond	4,800	PLN	28.10.2011

In September 2011 the Company concluded the framework agreement on bank guarantee for companies of TAURON Capital Group, effective till September 2014. Under the framework agreement the Company and companies of TAURON Capital Group may apply to release bank guarantees on account of the centralised limit up to the total amount of PLN 50,000 thousand. Under the limit the guarantees specified in the table below were raised:

Table No. 16 List of guarantees raised under the limit

No.	Beneficiary	Agreement	Guarantee amount	Currency	Effective term
1.	CAO	payment guarantee*	800,000	EUR	31.12.2012

* Guarantee issued on 28.11.2011 effective from 01.01.2012.

Simultaneously, within TAURON Capital Group, in order to secure transactions executed by the Company at TGE on electric energy markets and in order to participate in the system of transaction clearing liquidity, in 2011 TAURON Wytwarzanie granted the surety to the Company in favour of IRGIT due to clearing of future transactions, up to the level of PLN 145,000 thousand (the agreement was concluded on 23 February 2011).

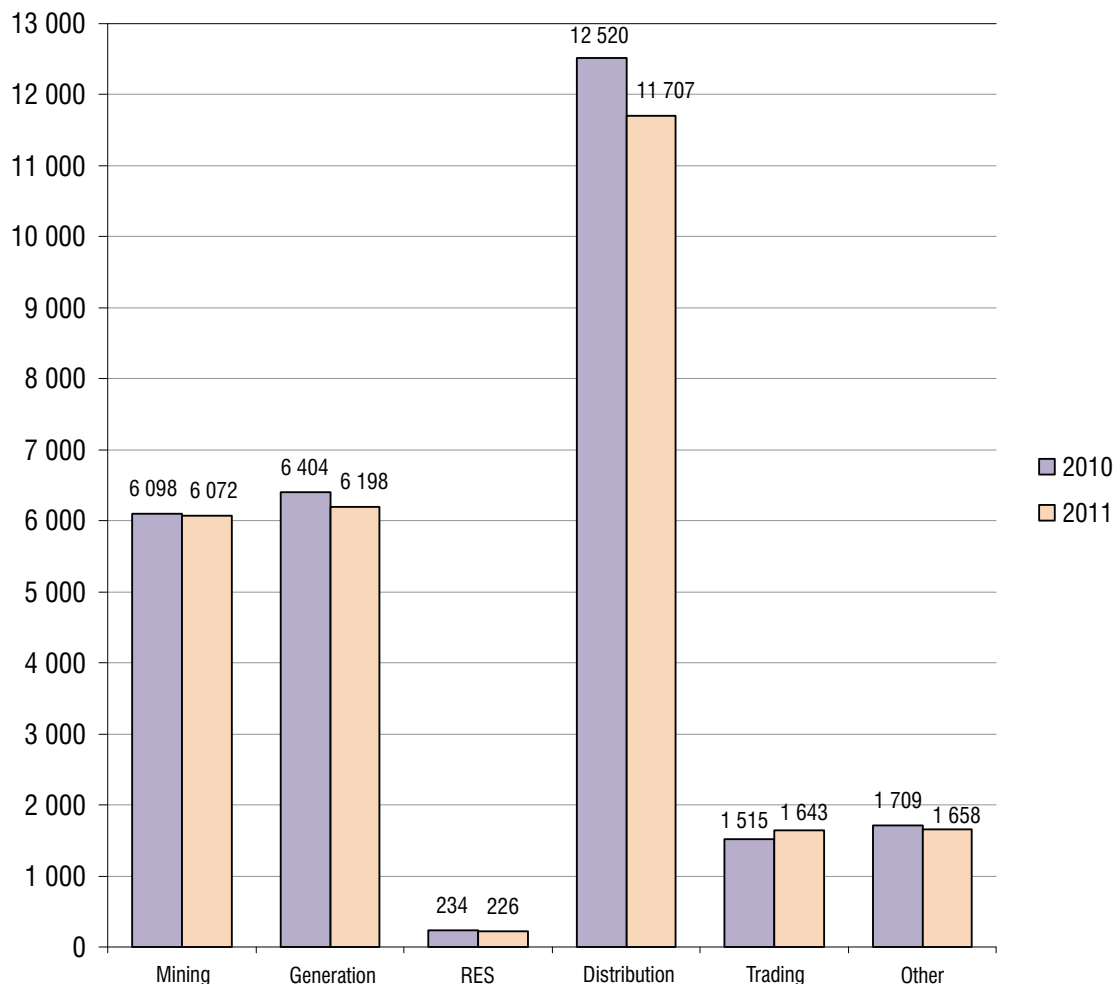
Moreover, in connection with the tenders executed and contracts concluded, in 2011 the companies of TAURON Capital Group received bank guarantees and insurance avals as well as due performance guarantees, or defects remediation guarantees.

2.8. Information concerning employment

The average employment in TAURON Capital Group in FTEs (rounded to the full FTE), divided into Segments of operations, is presented in the figure below.

It should be mentioned that within the individual business areas, the average employment in GZE subsidiaries should be considered since the moment they were acquired, i.e. since 13 December 2011.

Figure No. 9 Average employment in FTEs in TAURON Capital Group in 2011 and 2010



Changes in employment in individual Business Areas in 2011 result, among others from the implemented Programmes of Voluntary Resignations in the Business Areas: Distribution, Generation and RES, as well as from mobility of employees between individual Business Areas of TAURON Capital Group. The aforementioned allocation of employees between the Business areas influenced, among others, increase in average employment in Trading Business Area in 2011, in relation to 2010.

The total average employment in TAURON Capital Group in 2011 reached 27,504 FTEs, as compared to 28,480 FTEs in 2010.

2.9. Development policy of TAURON Capital Group

2.9.1. Characteristics of the policy in the area of development directions

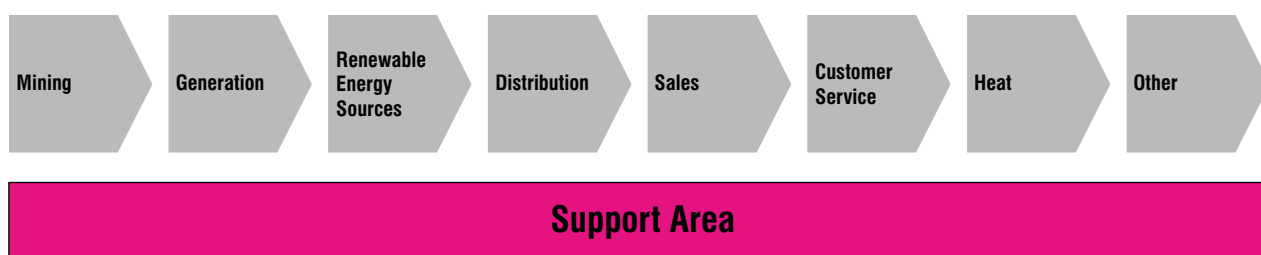
The analysis of the broadly understood external environment of TAURON Capital Group as well as standing and possibilities of TAURON Capital Group itself led to verification of strategic goals in 2011, as well as prompted the updating of their accomplishment. As a result, the Management Board adopted the updated Corporate Strategy which received positive opinion of the Supervisory Board on 28 April 2011. The Company informed of this event in the current report No. 25/2011 of 28 April 2011.

The overriding strategic goal of TAURON Capital Group is to provide for constant increase of value ensuring the secure return on the invested capital for shareholders. The implementation of the aforementioned goal will be measured on the basis of basic ratios of value development, i.e. EBITDA growth and ROIC level (Return On Invested Capital). Detailed information on the development directions resulting from the update of the Corporate Strategy is presented in item 2.9.3 of this report.

2.9.2. Planned Structure of TAURON Capital Group

The planned model of TAURON Capital Group structure has been determined in the Corporate Strategy which assumes creating of one company in each Business Area, which should allow for optimisation of operations of entities along the whole value chain, indicated in the figure below, in order to maximise the margin generated in the whole TAURON Capital Group.

Figure No. 10 Value chain in TAURON Capital Group



2.9.3. Implementation of Corporate Strategy

In the years 2009–2010, the assumptions of *Corporate Strategy for TAURON Polska Energia S.A. Group for 2008–2012 with estimates up to the year 2020*, adopted and approved by the Company in 2008 were implemented in accordance with the adopted plan, within which the main actions were connected with integration of TAURON Capital Group, along the value chain and with achievement of sales and EBIT margin growth by the Company. Following two years of implementation of *Corporate Strategy for TAURON Polska Energia S.A. Group for 2008–2012 with estimates up to the year 2020*, in 2011 the actions undertaken so far were reviewed, assessed in terms of their implementation and the assumptions adopted in 2008 were updated. An important group of factors which were analysed covered the new market circumstances and trends in power industry as well as the legal conditions (the EU climate and energy package, amendment to the Act of 10 April 1997. *Energy Law*, Energy policy of Poland until 2030, Programme of nuclear energy).

As a follow-up of implementation of the Corporate Strategy, in 2011 its implementation was based on adjustment of strategic priorities to the changing environment. The key direction of the Corporate Strategy is to focus on growth in the areas of operations where the highest potential for achieving high rates of return on investments exists and diversification of the generation portfolio. In addition, the objective of further improvement of the efficiency and building of effective organization has been sustained.

Accordingly, the updated Corporate Strategy focuses on four key objectives which jointly provide for growth of value of TAURON Capital Group:

I. Growth in the most attractive Areas of Business

The growth will focus in the areas of operations where the highest potential for achieving high rates of return on investments exists, i.e. RES and Generation. Due to the need to restore the generation capacity and the related investment expenditure, investment in generation assets (and potential acquisitions in this area) on the domestic market will be the priority for the Group.

Within the generation portfolio, achievement of the new production capacity in different technologies, including wind energy, is planned at the level of 3,200 MWe by 2020. Moreover, the growth of net power until 2020 will reach 1,379 MWe.

II. Operational and investment effectiveness at the level of best practice

The Corporate Strategy envisages further implementation of synergy of integration of TAURON Capital Group companies. The next stage of restructuring will commence, through improvement of business management and integration of support functions. This will also involve centralisation and, in justified cases, outsourcing of areas which are not directly connected with the core operations of TAURON Capital Group.

The Company will continue to treat budgetary discipline as its priority within investment expenses and operating costs. The activities related to improvement of operational and investment effectiveness will also enable to prepare TAURON Capital Group to operating under volatile market conditions, in particular, under the significant volatility of process of fuels, energy, emission allowances, etc.

III. Management of exposure to market and regulatory risks

In view of market and regulatory volatility, the essential element of Corporate Strategy is the active management of market risks. In order to optimise these risks and maximise rates of return TAURON Capital Group will diversify the generation portfolio by appropriate adjustment of individual types of technologies (limitation of long-term risk arising from investment decisions) as well as develop effective security policy, including security of energy supplies (limitation of medium- and short-term risk resulting from the trading activity). This approach will enable to reduce the volatility of result in TAURON Capital Group through asset portfolio management and control of risk limits.

In 2011 no significant change in generation capacity structure was noted. About 98% of the capacity installed in TAURON Capital Group was covered by coal-burning technology. In 2020, share of these technologies will be reduced to about 70%, including 15–20% from new units. Share of low emission technologies, i.e. gas, wind, water, biomass and biogas, will reach about 30%.

Effective strategy of securities will cover the whole actions in the value chain of TAURON Capital Group, starting from the security of the assumed volume of fuel supply from the sources held, ending up with coverage of the specific volume of electric energy sold to end customers from own generation units. The adopted approach will guarantee the secure operations of the assets held in the Generation Area through provision of fuel supply and maintaining of its price at the acceptable level. The new trading goals will refer to: effective use of assets of TAURON Capital Group, active management of market risk in TAURON Capital Group as well as extension of operations in areas generating additional mass of margin.

IV. Building of effective organisation

Within implementation of this goal, TAURON Capital Group intends to focus its activities on the whole value chain as well as on implementation of the programme of human resources management and managing by objectives.

Effective implementation of the updated Corporate Strategy in the whole value chain will improve the position of TAURON Capital Group among the leading energy companies in the region.

2.9.4. Factors essential for development

Results of operations of TAURON Capital Group will be affected mainly, as it happened in the past, by the following factors:

- the macroeconomic situation, especially in Poland, as well as the economic situation of the area of operations of the TAURON Capital Group, situation of the European Union and the global economy, including interest rate changes and currency rate, etc., influencing the valuation of assets and liabilities recognised by the Company in financial statements;
- political environment, especially in Poland as well as on the European Union level, including the opinions and decisions of public administration institutions and bodies, for example: UOKIK, ERO and the European Commission,
- situation in electric energy sector, including competition behaviour at the energy market,
- introduction of the support system of electric energy generation by high efficiency cogeneration in units fired with methane (mandatory since September 2010),
- geological and mining conditions,
- number of allowances to CO₂ emissions allocated on complimentary basis after 2012 and prices of the allowances acquired;
- level of compensation for covering of the stranded costs related to termination of the LTC,
- changes in regulations of the energy sector,
- changes in legal environment, including: tax law, commercial and energy law,
- demand for electric energy and other products of energy market,
- prices of electric energy and fuel coal as well as distribution tariffs, as factors influencing the level of revenue and costs;
- environmental protection requirements,
- research and technical progress,
- seasonality and weather conditions.

2.10. Assessment of implementation opportunities of investment projects

Strategic investment as well as their financing are managed centrally at the level of the Company. On the basis of the conducted analyses, the Management Board of the company assesses that TAURON Capital Group is able to finance the current and future investment projects from funds generated from operating activity and by acquisition of debt financing.

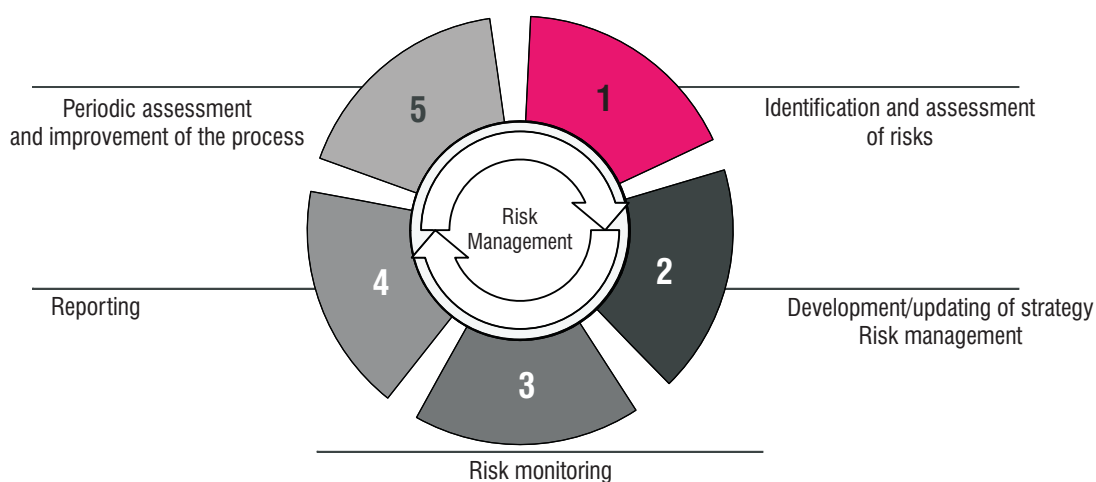
2.11. Risk and threat factors

Taking care for implementation of the Corporate Strategy, the Company manages business risks occurring in operations of the whole TAURON Capital Group. The business risks management process is aimed at implementation of the adopted business objectives of the TAURON Capital Group as a part of the acceptable risk level adopted by the Company's Management Board in 2011, the process of implementation of the *Corporate Risk Management Policy in the TAURON Group* was continued in TAURON Group.

The Comprehensive Risk Management System covers significant risks which occur in operations of the Company and TAURON Capital Group. The nature of risks is defined, in particular, by specifying their significance level and probability of materialization. To achieve this goal, the system covers and organises all the resources of TAURON Capital Group developing the infrastructure of corporate risk management (strategy, processes, authorisation, reporting, methodology and IT tools). The Risk Management System covers all elements of the value chain implemented of TAURON Capital Group and all the employees of TAURON Capital Group take part in the risk management process.

The figure below shows the processes within corporate risk management in TAURON Capital Group.

Figure No. 11 Processes within corporate risk management in TAURON Capital Group



In the Company, permanent team of experts operates, which includes persons holding relevant knowledge of the Company and its environment, established as the "Risk Committee", which permanently initiates, analyses, monitors, controls, supports and supervises the performance of corporate risk management in TAURON Capital Group.

Assessment of the extent TAURON Capital Group is exposed to the risk factors and threats listed below, takes into consideration their probability of occurrence and significance as well as adequacy of the applied risk management strategy. Order in which particular risks have been presented does not reflect the scale of the assessment.

Macroeconomic risk – is related, in particular, with the level of the Gross Domestic Product (GDP), interest rates, currency exchange rates, fiscal and monetary policy, unemployment rate and level of investment. Macroeconomic risk factors may significantly affect the financial results and market position of TAURON Capital Group, especially through the level of production of electric energy and heat as well as energy distribution and sales volume, availability and cost of acquisition of financial instruments.

Political risk – is connected with the manner and type of state intervention in the whole economy and its individual sectors. Political risk factors can have a significant influence on TAURON Group operations, in particular, through changes in the energy or financial policy of the state.

Risk of unstable legal system and the European Union regulations connected with the operations of the energy sector, including environment protection – the risk applies to all legal changes, in both Polish and the European Union regulations as well as to legislation environment uncertainty. The risk factors may have significant adverse effect on operations of TAURON Capital Group and its financial situation through increase of operating costs or loss of concession within the scope required for the operations.

Risk of non-compliance with the requirements of ERO /UOKiK/ and the Instruction of transmission grid operation and maintenance (IRIESD) – a risk of recognising by ERO that the DSO is not independent or does not treat entities on the market equally, infringement of antimonopoly regulations or overusing the dominating position. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through imposing of financial penalties.

Risk of Capital Group organisation and corporate management – risk connected with ineffective cooperation between the Group companies, reporting process, management processes and information management. Risk factors may have adverse effect on TAURON Capital Group operations, its financial situation or results of its activities by incomplete transposition of the parent company strategic objectives to subsidiary companies, or prolonged period of decision execution.

Competition risk – connected with the progressing liberalization of the energy market, especially with the planned release of electric energy prices for G group consumers and releasing heat prices, as well as with changes on the retail market and the consumers' right to change a provider. Risk factors may have adverse effect on TAURON Capital Group operations, its financial situation or results of its activities by or losing its hitherto consumers.

Risk of fund raising and financing service – the risk of lack of possibilities to raise funding for operating and investment needs or obtaining financing on conditions which are different from the adopted assumptions. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through the lack of resources for projects included in the Corporate Strategy and in investment plans, and for operations.

Risk connected with the termination of LTC – a risk of questioning by the President of the ERO of the amounts due to cover stranded costs as well as of the obligation to return advance payments received. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through the possibility of the European Commission to qualify the rules of utilising the resources of the programme as public aid which is in non-compliance with the Common Market. Such a qualification may imply the necessity to return the received aid with interest.

Environmental risk, including the risk of atmospheric conditions – there is a possibility to incur losses resulting from non-compliance with legal regulations, the way of implementing the European legislation into Polish legislation and administrative decisions and including the possibility of occurrence of environmental damage and serious industrial failure. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through the necessity to pay indemnities, risk of implementation of production tasks as well as local/regional inhabitants' protests.

Risk connected with the obligation to redeem CO₂ allowances – the risk is connected with emitting of CO₂ into the atmosphere as well as the need to redeem a relevant number of CO₂ allowances. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through imposing a fine for each unit of unredeemed credit. Limiting of free allotments and the resulting significant increase of costs to purchase of the outstanding CO₂ allowances may result in decreasing of the planned electricity sales profitability.

Risk of approval of tariffs by the President of ERO – the risk is connected with the process of approval of tariffs on electric energy, heat and distribution services by the President of URE. The main threat involves the risk of refusal to approve the tariff. Besides, the regulator may refuse to recognise investment expenditure in the development plan. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through higher cost of operations and loss of revenue.

Property failure risk – the risk of occurrence of significant and/or permanent failures and damages of equipment used by the TAURON Capital Group companies. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through the need to bear additional costs of grid and non-grid infrastructure overhaul, blackouts and disruptions in operations as well as with the need to offer discounts or pay fines.

Purchase of materials/fuels risk – the risk connected with significant and/or unexpected changes of the prices of coal and other fuels. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through the need to bear higher costs or imposing a fine in case of failure to fulfil these conditions.

Risk of the process of contract granting/procurement process of supplies/services – the risk is associated with a possibility of significant growth of prices of supplies/services provided by contractors, or their decreased availability. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through increased costs, extension of the process of preparation and conducting of the proceedings, granting of contract unfavourable for the Company or delay in implementation of investment.

Risk of unregulated legal status of the property utilised – the risk is connected with a possibility of occurrence of massive claims of land owners. The reason of this kind of risk may be the unregulated legal status of foundation of a building on the land without holding proprietary rights. The risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through increased costs or interruption of business continuity due to undermining of the legal status and claims of the third parties.

Volumetric risk – risk related to volatility of electric energy trade volume. The volumetric risk factors may have material unfavourable effect on operations of TAURON Capital Group, its financial situation or results of its activities through increased costs connected with closing of open positions on the forward market and/or balancing market, on futures market and/or current market as well as losing income and decrease of margin on sales of electric energy to consumers.

Information concerning financial risk, understood as currency risk and interest rate risk is presented in item 3.8.2. of this report.

3. ANALYSIS OF ASSETS AND FINANCIAL SITUATION OF THE CAPITAL GROUP

3.1. Principles of preparation of the annual consolidated financial statements

On 7 June 2010 the Extraordinary General Meeting of the Company adopted the resolution based on which the Company prepares financial statements in accordance with the International Financial Reporting Standards (IFRS), starting from financial statements for the period starting on 1 January 2010.

The consolidated financial statement has been prepared in accordance with the IFRS adopted by the European Union. IFRS cover standards and interpretations approved by the International Accounting Standards Board (IASB) as well as the International Financial Reporting Interpretation Committee.

The consolidated financial statement has been prepared with the assumption of continuation of business operations by the TAURON Capital Group companies in the predictable future. As of the date of the financial report, no circumstances are recognised, indicating any risk for business continuity of the Company.

The accounting principles (policy) adopted for drawing up of the financial statements have been provided in note 11 of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group for the year ended on 31 December 2011.

3.2. Overview of economic and financial values disclosed in the consolidated annual financial statement

Consolidated statement on financial situation

In the table below, the annual consolidated statement on financial situation is presented.

Table No. 17 Annual consolidated statement on financial situation (data in PLN thousand)

Statement on financial situation	Status as of 31 December 2011	Status as of 31 December 2010
ASSETS		
Fixed Assets	23,248,498	18,334,911
Tangible fixed assets	21,911,047	17,524,936
Intangible assets	988,950	346,340
Shares in affiliated companies and joint ventures recognised applying the equity method	22,717	764
Other long-term financial assets	197,470	177,452
Other long-term non-financial assets	96,349	123,613
Deferred Income tax assets	31,965	161,806
Current assets	5,156,082	5,090,976
Short-term intangible assets	870,954	624,190
Inventory	574,790	408,560
Receivables due to income tax	64,266	74,749
Trade receivables and other receivables	2,743,344	2,273,145
Other short-term financial assets	108,024	28,193
Other short-term non-financial assets	289,034	208,158
Cash and equivalents	505,670	1,473,981
Fixed assets classified for trade	8,951	4,397
TOTAL ASSETS	28,413,531	23,430,284
LIABILITIES		
Equity	16,139,068	15,212,071
Equity attributable to shareholders of the parent Company	15,677,721	14,704,825
Share capital	8,762,747	15,772,945
Supplementary capital	7,412,882	475,088
Hedging tools revaluation reserve	–	–
Foreign Exchange differences due to translation of foreign entities	87	(271)
Retained profits/Uncovered losses	(497,995)	(1,542,937)
Non-controlling shares	461,347	507,246
Long-term liabilities	7,431,923	4,070,063
Loans, credits and debt securities	4,251,944	1,076,178
Liabilities due to leasing and lease contracts with purchase option	56,232	67,810
Long-term provisions and employee benefits	1,202,840	1,059,028

Statement on financial situation	Status as of 31 December 2011	Status as of 31 December 2010
Long-term prepayments and governmental subsidies	642,549	644,522
Trade liabilities and other financial long-term liabilities	7,968	6,910
Provision for deferred tax assets	1,270,390	1,215,615
Short-term liabilities	4,842,540	4,148,150
Trade liabilities and other liabilities	2,349,201	1,629,723
Current portion of interest-bearing credits, loans and debt Securities	214,169	325,027
Current portion of liabilities due to leasing and lease contracts with purchase option	14,761	23,452
Other short-term liabilities	644,910	752,819
Accruals and governmental subsidies	279,058	189,712
Liabilities due to income tax	163,437	68,672
Short-term provisions and employee benefits	1,177,004	1,158,745
TOTAL LIABILITIES	28,413,531	23,430,284

As of 31 December 2011 the balance sheet total of TAURON Capital Group was higher by about 21.3% in relation to the status as of 31 December 2010.

At the end of 2011, fixed assets of TAURON Capital Group were higher by about 26.8%, which is the result of increased tangible fixed assets due to implementation of investment in generation and distribution assets, as well as takeover of GZE companies assets.

Current assets of TAURON Capital Group, according to the status as of 31 December 2011 reached the level of 101.3% of the status as of 31 December 2010, mainly due to decrease in cash and increase of the level of receivables.

As of 31 December 2011 and as of 31 December 2010, the total equity, as the dominating source of financing of TAURON Capital Group assets, reached PLN 16,139,068 thousand and PLN 15,212,071 thousand, respectively, which constitutes about 57% and 65% of total liabilities. The decrease in share capital results from the reduction of the Company shares par value, which is described in item 2.6 of this report. The resulting difference of PLN 7,010,198 thousand supplied the supplementary capital.

The change in status of long-term liabilities during the financial year ended on 31 December 2011 results mainly from the increased level of debt due to bank credits, loans and securities (issue of bonds). Short-term liabilities increased by PLN 694,390 thousand (16.7%) against the status as of 31 December 2010, mainly in connection with the increase trade liabilities and provisions, in total by PLN 737,737 thousand (among others, due to use of provisions related to the obligation to present certificates for redemption by companies of the Trading Segment). The balance of short-term bank credits, loans and debt securities as of 31 December 2011 amounted to PLN 214,169 thousand, which means the decrease by PLN 110,858 thousand (34.1%) in relation to the status as of 31 December 2010.

Consolidated statement on comprehensive income

The table below presents annual consolidated statement of comprehensive income.

Table No. 18 Annual consolidated statement on comprehensive income

Consolidated statement on comprehensive income	Year 2011		Year 2010		Dynamics (2011/2010)
	in thousand PLN	% of total revenue on sales	in thousand PLN	% of total revenue on sales	
Continuing operations					
Sales of goods for resale, finished goods and materials without elimination of excise	16,282,481	78%	11,108,492	72%	146.6%
Excise tax	(393,757)	2%	(418,178)	3%	94.2%
Revenue on sales of goods, products and materials	15,888,724	77%	10,690,314	69%	148.6%
Revenue on sales of services	4,825,806	23%	4,698,111	30%	102.7%
Other revenue	40,692	0.2%	40,454	0.3%	100.6%
Revenue on sales	20,755,222	100%	15,428,879	100%	134.5%
Own cost of sales	(18,184,818)	88%	(13,089,128)	85%	138.9%
Gross profit (loss) on sales	2,570,404	12%	2,339,751	15%	109.9%
Other operating revenue	106,162	1%	105,186	1%	100.9%
Costs of sales	(283,684)	1%	(231,252)	1%	122.7%
Overheads	(664,350)	3%	(670,308)	4%	99.1%
Other Operating Expenses	(117,043)	1%	(144,118)	1%	81.2%

Consolidated statement on comprehensive income	Year 2011		Year 2010		Dynamics (2011/2010)
	in thousand PLN	% of total revenue on sales	in thousand PLN	% of total revenue on sales	
Operating profit (loss)	1,611,489	8%	1,399,259	9%	115.2%
<i>Operating profit margin (%)</i>	7.8%		9.1%		
Financial revenue	115,767	1%	92,284	1%	125.4%
Financial expenses	(160,274)	1%	(233,993)	2%	68.5%
Share in the profit (loss) of an affiliated entity and joint venture recognised by equity method	(1,046)	–	(236)	–	–
Gross profit (loss)	1,565,936	8%	1,257,314	8%	124.5%
<i>Gross profit margin (%)</i>	7.5%		8.1%		
Income Tax	(326,576)	2%	(265,931)	2%	122.8%
Net profit (loss) on continuing operations	1,239,360	6%	991,383	6%	125.0%
<i>Net profit margin (%)</i>	6.0%		6.4%		
Net profit (loss) on discontinued operations	0	–	0	–	–
Net profit (loss) for the financial year	1,239,360	6%	991,383	6%	125.0%
Other comprehensive income for the financial year including deduction of tax	358		630		56.8%
Total income for financial year	1,239,718	6%	992,013	6%	125.0%
Profit attributable to:					
Shareholders of the parent company	1,220,011		858,656		
Non-controlling interests	19,349		132,727		
Total income attributable to:					
Shareholders of the parent company	1,220,369		859,151		
Non-controlling interests	19,349		132,862		
EBIT and EBITDA					
EBIT	1,611,489		1,399,259		115.2%
EBITDA	3,023,036		2,758,486		109.6%

In 2011 the TAURON Capital Group recognised the total sales revenue at a level of PLN 20,755,222 thousand, which represents an increase of about 34.5%. Such a high growth in sales reached by TAURON Group in 2011, as compared to 2010, is associated with the obligation of conduct sales of the electric energy by the generators through power exchange – sales value makes about 21%. Taking this fact into account and bringing the data to comparability (in 2010 the sales of electric energy from Generation Segment was subject to exclusion within consolidation of revenues of the TAURON Capital Group – almost the whole volume of the produced energy was sold in TAURON Capital Group), the growth of revenue would reach 6.3%.

As compared to 2010, TAURON Capital Group reached higher revenue on sales in all operating segments, excluding the Segment: Other (change by about 0.6%). The highest dynamics of growth was recorded in the Trading Segment, mainly due to the increase in the volume of electric energy sales, as well as increase in sales price.

Increase in costs of operating activities is connected with the higher volume of sales, mainly of electric energy. In TAURON Capital Group companies, activities in the area of optimisation of fixed costs are on-going.

The lower dynamics of cost growth was reflected in improvement of EBIT and EBITDA ratios as well as net profit. The net profit margin in 2011 under the comparable conditions reached the level of 7.6%, which means the level higher as compared to 2010 (6.4%).

Statement of Cash Flow

The table below presents the cash flow statement

Table No. 19 Statement of Cash Flow (data in PLN thousand)

Statement of Cash Flow	Year ended 31 December 2011	Year ended 31 December 2010
Cash flows from operating activities		
Gross profit (loss)	1,565,936	1,257,314
Adjustments	647,715	1,263,031
Net cash from operating activities	2,213,651	2,520,345
Cash flows from investment activities		
Sales of tangible fixed assets and intangible assets	39,957	11,731
Purchase of tangible fixed assets and intangible assets	(2,302,270)	(1,518,088)
Sales of other financial assets	114,304	56,189
Purchase of other financial assets	(147,989)	(69,570)
Acquisition of shares in affiliated companies and joint ventures recognised applying the equity method	(23,000)	(1,000)
Acquisition of subsidiary following deduction of cash taken over	(3,379,615)	23
Dividend received	8,173	4,349
Interest received	666	1,377
Repayment of loans granted	240	1,475
Granting of loans	–	(1,400)
Other	–	6,438
Cash flows from investment activities	(5,689,534)	(1,508,476)
Cash flows from financial activities		
Repayment of liabilities due to financial leasing	(25,603)	(35,842)
Cash inflows due to loans/credits	87,254	167,115
Repayment of loans/credits	(467,183)	(744,020)
Issue of debt securities	3,300,000	848,200
Redemption of debt securities	–	(608,692)
Dividends paid to shareholders of the parent company	(262,882)	–
Dividends paid to minority shareholders	(13,676)	(5,573)
Interest paid	(52,292)	(115,820)
Purchase of non-controlling interest	(37,800)	(9,863)
Other	(17,779)	(8,369)
Net cash from financial activities	2,510,039	(512,864)
Increase/(decrease) in net cash and cash equivalents	(965,844)	499,005
Net exchange differences	(3)	(134)
Cash opening balance	1,471,660	972,655
Cash closing balance	505,816	1,471,660

Total cash flows from operating, investment and financial activity of TAURON Group for financial year ended on 31 December 2011 reached PLN (965,844) thousand, as compared to PLN 499,005 thousand for the year ended on 31 December 2010. The main factor influencing the change in value as compared to 2010 was the acquisition of GZE companies, which is recognised in investment activity and financial activity (issue of bonds, among others to finance the transaction).

Decrease of cash flows on operating activity in 2011 as compared to 2010, by about PLN 306,694 thousand is mainly the result of: higher gross profit (increase by about PLN 308,622 thousand), higher depreciation, change in the status of inventory and decrease in the status of liabilities, excluding loans and credits.

Negative net cash flows on investment activity for the financial year ended on 31 December 2011 reached PLN 5,689,534 thousand. The above situation results from increased investment expenses, including purchase of GZE shares.

Positive net cash flows on financial activity for the financial year ended on 31 December 2011 reached PLN 2,510,039 thousand, as compared to PLN -512,864 thousand for the financial year ended on 31 December 2010. It results mainly from issue of bonds in 2011 at the value of 3,300,000 thousand, which were used to finance transaction of purchase of GZE shares.

Cash flows reached by TAURON Capital Group correspond to the relevant picture of the developing enterprise: operating cash stream is positive, investment stream is negative and financial cash stream is positive. It means that investment expenses exceed operating inflows, therefore, acquisition of external financing sources is necessary for further development of TAURON Capital Group and for implementation of its investment plans.

3.3. Characteristics of assets and liabilities of the consolidated balance sheet

Structure of the consolidated statement on financial standing

In the table below, the structure of the annual consolidated statement on financial standing is presented.

Table No. 20 Structure of the annual consolidated statement on financial standing

Consolidated statement on financial standing	Status as of 31/12/2011	Status as of 31/12/2010
ASSETS		
Fixed Assets	82%	78%
Current assets	18%	22%
Fixed assets permanently classified for trade	0.03%	0.02%
TOTAL ASSETS	100%	100%
LIABILITIES		
Equity attributable to shareholders of the parent company	55%	63%
Non-controlling shares	2%	2%
Total equity	57%	65%
Long-term liabilities	26%	17%
Short-term liabilities	17%	18%
Total liabilities	43%	35%
TOTAL LIABILITIES	100%	100%
Financial liabilities	4,537,106	1,492,467
Net financial liabilities	4,031,436	18,486
Ratio net debt/EBITDA	1.33	0.01
Current liquidity ratio	1.06	1.23

In the structure of assets as of 31 December 2011 the fixed assets constitute about 82% of total assets in relation to 78% as of 31 December 2010.

Current assets as of 31 December 2011 constitute 18% of total assets, which means the decrease in current assets share in the structure in relation to the level as of 31 December 2010 amounting to 22%.

In the structure of liabilities as of 31 December 2011 the liabilities make about 43% of total liabilities, as compared to the status at the end of 2010, making about 35%, among which in 2011, the long-term liabilities make 26%, short-term liabilities make 17%, while in 2010 the share is comparable: 17% and 18%, respectively.

In relation to 2010, in 2011 the increase in net financial liabilities was noted, which resulted in the growth of net debt ratio to EBITDA – to the level of 1.33. The ratio of current liquidity decreased to the level of 1.06. Irrespective of the above figures, the liquidity of the Company is not at risk – the indicators are maintained at the safe level.

3.4. Significant off-balance sheet items

The significant conditional liabilities of TAURON Capital Group are related to the following issues:

- the use of the real estate without a contract,
- compensation due to stranded costs,
- claims of Huta Łaziska,
- excise tax and real estate tax.

Use of real estate without a contract

The distribution companies belonging to TAURON do not hold legal titles to all plots of land on which the distribution systems and the related equipment are situated. In the future, TAURON Capital Group may be required to incur costs for the use of real estate without the underlying contracts; however, it must be emphasized that the risk of loss of assets is remote. TAURON Capital Group recognizes

provision for all court disputes filed in this respect. The provision is not established for unreported potential claims from owners of land of unregulated status due to the lack of detailed record of unregulated land and the resulting inability to reliably estimate the amount of potential claims. However, considering the history of the reported claims and the costs incurred in this respect in previous years, the risk of incurring significant costs due to such claims can be considered as remote.

Compensation for stranded costs

In accordance with enforcement of the Act of 29 June 2007 on *Principles for Covering Costs Incurred by Electricity Generators due to Early Termination of Long-term Electricity and System Services Agreements*, TAURON Wytwarzanie voluntarily joined the programme of early termination of LTC by signing an agreement to terminate such contracts. Concluding of such an agreement provides a basis for electricity generators to receive funds to cover their expenses which are not covered by the income derived from the sales of generated electricity, reserve capacity and system-related services on a competitive market after early termination of the LTC, resulting from the expenditures incurred by such companies for assets related to electricity generation up to 1 May 2004. In accordance with the aforementioned Act, the maximum amount of stranded costs and the values adopted in calculation of annual adjustments to the stranded costs were established for each electricity generator. After termination of LTC, starting from 2008, TAURON Wytwarzanie receives quarterly cash advances based on the submitted applications. Annual adjustments will be subsequently made to the stranded costs throughout the so-called adjustment period, lasting until the expiry of the longest long-term agreement held by the given company. The final adjustment to the stranded costs will be made in the year following the year in which the adjustment period of the given company ceases.

Pursuant to the decision of the President of ERO dated 31 July 2009, TAURON Wytwarzanie was required to return the amount of PLN 159,508 thousand to Zarządca Rozliczeń S.A. (Clearing Administrator) by 30 September 2009. The company appealed against the above decision to the District Court in Warsaw – the Court for Competition and Consumers Protection through the President of ERO and submitted a motion to suspend its execution. On 24 September 2009, the Court issued the verdicts to suspend the execution of the decision with regard to amounts exceeding the amount of PLN 79,754 thousand. In fulfilment of the verdict of the Court, the company paid the amount referred to above. According to the judgement of the District Court in Warsaw – the Court for Competition and Consumers Protection, dated 26 May 2010, the Court modified the challenged decision and acknowledged the company's right to make a positive adjustment to stranded costs of PLN 79,088 thousand. On 8 July 2010, the President of ERO lodged an appeal against the judgement of the Regional Court in Warsaw – the Court for Competition and Consumers Protection with the Court of Appeal in Warsaw (the 6th Civil Division). At the date of this report financial statements, the aforementioned court proceedings have not been resolved.

Claims of Huta Łaziska S.A.

During the recent years, the GZE subsidiary participated in the court claims with Huta Łaziska S.A. (Huta – Steelworks). The main reason for such situation was the suspension of electric energy supplies by GZE to the Steelworks in 2001 due to default in payment. According to the decision of 12 October 2001, the President of ERO ordered GZE to resume the electric energy supplies to the Steelworks under the conditions of the contract of 30 July 2001 at the price of 67 PLN/MWh until the final resolution of the dispute, and on 14 November 2001, he finally adjudicated the dispute, by issuing the decision stating that suspension of electric energy supplies was not justified. The Steelworks lodged an appeal against this decision. On 25 July 2006 the Court of Appeal in Warsaw issued the legally binding verdict concluding the dispute on legitimacy of the decision of the President of ERO of 14 November 2001. The Steelworks filed the cassation appeal against the aforementioned verdict of the Court of Appeal, which was dismissed with the verdict of the Supreme Court of 10 May 2007.

Due to suspension of energy supplies, the Steelworks submits numerous claims against GZE, none of which was acknowledged as legitimate by the Courts. Currently the case filed by the Steelworks on 13 March 2007 is pending, against GZE and the State Treasury, concerning payment of PLN 182,060 thousand with interest accrued since the day of filing of the application until the day of payment, due to compensation for the alleged losses arising from GZE failure to implement the provisions of the decision issued by President of ERO of 12 October 2001. In this case, on 26 October 2009 the District Court in Warsaw issued the verdict in which the application of the claimant was dismissed, and the Court of Appeal dismissed the appeal of the Steelworks, however, the Supreme Court waived the decisions of the Court of Appeal with its verdict of 29 December 2011 and submitted the case for judicial review.

Based on the legal analysis of the claims submitted by Steelwork's and its main shareholder – GEMI Sp. z o.o., – the Company states that the claims are not legitimate and the risk of necessity of their satisfying is remote. Consequently, there is no need to establish the provision for the related costs.

Excise tax and real estate tax

Due to the non-compliance of Polish regulations regarding excise charged on electricity with the EU regulations, on 11 February 2009, the power plants and cogeneration plants being part of the TAURON Group submitted corrections of their tax declarations together with requests to recognize the surplus of excise for the years 2006–2008 and for January and February 2009. The total amount of the surplus stated in the requests (excluding interest) was approximately PLN 901,428 thousand. Currently proceedings relating to the individual companies in the TAURON Capital Group are pending before the appropriate Customs Chambers and Regional Administrative Courts.

On 12 February 2009, the European Court of Justice issued the judgement confirming that Poland had breached the EU law by failing to adjust, until 1 January 2006, its electricity taxation system to the requirements of Article 21 paragraph 5 of the Council Directive 2003/96/EC of 27 October 2003 on *Restructuring the Community Framework for the Taxation of Energy Products and Electricity* (amended by the Council Directive 2004/74/EC dated 29 April 2004), as, in the period until 28 February 2009, the tax obligation in respect of excise on electricity in Poland occurred at the moment the electricity was released by the generator instead of at the moment of its supply by the distributor or re distributor. In the light of the above, basis exist for obtaining the refund of the excise paid in breach of the EU law. The Ministry of Finance, however, presents the opinion that such a refund would result in unjustified enrichment of electricity-generators and therefore it is groundless. For this reason, the process of excise recovery may extend until final court decisions are issued.

The approach to taxation of equipment used for generation and transmission of electricity with real estate tax is subject to varying interpretations. Due to the fact that the real estate tax is collected by local authorities, their approach is not consistent and sometimes the calculation of taxable base is challenged. As of the date of this report, the potential outcomes of the proceedings conducted in this respect are not significant for the TAURON Group. Depending on the decisions issued by courts and potential changes in law, situation with regard to taxation of energy equipment with real estate tax may change in the future.

The other off-balance items are included in notes 35 and 35 of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group for the year ended on 31 December 2011.

3.5. Differences between the financial results recognised in the annual report and the forecasts of results for the year as published earlier

The Management Board did not publish any forecasts of financial results of Share price/Book value per 1 share.

3.6. Financial and non-financial ratios

The table below presents the basic financial ratios of TAURON Capital Group.

Table No. 21 The table below presents the basic financial ratios of TAURON Capital Group

Ratio	Definition	Year 2011	Year 2010
PROFITABILITY			
EBIT Margin	Operating result / Revenue on sales	7.8%	9.1%
EBITDA Margin	EBITDA / Revenue on sales	14.6%	17.9%
Net Profitability	Net result / Revenue on sales	6.0%	6.4%
Return on Equity (ROE)	Net profit / equity	7.7%	6.5%
LIQUIDITY			
Current liquidity ratio	Current assets / Short-term liabilities	1.06	1.23
DEBT			
General debt ratio	Total obligations / total liabilities	0.43	0.35
Net debt/ EBITDA	(Financial liabilities - Cash) / EBITDA	1.33	0.01
OTHER RATIOS			
Earnings per share (EPS)	Net result / Number of ordinary shares	0.70	0.54
Price-earnings ratio (PE)	Share price / Earnings per share	7.69	10.61
Price book value ratio (PBV)	Share price / Book value per 1 share	1.07	0.67

During the first three quarters of 2010, the electric energy produced in Generation Segment was sold within TAURON Capital Group and was subject to consolidation exclusion. Starting from the 4th quarter of 2010 and during the whole 2011, the energy was sold through the so-called public trade and its was not subject to exclusion. It means that in case the profitability ratios recognised as revenue were brought to managerial comparability, their value would be higher. Accordingly:

- the operational profitability ratio (EBIT) would reach 9.8%. The indicator, calculated based on data from the financial statement, reached the level of 7.8%, which means that for each 1 million of revenue on sales, it provided operating profit of about PLN 78 thousand;
- the profitability ratio based on EBITDA would reach 18.4%. The indicator, calculated based on data from the financial statement, reached the level of 14.6%, which means that for each 1 million of revenue on sales, it provided operating profit of about PLN 146 thousand, adjusted by the costs which do not generate negative cash flows;
- the net profitability ratio would reach 7.6%. The indicator, calculated based on data from the financial statement, reached the level of 6.0%, which means that for each 1 million of revenue on sales, it provided net profit of about PLN 60 thousand.

The return on equity (ROA) increased to the level of 7.7% in 2011, which means that TAURON Capital Group generated for its owners the return of PLN 77 thousand on each invested 1 million PLN.

Current liquidity ratio reached the value of 1.06 in comparison with the value of 1.23 from the previous year which results from increased share of liabilities with short maturity period (up to one year in financing the current assets). Irrespective of decrease of this ration, in 2011 TAURON Group maintained its full capacity to cover short-term liabilities with cash held, and short-term current assets possible to liquidate in short time.

The total debt ratio as well as Net debt/EBITDA ratio reflect the increasing share of liabilities in TAURON Group financing. The reason of growth in this ratio is the issue of bonds to purchase GZE shares in December 2011. The current level of this ratio enables TAURON Capital Group to acquire external financing required to implement the investments planned by TAURON Capital Group.

The EPS ratio reached for 2011 at the level of 0.70 increased by about 29.8% in relation to 2010 when it amounted to 0.54. The level of this indicator is significantly influenced by the level of net profit attributable to shareholders of the parent company, which increased from PLN 858,656 thousand in 2010 to PLN 1,220,011 thousand in 2011.

3.7. Income from the bonds issue programme

In accordance with the information contained in item 2.7.1 of this report, on 28 October 2011, the contract was concluded between the Company and Bank Handlowy w Warszawie S.A., ING Bank Śląski S.A., Bank Polska Kasa Opieki S.A., BRE Bank S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Nordea Bank Polska S.A., Nordea Bank AB, on the basis of which the value of bond programme of TAURON Polska Energia S.A. was increased by tranche C at the value of PLN 3 billion, i.e. to the total amount of PLN 4.3 billion. The primary agreement on the bond issue programme was signed on 16 December 2010 at the amount of PLN 1,300,000 thousand, consisting of two tranches: Tranche A of the value up to the value of PLN 850,000 thousand and Tranche B of the value up to PLN 450,000 thousand. In 2010 Tranche A was used for refinancing of partial debt of TAURON Group companies.

On 12 December 2011 two issues of bonds were executed within:

- Tranche B at the level of PLN 300,000 thousand,
- Tranche C at the level of PLN 3,000,000 thousand,

The whole resources gained from the issue of the bonds were used for purchased of GZE shares by Vattenfall AB.

3.8. Financial instruments

3.8.1. Implementing financial instruments in the elimination of credit risk, significant disruptions of cash flows and losing financial liquidity

TAURON Capital Group carries out on-going monitoring of credit risk generated within the conducted operations.

In 2011 the companies of TAURON Capital Group were exposed to credit risk of customers, resulting from the concluded contracts. In order to reduce it, based on regularly performed analyses of creditworthiness and financial standing of the contracting parties, in justified cases, appropriate collaterals are required from the customer, for example in the form of bank, insurance or corporate guarantees, avals, material collateral as well as regulations enabling to withhold deliveries of goods, products or rendering services in case of default in settling the accounts.

In 2011, in order to minimize the possibility of the occurrence of cash flows disruptions as well as the risk of losing liquidity, TAURON Capital Group implemented cash pooling mechanism, which irrespective of means contributed by particular members, has a flexible credit line in the form of overdraft, the amount of which was increased from PLN 100,000 in 2011 to PLN 300,000 thousand for the years 2012–2014.

Moreover, at the end of 2011, the instrument providing for liquidity safety for companies of TAURON Capital Group (simultaneously reducing the risk of loss of financial liquidity) was the available part of Tranche B of the 5-years programme of Company bonds issue, at the level of PLN 150,000, with a possibility to be launched at any moment, and covered by the bank guarantee. Irrespectively, the Company also held two contracts signed with the European Investment Bank (referred to in item 2.7.3) on the available financing at the level of PLN 510,000 thousand.

In 2011, TAURON Group concluded forward futures contracts, as a part of financial risk management to hedge the currency risk exposure arising during the trading operations of the companies. The aim of these transactions was securing of particular companies against the risk of exchange rate and interest rate changes resulting from currency rates volatility.

As of 31 December 2011, Companies of TAURON Capital Group had one active future derivative transaction specified in the table below.

Table No. 22 Information on forward transactions and derivatives as of 30 December 2011

Type of transaction concluded	Total par value of the specific type of transaction	Currency			Maturity date of the specific type		Valuation of the specific type of transaction
		EUR	USD	CZK	up to one year	above one year	
Forward	PLN 8,960,400	–	–	x	x	–	PLN -80,301
IRS	–						
Option	–						
Other	–						

3.8.2. Goals and methods of financial risk management

TAURON Capital Group manages financial risk, understood as currency risk and interest rate risk in accordance with the developed and adopted regulations *Policy of risk management specific for the financial area in TAURON Capital Group*, which is the collection of principles and standards compliant with the best practices in this area.

Due to correlation between the risk borne and the level of achievable income, these regulations are used to maintain the risks at the previously established, acceptable level. The main goal of financial risk management is to minimise TAURON Capital Group cash flows sensitivity to financial risk factors as well as to reduce financial costs and collateral costs as a part of transactions with the use of derivative instruments.

Simultaneously, the policy implements hedge accounting principles which determine the rules and types of hedge accounting policy as well as the booking approach to recognising of hedging instruments and items hedged under the hedge accounting, in compliance with IFRS. In accordance with the said policy, the Company (which is the only entity to conclude transactions with external entities, i.e. financial institutions) intends to use the derivatives the characteristics of which will allow for application of hedge accounting in the future.

Moreover, in the second half of 2011, the companies of TAURON Capital Group implemented *the Policy of Financial Liquidity Management in TAURON Group*. Due to the Policy implemented, based, among others on precise, weekly update of the financial plans, analysis of scenarios and comparative analyses, the Company optimises the management of the liquidity position of TAURON Capital Group, accordingly decreasing the risk of losing of the liquidity. Based on the policy adopted, the Company determines the optimum size and structure of liquidity provision of TAURON Capital Group as well as performs the measurements and assessment of liquidity at the level of TAURON Capital Group.

3.9. Present and forecast financial situation

Financial situation of TAURON Group is favourable. No events negatively influencing further operations of TAURON Group have been recorded.

The Company Management Board expects that TAURON Capital Group financial standing should not deteriorate.

3.10. Factors and events of unusual character significantly affecting the financial results achieved

3.10.1. Internal factors and their assessment

The results of TAURON Capital Group in 2011 were influenced by the following internal factors:

- restructuring processes of companies of TAURON Capital Group, including merger of generation, distribution and heat assets as well as change of the core activities in TAURON Sprzedaż and TAURON Obsługa Klienta;
- programmes of voluntary resignation of employees introduced in companies of TAURON Capital Group (TAURON Wytwarzanie, TAURON Dystrybucja, TAURON Ciepło, TAURON EKOENERGIA);
- changes in organisational and proprietary structure of companies of TAURON Capital Group;
- purchase of shares of GZE company and its subsidiaries;
- unfavourable geological and mining conditions as well as natural hazards occurring in deposits of mining plants which influenced the financial result of the companies of Mining Segment.

The aforementioned factors influenced the development of results of TAURON Capital Group companies indirectly, creating mainly changes on the part of costs, the effect of which will be visible both in short-term and in long-term perspective.

3.10.2. External factors and their assessment

The results of TAURON Capital Group in 2011 were influenced by the following external factors:

Macroeconomic situation

TAURON Capital Group conducts its operations mainly on the Polish market, within which the Company takes advantage of positive market trends. Increased internal demand, mainly the positive correlation between the growing demand for electric energy and the economic growth, expressed by GDP, contributed to increased revenue of the Company.

According to the data of the Chief Statistical Office (GUS), the GDP of Poland went up by 4.3% in 2011, as compared to the corresponding period of previous year. In view of other EU Member States, the GDP growth achieved in Poland was significantly higher and its structure positively reflects the strength of the Polish economy, which is directly translated into growth of sales and revenues of the Company and TAURON Capital Group.

Year 2011 was the consecutive period in which the growing trend in demand for electric energy in KSE was observed. Consumption of electric energy in Poland, as compared to 2010 was higher by 1.9%.

Situation on the European energy market

Situation on the electric energy market in Poland was significantly influenced by events and trends occurring on the foreign markets. The key events from the perspective of the electric energy market included:

- 1) abandonment of nuclear energy in Germany – failure of the nuclear reactor in Fukushima did not affect Poland directly, however, gradual closing of reactors in Germany will result in the deficit of power in the future, which may have adverse effect on energy safety in this regions and stimulate the growth of energy prices;
- 2) negotiations at the EU level concerning the form of the National Allocation Plan for CO₂ emission allowances for the years 2013–2020. At the end of June 2011, Poland, demanding the analysis of costs involved in reduction of CO₂ emission, blocked the adoption of conclusions of the Council in the area of environment, concerning the roadmap for reducing CO₂ emission in the EU till 2050. The roadmap assumed that until 2020, the reduction of CO₂ emissions will reach 25% (instead of 20% agreed in 2008). This situation may influence growth of energy prices at the wholesale market in Poland in the future, as well as at the retail market;
- 3) volatility of prices of CO₂ allowances – in the first half of 2011, the CO₂ allowances prices quoted at the world stock exchange demonstrated the growing trend. The significant growth in prices was observed in the second half of March, after Germany had announced the decision on plans of closing of seven nuclear plants. Then the situation stabilised and, starting from June prices of EUA were quoted above 16 EUR/t. In the second half of the year, prices of allowances slumped. The reason for such development of the situation was the alarming information concerning the Greek economy, which substantially affected the European financial markets, including, indirectly the CO₂. Concerns related to the economic downturn of the countries of Eurozone as well as the vision of the subsequent wave of the world financial crisis, led to further discounts of CO₂ emission allowances in the second half of the year. Starting from June, the declining trend was dominating on the market, which led the EUA prices in December 2011 to the level of 7 EUR/t.

Situation in electric energy sector

Year 2011 in Polish energy sector did not bring any significant changes, and the effects of activities undertaken in the previous years were continued. The stable situation in the sector providing hard coal, the main fuel of conventional power industry, prevented dramatic changes of prices. Slight increase of raw material prices at the SPOT market had limited impact on energy generation costs.

During 2011 only one large unit of conventional energy generation was included in KSE. It was the 858 MW unit in Elektrownia Bełchatów, commissioned at the end of the third quarter of 2011. On the other hand, significant increase of the installed capacity was attributed to renewable energy whose volume exceeded 3 000 MW in total. The commissioned wind parks were dominating, which reached above 1 900 MW of the installed capacity until the end of 2011. Increased availability of power in KSE as well as the growing demand for energy were reflected by the growth of energy production which, according to the data provided by PSE Operator, increased by 4.36% in 2011, in relation to 2010. Analogically, the consumption of electric energy in 2011 increased by 1.9% year to year. The difference between the production growth and the domestic energy consumption was exported, which was supported by favourable price relations between the Polish market and the neighbouring Germany and Czech Republic. The total surplus of export over import of energy in the whole 2011 reached over 5 TWh and it was higher by over 3.5 TWh than in 2010.

The continued liberalisation of the energy market and campaigns promoting using TPA as a principle, accompanied by growing competition in order to acquire the retail client, resulted in significant number of energy consumers changing the supplier. According to the data of URE, until the end of 2011, this group reached almost 22 thousand business clients and over 14.3 thousand of households, which in case of G tariff means over ten-fold increase in relation to the end of 2010.

The year 2011 also brought the follow-up of legislative changes. The most important of them was the extension of possibilities of fulfilment of energy sales obligations by generators, introduced pursuant to the Act of 19 August 2011 on amendment of *the Act: Energy Law*.

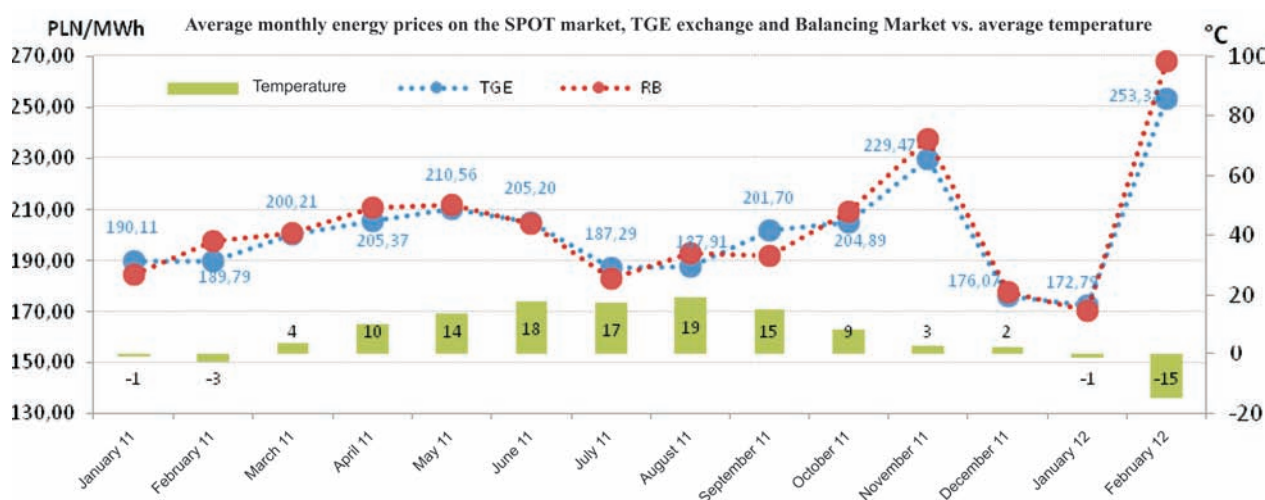
The amendment of the Energy Law has also introduced changes related to the definition of the end consumer, according to which the end consumer performs purchases of fuel or energy for own use, while electric energy purchased for the needs of its generation, transmission or distribution is not classified as energy for own use. The definition of market organised by entity providing regulated market on the territory of the Republic of Poland was also extended, by introducing the company carrying out the over-the-counter market.

Prices of electric energy and CO₂ emission allowances on the Polish, Czech and German market

In 2011 prices of energy on the Polish market did not follow the clear long-term trend. Low prices observed in the first quarter were changed as a result of the nuclear accident in Fukushima, which happened due to the earthquake in March 2011 as well as the decision of Germany on withdrawal from the nuclear energy. During the consecutive months it stimulated the growth of prices by over 10%. However, already in the summer season, due to low temperatures, the growths were strongly adjusted, which was additionally supported by the information on the downturn in the Eurozone. The slump in prices was also encouraged by large volumes of energy supplied to the balancing market by the newly commissioned power unit in Elektrownia Bełchatów. Starting from September 2011, the prices started to grow again in view of the threat of German deficits of energy in the 4th quarter, and consequently, higher probability of import of energy from Poland.

The highest growth in prices was observed in November 2011 when the availability of power in the National Power System (KSE) was low, due to numerous repairs of blocks of the Centrally Controlled Generating Units (JWCD). However, December 2011 turned out to be completely different than assumed and due to exceptionally high air temperatures for this season of the year, and the related decreased demand for electric energy, prices of electric energy dropped and reached the lowest level during the year. The average price of electric energy for the day-ahead market, executed one day before the physical delivery (SPOT market), was 199.04 PLN/MWh, i.e. less than 4% more than in 2010.

Figure No. 12 Average monthly energy prices on the SPOT market, TGE exchange and Balancing Market vs. average temperature



During 2010, at the forward market, the average annual price level for the band product of equal power on each hour of the year (BASE), with delivery in 2011 (BASE Y-11) reached about 193.40 PLN/MWh (based on the registered transactions on the exchange and on trading platforms publishing such data). The highest turnover of BASE Y-11 contract occurred in the period from September 2010. The majority of the turnover in public listing, i.e. about 90% of the contracting was performed at TGE at the average price of about 193.30 PLN/MWh and the volume of 53.6 TWh. Trade outside TGE (brokers' trading platforms: TFS (Traditional Financial Services), GFI (Global Financial Information Group), etc. reached 4.9 TWh at the average price at the level of about 194.00 PLN/MWh.

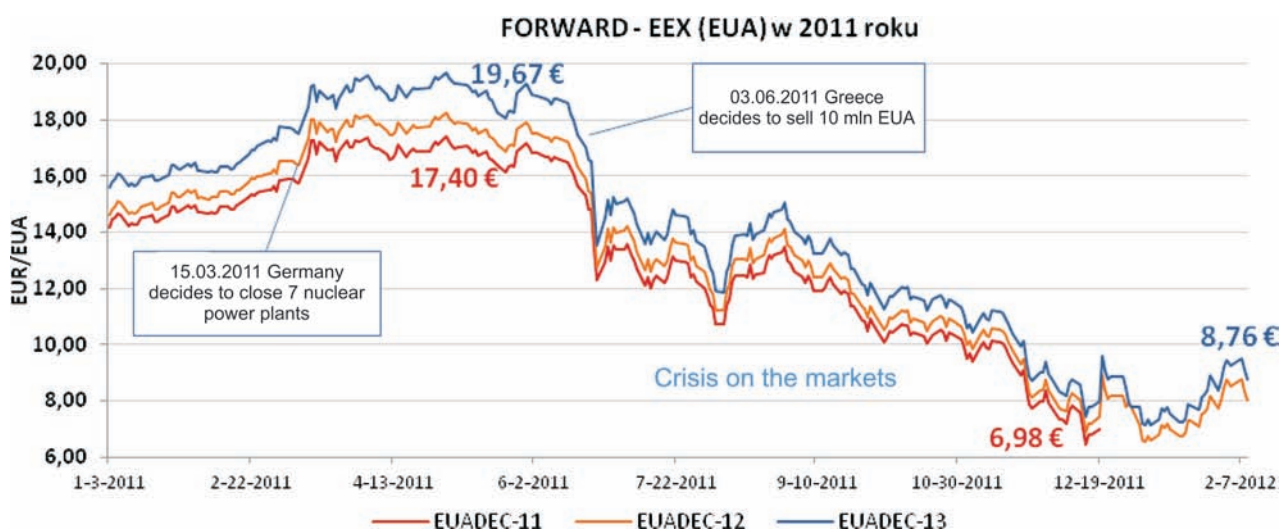
At the forward market, the most liquid contract was BASE Y-12. However, the volatility was not too high ranging from 200 PLN/MWh at the beginning of the year to 206 PLN/MWh recorded after the accident in the nuclear plant in Fukushima (Japan). In the second half of 2011, due to slumps in prices of CO₂ emission allowances and concern of serious slowdown in economy, the contract prices started to fall systematically, reaching the level of 201.50 PLN/MWh at the end of the year.

Energy prices on the neighbouring markets followed similar tendencies to those observed on the Polish market. In Germany and Czech Republic, strongly correlated in terms of prices, significant increase in prices was observed after the antinuclear decision of the German government. The situation stabilised in the middle of 2011 due to the crisis in Eurozone and cold summer. In the second half of 2011, like in Poland, November was the most expensive month while December was the cheapest. In addition, in December, the slump in prices was encouraged by very high generation of energy from wind and solar sources. In Germany, share of electric energy generated from

renewable sources in the whole 2011 exceeded 20% of the total energy generated. The average SPOT price in Germany amounted to 51 EUR/MWh, while in Czech Republic it was lower by only 0.5 EUR.

Within the market of CO₂ emission allowances, at the beginning of 2011, reports of hackers' attacks on registers of Member States stimulated Poland to close its register of allowances for preventive reasons, and the European Commission decided to block the possibility to execute transfers in all community registers. This situation caused inertness of the market which happened at the beginning of February 2011. Then the accident in nuclear plant in Fukushima, leading to withdrawal from pro-nuclear energy policy, influenced the strengthening of prices which was additionally strengthened by incorporation of the aviation sector to the European Union CO₂ Emissions Trading System (EU ETS). In June, the alarming reports concerning the economic situation in Greece became the strong signal of economic decline, covering with its scope the growing number of countries and economic sectors, reflected in the systematic decrease of allowances prices. The average price of forward contracts with delivery in December 2011 (European Union Allowances December 2011 – EUADEC11) in the second half of 2011 decreased by 32% in relation to the average price of the first half of 2011, reaching the minimum at the level of 6.30 EUR/t EUA, and then oscillating above the value of 7 EUR/t EUA.

Figure No. 13 FORWARD – EEX (EUA) in 2011



Obligation of public sales of electric energy by generators

Year 2011 was the consecutive year of effectiveness of the so-called “exchange obligation”, according to which the generating enterprises are obliged to sell the obligatory volume at TGE (for generators taking advantage of LTC compensations, it means 100% of the sold electric energy). The above-mentioned changes caused the enhancement of effectiveness of the Company – acting also in favour of companies of TAURON Capital Group – at TGE. Concluding of transactions at TGE is also associated with the necessity to maintain appropriate hedges and to maintain the deposit to be cleared during the execution of the forward transaction. Additional hedges influenced the growth of financial costs and operational costs connected with trading conducted by the Company. Simultaneously, such costs did not occur in companies of TAURON Capital Group.

Changes in regulations of the energy sector – decisions of the President of URE

In 2011 the President of ERO maintained the obligation to submit tariffs for households and, once again, resigned from liberalisation of this segment of electric energy consumers. Accordingly, the trading enterprises had limited influence on the margin generated in this sales segment (tariff G).

Prices of certificates of origin of energy from renewable and cogeneration sources

Quotes of prices of proprietary rights arising from certificates of origin of electric energy produced using the renewable energy sources, the so-called green certificates, and proprietary rights arising from certificates of origin of electric energy produced in high efficiency gas cogeneration, in the gas-fired unit or a unit of installed capacity below 1 MW, the so-called green certificates, were steadily growing during 2011. The prices were approaching the level determined by the substitution fees published by the President of URE, which in 2011, reached, respectively: 274.92 PLN/MWh and 127.15 PLN/MWh.

Figure No. 14 Indices of property rights under so-called green certificates – prices in 2011

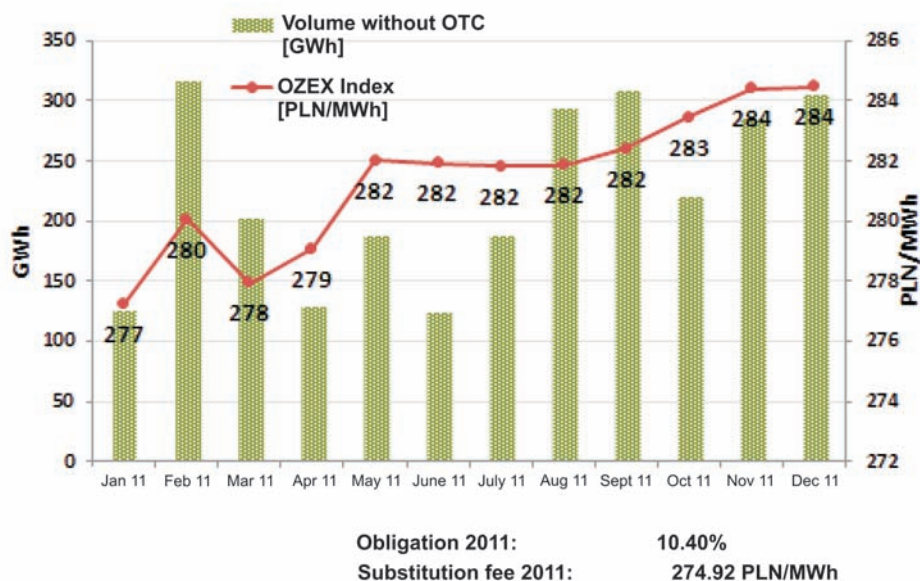
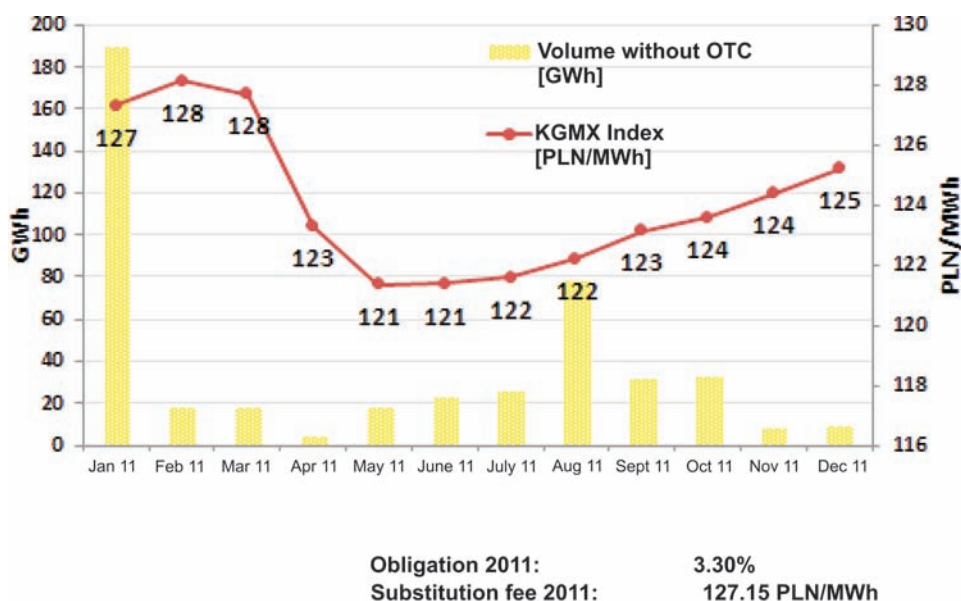
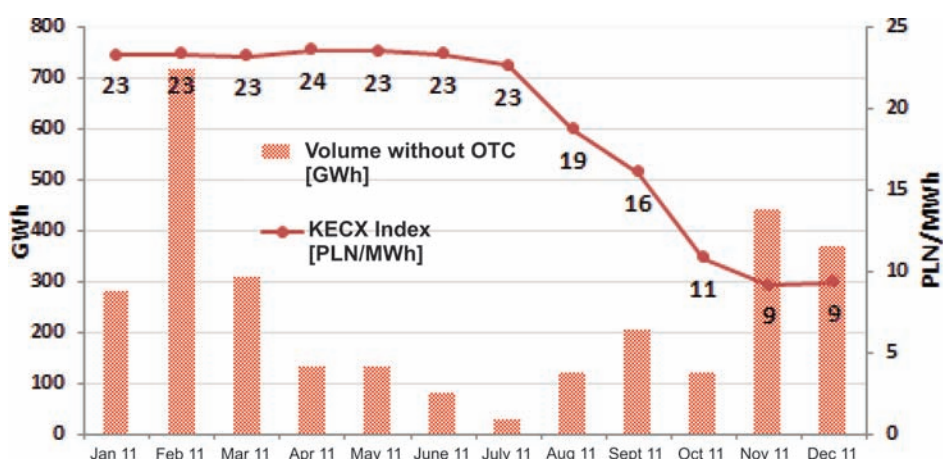


Figure No. 15 Indices of property rights under so-called yellow certificates – prices in 2011



Different situation was observed at the market of proprietary rights resulting from certificates of origin of electric energy produced in high efficiency cogeneration, the so-called red certificates, where prices of certificates started to fall dramatically in the second half of the year. Finally, in November and December 2011 the prices stabilised at the level of 9 PLN/MWh. The reason for discounting of red proprietary certificates was the excessive supply resulting mainly from substantial number of rights of the previous years, collected by energy enterprises, in connection with lack of decision (legal acts) on continuation of the current support system for electric energy to be produced in cogeneration after 2012. The slump in prices of proprietary rights of the so-called red certificates caused significant decrease of the planned redemption costs, partly discounted in sales prices from end customers.

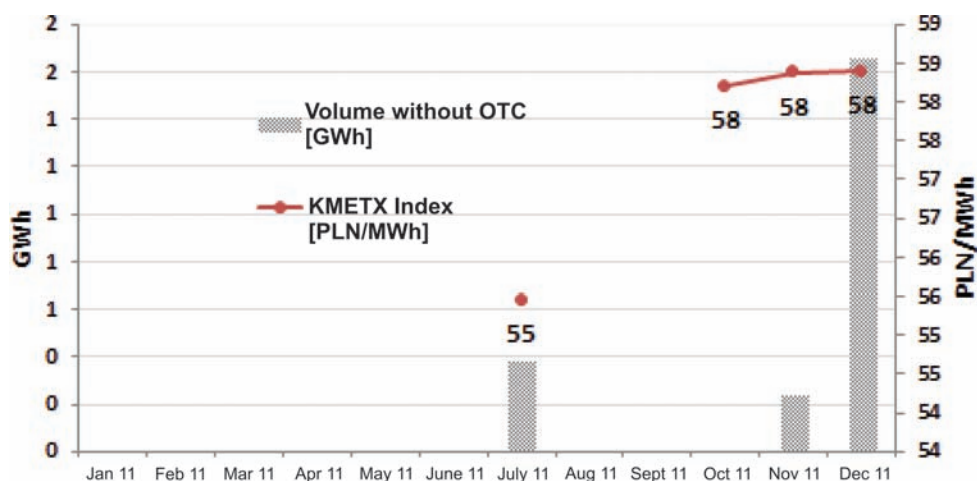
Figure No. 16 Indices of property rights under so-called red certificates – prices in 2011



Obligation 2011: 22.20%
 Substitution fee 2011: 29.58 PLN/MWh

In addition, since 10 September 2011, electric energy sold by energy enterprises to end consumers, provides basis for calculation of the level of fulfilment of obligation of art. 9a item 8 of the Act of 10 April 1997 *Energy Law* within the scope of the so-called violet certificates (certificates of origin of electric energy produced in high efficiency gas cogeneration, in the methane- or biogas-fired unit) at the level of 0.4% and the substitution fee of 59.16 PLN/MWh. Due to the low level of obligatory redemption of these rights, it had insignificant effect on floating costs of the trading enterprises.

Figure No. 17 Indices of property rights under so-called violet certificates – prices in 2011



Obligation 2011: 0.40%
 Substitution fee 2011: 59.16 PLN/MWh

Competition on the energy market

Year 2011 has shown that the electric energy market is becoming more and more competitive which is influenced by, among others, growing activity of the suppliers and clients related to the possibility to select the supplier. It is particularly visible in case of large clients (connected mainly to high and medium voltage grids), where decrease in margin acquired from sales of energy is observed. Similar trend should be expected in other segments of clients.

Activities of competition determined the necessity of intensive actions to be taken by TAURON Capital Group companies in order to maintain the hitherto clients and acquire new ones. New product offers were launched for sales and loyalty programmes for clients were

implemented by TAURON Capital Group companies. In 2011, widespread sales action was undertaken, related to acquisition of small and medium-sized enterprises (Tariff Groups C), purchasing energy from other suppliers, i.e. at the area of DSO, outside TAURON Capital Group. Moreover, in the business clients segment, intensive sales actions were conducted which were significantly reflected by the aforementioned growth of sales to TPA clients which are not connected to the distribution grid of TAURON Capital Group. Promotion actions were also conducted for current clients, consequently reducing the risk of loss of margin and sales volume.

Weather conditions

Weather conditions have the most significant impact on operations of the RES Segment as well as heat companies of the Segment: Other – due to dependence of the level of produced energy (from hydro plants) as well as heat generation on atmospheric conditions. Year 2011 differed significantly from the previous year in terms of temperatures and hydrological conditions and its was dominated by unusual distribution of temperatures and hydrological conditions in individual quarters of the year. This included, among others, positive ambient temperatures causing very fast snow melting and high level of water flows, as well as decreased demand for heat in the 1st quarter, long periods of drought in the 2nd and 3rd quarter as well as high temperatures and unfavourable hydrological conditions in the 4th quarter, much below the average of the previous years.

3.11. Assessment of financial resources management

In accordance with the adopted strategy, the Company centralised the area of financial management in TAURON Capital Group, at the same time maximising its capacity to fulfil the liabilities incurred. The main tools allowing for effective management of financial resources is the central financing model implemented in 2010 as well as the *Policy of Liquidity management in TAURON Group*, implemented in the second half of 2011, including the cash pooling operating in TAURON Capital Group. Moreover, the financial management system is supported by the central *Policy of managing risks specific in the financial area of TAURON Group* and the central *Insurance policy of TAURON Group*, in which the Company plays the role of manager and decision maker in the scope of directions of the actions undertaken, enabling to establish relevant limits of risk exposure.

In accordance with the adopted central model of financing, the Company is responsible for acquisition of financial resources for the companies of TAURON Capital Group. Resources acquired both internally (from companies of TAURON Capital Group generating financial surpluses), as well as externally (from the financial market) are subsequently transferred to companies of TAURON Capital Group, reporting the need for financing (for this purpose the programme of issue of intra group bonds was implemented in TAURON Capital Group).

Such model of acquisition of funding sources allows, among other things, for decreasing of the costs of capital, increasing of the possibility to obtain financing, it reduces the number and form of hedges established on assets of TAURON Capital Group (the Company acquired unsecured financing) and covenants required by financial institutions, as well as reduces administrative costs. The central model of financing also enables to acquire financial sources unavailable for individual companies, such as, for example, Euro bonds. Implementation of the central financing model effectively influenced the change of approach to investment funding in TAURON Capital Group. The financing is acquired based on consolidated balance sheet of the whole TAURON Capital Group, while the funding sources are not assigned to any specific investment projects, but they are incurred to cover the financial gap at the level of TAURON Capital Group. The structure of financing of investment projects in the specific period corresponds to the whole activity of TAURON Capital Group. The model adopted allows for implementation of investment plans in accordance with the approved Corporate Strategy.

The second essential element influencing the effectiveness of financial management is the policy of liquidity management. Through implementation of relevant forecasting standards it becomes possible to establish the precise liquidity position allowing for optimising of selection of the moment of fund raising as well as the maturity term and types of deposit instruments as well as the appropriate level of liquidity provision. The above factors influence both the cost reduction and safety enhancement. The current liquidity management is supported by the cash pooling mechanism implemented in 2010. Its overriding goal is to provide for current financial liquidity in TAURON Capital Group, with simultaneous limitation of costs of short-term external financing and maximising of financial revenue due to cash surpluses held. Owing to the cash pooling structure, the companies of TAURON Capital Group, facing short-term deficits of funds, may, at the first instance use the funds of companies recognising financial surpluses, without the need to acquire external financing.

Within the current financial activity, companies of TAURON Capital Group effectively managed the cycle of money flow through adjustment of payment terms of liabilities and receivables. Moreover, in 2011 the programme of bank guarantees was implemented which can be used by all companies of TAURON Capital Group,

In 2011, companies of TAURON Capital Group, among others due to the models and instruments of central financing, had full capacity to settle their liabilities according to their payment term.

3.12. Information concerning the entity authorised to examine financial statements

Information concerning the contract with entity authorised to examine financial statements was presented in note 41 of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group for the year ended on 31 December 2011.

4. SHARES AND SHAREHOLDERS

4.1. Structure of the share capital

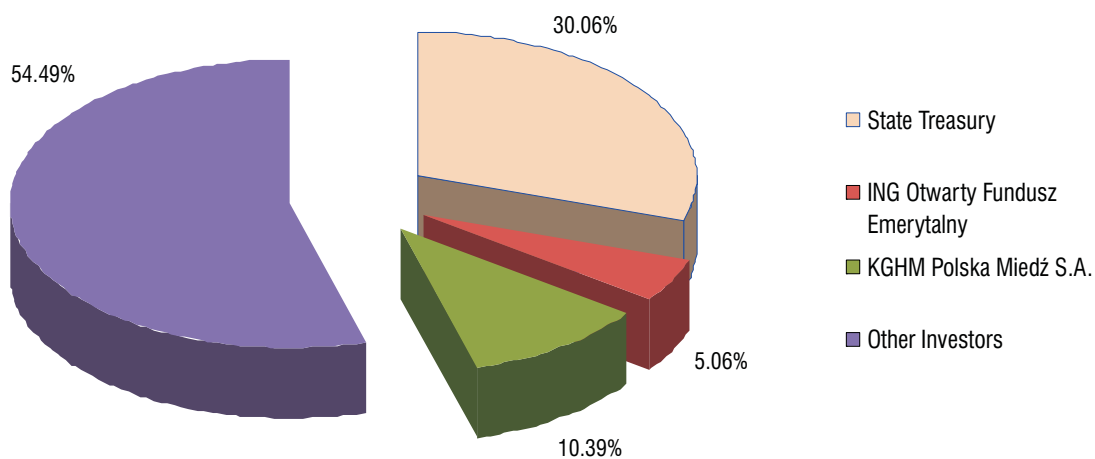
As of 31 December and on the day of this report:

- the share capital of the Company, in accordance with the entry to the National Court Register, amounted to PLN 8,762,746,970.00 and it was divided into 1,752,549,394.00 at par value of PLN 5 each, including 1,589,438,762 ordinary registered shares of AA series and 163,110.632 ordinary bearer shares of BB series.
- The structure of the share capital of the Company was as presented in the table below.

Table No. 23 Structure of the share capital of the Company as of 31 December and on the day of this report

No.	Shareholder	Number of shares/ number of votes at GM	Share in share capital/ share in general number of votes
1.	State Treasury	526,883,897	30.06%
2.	KGHM Polska Miedź S.A.	182,110,566	10.39%
3.	ING Otwarty Fundusz Emerytalny (Open Pension Fund)	88,742,929	5.06%
4.	Other individual and corporate investors	954,812,002	54.49%

Figure No. 18 Structure of shareholding as of 31 December 2011 and as of the date of this report



4.2. Number and par value of the Company shares as well as shares and stocks in affiliated entities of the Company held by the members of the management and supervisory bodies

Proprietary status of the Company shares and share/stocks in entities affiliated with the Company, held by persons managing and supervising the Company, as of 31 December 2011 and as of the day of this report was as follows:

Table No. 24 Proprietary status of the Company shares and share/stocks in entities affiliated with the Company – managing persons

Name and surname	TAURON shares		Share/stocks in entities affiliated with TAURON	
	Number	par value (PLN)	Number	par value (PLN)
as of 31/12/2011				
Dariusz Lubera	6,576	32,880	0	0
Joanna Schmid	0	0	0	0
Dariusz Stolarczyk	42,611	213,055	0	0
Krzysztof Zamasz	935	4,675	0	0
Krzysztof Zawadzki	27,337	136,685	0	0
as of the date of this report				
Dariusz Lubera	6,576	32,880	0	0
Joanna Schmid	0	0	0	0
Dariusz Stolarczyk	42,611	213,055	0	0
Krzysztof Zamasz	935	4,675	0	0
Krzysztof Zawadzki	27,337	136,685	0	0

Table No. 25 Proprietary status of the Company shares and share/stocks in entities affiliated with the Company – supervising persons

Name and surname	TAURON shares		Share/stocks in entities affiliated with TAURON	
	Number	par value (PLN)	Number	par value (PLN)
as of 31/12/2011				
Antoni Tajduś	0	0	0	0
Agnieszka Trzaskalska	0	0	0	0
Leszek Koziorowski	0	0	0	0
Jacek Kuciński	935	4,675	0	0
Włodzimierz Luty	935	4,675	0	0
Michał Michalewski*	0	0	0	0
Jacek Szyke	0	0	0	0
Marek Ściążko	0	0	0	0
as of the date of this report				
Antoni Tajduś	0	0	0	0
Agnieszka Trzaskalska	0	0	0	0
Leszek Koziorowski	0	0	0	0
Jacek Kuciński	935	4,675	0	0
Włodzimierz Luty	935	4,675	0	0
Jacek Szyke	0	0	0	0
Marek Ściążko	0	0	0	0
Rafał Wardziński**	0	0	0	0

* On 11 January 2012, Mr Michał Michalewski was dismissed from the Supervisory Board of the Company.

** On 11 January 2012, Mr Rafał Wardziński was appointed to the Supervisory Board of the Company.

4.3. Agreements concerning potential changes in shareholding structure

The Management Board does not have any information on existence of any agreements (including agreements concluded after the balance sheet day), as a result of which changes in ratio of the shares held by shareholders and bondholders may occur in the future.

4.4. Purchase of treasury shares

In 2011 the Company did not purchase treasury shares.

4.5. Programmes of employees shares

In 2011 the employees shares programmes did not operate.

4.6. Listing of shares at the Warsaw Stock Exchange (GPW)

Shares of the Company have been listed at the Primary Market of the Warsaw Stock Exchange since 30 June 2010.

In 2011 the price of Company shares ranged from PLN 4.65 to PLN 6.81. In this period, irrespective of improvement of financial results by TAURON Capital Group in relation to 2010, the slump in the Company share price was close to the trend of indices WIG20 and WIG, which noted negative rate of return in this period. However, it should be indicated that the rate of return of the Company shares since the day of debut at GPW until the end of 2011 reached 6.7%, which made a better result as compared to index WIG20 and WIG Energia. Behaviour of share prices of companies listed at the Warsaw Stock Exchange in 2011 was mainly determined by macroeconomic factors related to the crisis in Eurozone as well as the uncertainty at the world markets. Slump at the stock markets which occurred in August 2011 caused significant losses on investors' portfolio, and it was impossible to remedy them until the end of the year due to the worsening macroeconomic situation, unresolved debt problems of the Eurozone countries and threat of recession in this region. Until the end of 2011 the most important European stock exchanges were following the sideways trend, while the prices of the securities listed showed significant volatility.

As of 31 December 2011, the Company was included in the following key exchange indices:

1. **WIG** – covering all companies listed at the Primary Market of GPW which meet the base criteria of participation in the indices,
2. **WIG20** – calculated based on the value of share portfolio of 20 biggest and most liquid companies of the Primary Market of GPW,
3. **WIG-Energia** – the sectoral index covering companies participating in WIG index and simultaneously classified to the “energy” sector,
4. **WIG-Poland** – the national index which includes only the shares of national companies listed at the Primary Market of GPW, which meet the base criteria of participation in the indices,
5. **MSCI Poland Standard Index** – index covering over 20 key companies listed at GPW.
6. **CECE Index** – index of the Vienna Exchange, covering the biggest companies of Central and Eastern Europe.

Table No. 26 Key data concerning shares

Key data concerning shares	2011	2010
Maximum price [PLN]	6.81	6.92
Minimum price [PLN]	4.65	4.96
Latest price [PLN]	5.35	6.57
Capitalisation at the end of the period [M PLN]	9,376	11,514
Capitalisation at the end of the period [%]	2.10	2.12
Book value [M PLN]	15,922.47	15,044.64
C/Z	8.10	14.30
C/WK	0.59	0.77
Rate of return at the end of the period [%]	-16.73	–
Dividend rate [%]	2.8	0.0
Value of turnover [M PLN]	5,574.82	8,821.85
Share in turnover [%]	2.21	1.99
Turnover ratio [%]	58.80	46.00
Average volume per session	3,721,539	5,624,588
Average number of transactions per session	1,373	2,431
Average spread [pb]	22	20
Value of turnover [M PLN]	18.45	2.83
Volume	3,027	204

Source: Statistical Bulletin of GPW

The figures below present the quotes of Company shares and value of turnover in 2011 as well as quotes of Company shares as compared to WIG20 index and WIG-Energia index in 2011.

Figure No. 19 Company's share price and turnover value in 2011

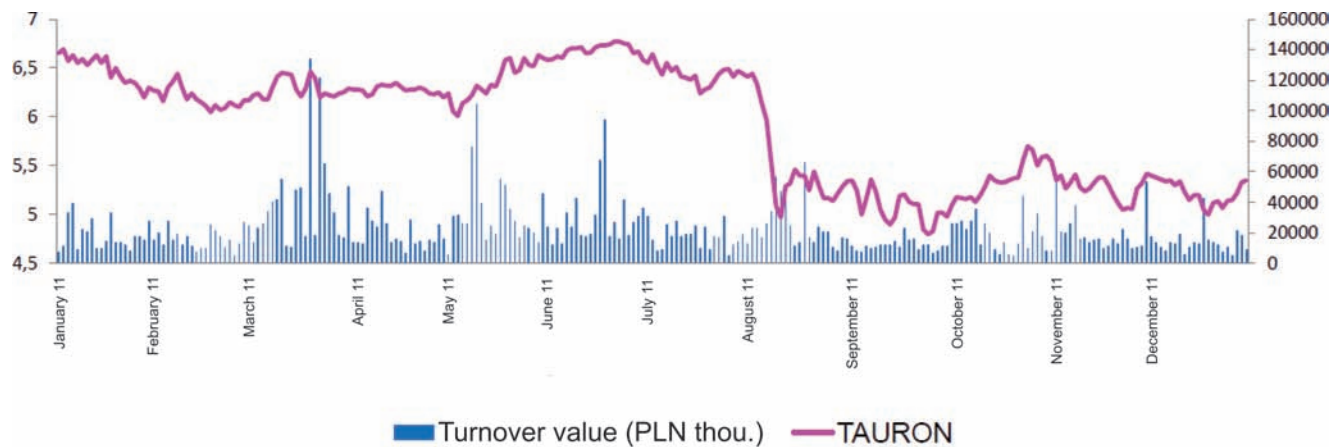


Figure No. 20 Company's share price vs. WIG20 and WIG-Energia indices in 2011



Recommendations for Company shares

In 2011 the analysts of brokerage houses and investment banks issued in total 24 recommendations for the Company shares, including:

- 13 "buy" recommendations,
- 10 "hold" recommendations,
- 1 "sell" recommendation.

5. STATEMENT OF APPLICATION OF CORPORATE GOVERNANCE

Pursuant to § 91 item 5 point 4) of the Regulation of the Minister of Finance of 19 February 2009 on current and periodical information submitted by issuers of securities and conditions to acknowledge as equivalent information required by legal regulations of a country not being a member state (Journal of Laws No. 33 item 259 as amended), The Company Management Board submits the Statement of Application of Corporate Governance in 2011.

5.1. Indicating the applied set of rules of corporate governance

The Company is subject to rules of corporate governance described in the document *Good Practices of Companies Listed at GPW* (Corporate Governance Regulations), constituting Attachment to the Resolution No. 20/1287/2011 of the Stock Exchange Board of 19 October 2011. The document contains rules of corporate governance which the Company undertook to follow on voluntary basis.

Good Practices of Companies Listed at GPW were adopted for application by the Company Management Board. All recommendations, effective for the specific period, were fulfilled in the financial year 2011.

The text of the aforementioned set of rules the Company is subject to, the application of which could have been decided by the Company on voluntary basis is published at the GPW website at (<http://www.corp-gov.gpw.pl>).

5.2. Indicating abandoned rules of corporate governance

The Company adopted all regulations of corporate governance resulting from *Good Practices of Companies Listed at GPW*. In the period since the day of commencement of public listing of the Company shares there have been no occurrences of infringement of the corporate governance regulations adopted.

5.3. Description of main characteristics of internal control and risk management systems in relation to the process of generating the financial statements and consolidated financial statements

The internal control and risk management system in relation to the process of generating financial statements and consolidated financial statements is implemented by the Company through:

Supervision over application of coherent accounting principles by the companies of TAURON Capital Group which generating the consolidated financial statement of TAURON Capital Group

In order to provide for coherent accounting principles based on IFRS, approved by the EU, in TAURON Capital Group *the Accounting Policy of TAURON Polska Energia S.A. TAURON Capital Group* was developed and implemented. The document is subject to relevant amendments and updates in case of amendments to the regulations. The rules contained in the document are applicable to unit financial statements of the Company and consolidated financial statement of TAURON Capital Group. The Companies of TAURON Capital Group are obliged to apply *the Accounting Policy of TAURON Polska Energia S.A. TAURON Capital Group* while preparing the reporting packages which provide basis for generating of the consolidated financial statement of TAURON Capital Group.

The reporting packages are verified by the Office for Consolidation and Reporting in the parent company as well as by the independent auditor during examination or review of consolidated financial statements of TAURON Capital Group.

Procedures of authorisation and reviewing of financial statements of the Company and consolidated financial statements of TAURON Capital Group

In the Company, procedures of authorisation of financial statements have been implemented. Quarterly, semi-annual and annual financial statements of the Company as well as consolidated financial statements of TAURON Capital Group are approved by the Company Management Board before publication. Annual financial statements of the Company as well as consolidated financial statements of TAURON Capital Group are also presented for review by the Company Supervisory Board before publication. The Vice President of the Board, Chief Financial Officer supervises the preparation of financial statements, whereas Management Boards of companies covered by consolidation are responsible for reporting packages for TAURON Group consolidated financial statement.

Within the structure of the Supervisory Board of the Company, the Audit Committee of TAURON Polska Energia S.A. operates (Audit Committee) whose composition, competence and description of activities are covered in item 5.11.3 of this report.

IT systems

The Company keeps accounting books which constitute the basis for generating of the financial statement in the financial-accounting computer system SAP, implemented in the Company in the middle of 2011. Preparing of the consolidated financial statement takes place with application of IT tool designed for consolidation of financial statements. Access to IT systems is restricted by relevant authorisations for the entitled employees. In the Company IT and organizational solutions operate which control the access to financial-accounting systems and provide adequate protection and archiving of accounting books.

Internal audit

In the Company Internal Audit Department operates whose objective is to plan and implement the auditing tasks, among others, of advisory nature, as well as to perform the commissioned temporary inspections. The procedures and rules of implementation of the audit are specified in *Regulations of Internal audit in TAURON Group* as well as in rules of cooperation binding in individual companies of TAURON Capital Group. While implementing the function of internal audit, the Company acts in compliance with the Code of Ethics and International Standards of Internal Audit Professional Practice.

Submission of financial statements of the Company and consolidated statements of TAURON Capital Group for examination or review by independent chartered accountant

Annual financial statements of the Company and consolidated statements of TAURON Capital Group are subject to examination by independent chartered accountant. Semi-annual financial statements of the Company and consolidated statements of TAURON Capital Group are subject to examination by chartered accountant. In 2010 the Company selected one entity authorised to examine and review financial statements for significant companies of TAURON Capital Group as well as the consolidated financial statement.

5.4. Shareholders holding large blocks of shares

The table below presents shareholders having, as of 31 December 2010 and as of the day of making the present report, to the knowledge of the Company's Management Board, directly or indirectly large blocks of shares of the Company

Table No. 27 Shareholders holding large blocks of shares

Shareholders	Number of shares held	Percentage interest in share capital	Number of votes held	Percentage interest in general number of votes
State Treasury*	526,883,897	30.06%	526,883,897	30.06%
KGHM Polska Miedz S.A.**	182,110,566	10.39%	182,110,566	10.39%
ING Otwarty Fundusz Emerytalny (Open Pension Fund)***	88,742,929	5.06%	88,742,929	5.06%

* In accordance with the shareholder's notification of 29/03/2011.

** In accordance with the shareholder's notification of 23/03/2011.

*** In accordance with the shareholder's notification of 28/12/2011.

5.5. Owners of securities providing special control rights

In the financial year 2011, the Company did not issue securities which would provide special control rights towards to the Company.

5.6. Limitations on performing of the voting right

Limitations on performing the voting right have been included in § 10 of the Company Articles of Association which is available at the Company website <http://www.tauron-pe.pl/>.

The aforementioned limitations on performing of the voting right have been formulated in the following way:

1. The voting right of shareholders holding over 10% of total votes in the Company shall be limited in the way that none of them can perform at the General Meeting more than 10% of the total votes in the Company.
2. Voting right limitation included in point 1 above does not apply to the State Treasury and entities subsidiary to the State Treasury in the period of time in which the State Treasury together with subsidiary entities subsidiary of the State Treasury has a number of the Company's shares entitling to performing at least 25% of total votes in the Company.
3. Shareholders' votes, between which there is a controlling or dependence relationship within the meaning of § 10 of the Articles of Association (Association of Shareholders) are cumulated; in case when the cumulated number of votes exceeds 10% of total votes in the Company, it is subject to reduction. Rules of votes accumulation and reduction have been defined in 6 and 7 below.
4. A shareholder, within the meaning of § 10 of the Articles of Association is every person, including its parent company and subsidiary company, which is entitled directly or indirectly to a voting right at the General Assembly on the basis of any legal title; it also applies to a person who does not hold the Company's shares, and in particular to a user, pledgee, person entitled on the basis of a depositary receipt under regulations of the Act of 29 July 2005 on trading in financial instruments, as well as a person entitled to take part in the General Meeting despite disposal of shares after the date of establishing the right to take part in the General Meeting.

5. A parent company and subsidiary company, for the purposes of § 10 of the Articles of Association, is understood as a person:
 - 1) holding a status of a dominating entrepreneur, dependent entrepreneur or has both the status of a dominating and dependent entrepreneur within the meaning of 16 February 2007 on competition and consumers' protection or,
 - 2) holding the status of a parent company, higher level parent company, subsidiary company, lower level subsidiary company or which has both the status of a parent company (including a parent company of higher status and subsidiary (including a subsidiary company of lower level status or co-subsidiary) within the meaning of Accounting Act of 29 September 1994, or which has (parent company) or one which is under (subsidiary company) decisive influence within the meaning of the Act of 22 September 2006 on transparency of financial relationships between public bodies and public entrepreneurs and on financial transparency of some entrepreneurs, or
 - 3) whose votes resulting from the Company's shares owned directly or indirectly are subject to accumulation with votes of another person or other persons on conditions defined in the Act of 29 July 2005 on public offering and conditions of introducing financial instruments to an organized trading system and on public companies in connection with holding, disposing of or acquiring large blocks of the Company shares.
6. Accumulation of votes is based on aggregating of the number of votes held by particular shareholders of Shareholders' Group.
7. Reduction of votes is based on decreasing the total number of votes in the Company that shareholders, who are a part of Association of Shareholders, are entitled to at the General Meeting to the level of 10% of total votes in the Company. Reduction of votes takes place in accordance with the following rules:
 - 1) number of votes of a shareholder who holds the biggest amount of votes in the Company among all shareholders who are members of Association of Shareholders is subject to being decreased by a number of votes equal to surplus of over 10% total votes in the Company that all shareholders in total are entitled to and who are members of the Association of Shareholders,
 - 2) if, despite the aforementioned reduction, the total number of votes that shareholders who are members of the Association of Shareholders are entitled to exceeds 10% of the total votes in the Company, a further reduction of votes belonging to other shareholders who are members of the Association of Shareholders takes place. Further reduction of particular shareholders' votes takes place in order established on the basis of the amount of votes that particular shareholders who are members of the Association of Shareholders hold (from the highest to the lowest one). Further reduction takes place until the moment when the total number of votes held by shareholders who are members of the Association of Shareholders does not exceed 10% of the total votes in the Company,
 - 3) in each case the shareholder whose voting right has been limited shall have to right to perform at least one vote,
 - 4) limitation on performing the voting right applies also to a shareholder absent at the General Meeting.
8. Each shareholder who is going to take part in the General Meeting, in person or through a proxy is obliged to, without a separate notice stipulated in item 9 below, notify the Management Board or the Chairperson of the General Meeting that she/he holds, directly or indirectly, more than 10% of the total votes in the Company.
9. Notwithstanding the provisions of item 8 above, in order to establish the basis for accumulation and reduction of votes, the Company's shareholder, the Management Board, the Supervisory Board or particular members of these bodies have the right to demand that the Company shareholder provides information whether she/he is a person holding the status of an entity dominating or subordinate towards other shareholder within the meaning of § 10 of the Articles of Association. The aforementioned entitlement includes also the right to demand revealing the number of votes that the Company's shareholder has independently or jointly with other shareholders of the Company.
10. A person who has failed to fulfil or fulfilled the information obligation stipulated in items 8 and 9 above improperly, until the moment of improvement of the information obligation performed improperly shall have the voting right from one share only; performing voting rights from other shares by such a person shall be null and void.

5.7. Limitations on transfer of securities proprietary rights

As of 31 December 2011 and on the day of this report, there are no limitations in the Company on the transfer of proprietary rights of Company securities.

5.8. Rules on appointing and dismissing managing and supervising persons and their rights

5.8.1. Management Board

Rules on appointing and dismissing members of the Management Board

The Management Board of the Company consists of one to six persons, including the President and Vice-Presidents. Members of the Management Board are appointed for the period of a joint term of office which lasts three years, except for the first term of office which is two years.

Members of the Management Board or the whole Management Board are appointed and dismissed by the Supervisory Board. Each of the members of the Management Board can be dismissed or suspended in office by the Supervisory Board or the General Meeting.

Competence of the Management Board

The Management Board conducts the Company's issues and represents the Company in all judicial and non-judicial proceedings. All issues connected with managing of the Company not restricted by the regulations of law and provisions of the Company Articles of Associations for the General Meeting or Supervisory Board lie within the competences of the Company's Management Board.

In accordance with the Company Articles of Association, all issues which exceed the regular scope of Company activities require resolution of the Management Board, in particular the following issues:

- 1) Management Board bylaws,
- 2) organizational regulations of the Company enterprise,
- 3) establishment and liquidation of branches,
- 4) appointment of a proxy,
- 5) raising credits and loans,
- 6) accepting annual material and financial plans as well as long-term plans and Company strategy,
- 7) incurring contingent liabilities within the meaning of the Act of 29 September 1994 *on Accounting*, including granting guaranties and sureties by the Company as well as issuing bills of exchange, of the value not exceeding the equivalent of EUR 5,000,000 in PLN,
- 8) making donations, cancelling interest or releasing from debt,
- 9) purchase of real property, perpetual usufruct of shares in property or in perpetual usufruct with the value not exceeding the equivalent of EUR 5,000,000 in PLN,
- 10) purchase of the components of fixed assets excluding real property, perpetual usufruct or share in property or perpetual usufruct with the value equal to or exceeding the equivalent of EUR 10,000 in PLN, but not exceeding the equivalent of EUR 5,000,000 in PLN,
- 11) disposal of the components of fixed assets including real property, perpetual usufruct or share in property or perpetual usufruct with the value equal to or exceeding the equivalent of EUR 10,000 in PLN, but not exceeding the equivalent of EUR 5,000,000 in PLN,
- 12) defining the right to perform a vote at the General Meeting or at Shareholders' Meetings of companies in which the Company holds stocks or shares, on issues being the competences of the General Meetings or Shareholders' Meetings of these companies, except for defining the way of performing the right to vote at the General Meeting or at the Shareholders' Meeting of companies in which the Company holds over 50% of stocks or shares in matters concerning:
 - a) disposing and leasing of the Company's enterprise or its organized part as well as establishing a limited proprietary right on them, if their value exceeds the equivalent of the amount of EUR 5,000,000 in PLN,
 - b) dissolution and liquidation of the Company,
- 13) rules of conducting sponsoring activity,
- 14) adoption of the annual plan of sponsoring activity,
- 15) issues, whose examination the Management Board refers to the Supervisory Board or the General Meeting.

5.8.2. Supervisory Board

Rules on appointing and dismissing members of the Supervisory Board

The Supervisory Board consists of five to nine persons, appointed for the joint term of office which is three years, except for the first term of office which is for one year. In accordance with the Company's Articles of Association, members of the Supervisory Board are appointed and dismissed by the General Meeting, subject to: In accordance with the Company Articles of Association, members of the Supervisory Board are appointed and dismissed by the General Meeting, z subject to:

- 1) in the period, in which the State Treasury, together with entities dependent on the State Treasury 4 within the meaning of § 10 item 5 of the Articles of Association, has a number of shares of the Company entitling to perform at least 25% of the total votes in the Company, the State Treasury is represented by the minister competent for the issues of the State Treasury, is entitled to appoint and dismiss the members of the Supervisory Board in the amount equal to half of the maximum number of the composition of the Supervisory Board defined in the Articles of Association (in case when the number is not integral it is rounded down to an integral number, for example 4.5 is rounded down to 4 increased by 1, provided that the State Treasury:
 - a) is obliged to vote at the General Meeting on establishing the number of members in the Supervisory Board representing the maximum number of members of the Supervisory Board defined in the Articles of Association or in case of submitting

such a motion to the Management Board by a shareholder or shareholders who have a number of votes entitling to perform at least 5% of the total votes in the Company,

- b) is excluded from the voting right at the General Meeting on appointing and dismissing of other members of the Supervisory Board, including independent members of the Supervisory Board; it does not, however, apply to the case when the Supervisory Board cannot act due to a composition minor than required by the Articles of Association, and the shareholders present at the General Meeting other than the State Treasury do not supplement the composition of the Supervisory Board in accordance with the distribution of places in the Supervisory Board defined in present point;
- 2) in the period of time in which the State Treasury, together with entities dependent on the State Treasury within the meaning of § 10 item 5 of the Articles of Association, has a number of the Company's shares entitling to perform under 25% of total voting rights in the Company, the State Treasury, represented by a minister competent for the issues of the State Treasury shall be entitled to appoint and dismiss one member of the Supervisory Board.
- 3) appointing and dismissing of members of the Supervisory Board by the State Treasury pursuant to the aforementioned item 1) or item 2) takes place by means of a statement submitted to the Company.

At least two members of the Supervisory Board shall meet the criteria of independence in relation to the Company and subsidiaries significantly related to the Company (independent members of the Supervisory Board). The definition of an "independent member of the Supervisory Board" shall mean an independent member of the Supervisory Board within the meaning the Recommendation of the European Commission of 15 February 2005, on the role of non-executive directors or directors not being members of Supervisory Boards of listed companies and board's committee (supervising board) (2005/162/EC) taking into consideration Good Practices of Companies Listed at GPW.

Independent members of the Supervisory Board provide the Company, before being appointed to the composition of the Supervisory Board, with a written statement of having fulfilled the prerequisites of independence. In case of a situation causing failure to fulfil the of independence, a member of the Supervisory Board is required to immediately notify the Company of this fact. The Company shall inform shareholders of the present number of independent members of the Supervisory Board.

Competence of the Supervisory Board

The Supervisory Board carries out continuous supervision over the Company's activities in all areas of its operations. The competences of the Supervisory Board include:

- 1) assessment of the Management Board report on the Company operations as well of the financial statement for the previous financial year in the scope of their compliance with the books, documents as well as with the actual status. It also applies to the consolidated financial statement of the Capital Group, provided that it is generated,
- 2) assessment of the Management Board conclusions on profit distribution or loss coverage,
- 3) submitting of a written report to the General Meeting on the results of operations covered by items 1 and 2,
- 4) preparing of reports of the Supervisory Board on supervision of implementation of investments by the Management Board, including the purchase of fixed assets, and in particular, giving opinions on the correctness and effectiveness of spending of financial resources related to the above expenditures,
- 5) preparing, together with the report on results of the annual financial statement of the Company, an opinion of the Supervisory Board on the issue of economic legitimacy of involving the Company capital committed in a given financial year in other entities of commercial law,
- 6) selecting of the chartered accountant to carry out the examination of the Company financial statement and consolidated financial statement of the Capital Group,
- 7) determining the scope and deadlines of submitting of annual material and financial plans as well as long-term strategic plans, by the Management Board,
- 8) giving opinions on long-term plans and strategies of the Company and Capital Group,
- 9) giving opinions and approval of the rules of conducting sponsoring activity,
- 10) giving opinions on the annual plan of conducting of the sponsoring activity as well as quarterly reports on its implementation,
- 11) passing of bylaws describing in details the procedures of performance of the Supervisory Board,
- 12) adopting of consolidated text of the Company Articles of Association, prepared by the Company's Management Board,
- 13) approving of the bylaws of the Company Management Board,
- 14) approving of the organizational regulations of the Company enterprise.

Competence of the Supervisory Board includes also granting the Management Board permission to:

- 1) purchase of property, perpetual usufruct of shares in property or in perpetual usufruct with the value not exceeding the equivalent of EUR 5,000,000 in PLN,
- 2) purchase of the components of fixed assets excluding real property, perpetual usufruct or share in real property or perpetual usufruct, bonds issued by the companies of the Capital Group of the value equal to or exceeding the equivalent of EUR 5,000,000 in PLN,
- 3) dispose of the components of fixed assets including real property, perpetual usufruct or share in real property or perpetual usufruct, of the value equal to or exceeding the equivalent of EUR 5,000,000 in PLN,
- 4) incur contingent liabilities, including granting guaranties and sureties by the Company with the value exceeding the equivalent of EUR 5,000,000 in PLN,
- 5) issuing bills of exchange of the value exceeding the equivalent of EUR 5,000,000 in PLN,
- 6) advance payment on account of the expected dividend
- 7) taking over or purchase of stocks or shares in other companies, with the value exceeding the equivalent of EUR 5,000,000 in PLN, except for situations when taking over of stocks or shares of these companies takes place in exchange for the Company liabilities as a part of composition or bankruptcy proceedings,
- 8) disposal of stocks or shares, with the value exceeding the amount of EUR 5,000,000 in PLN, with defining of the conditions and procedure of their disposal, except for:
 - a) disposal of shares which are traded on the regulated market,
 - b) disposal of stocks or shares that the Company holds at the amount not exceeding 10% interest in the share capital of particular companies.

Moreover, competence of the Supervisory Board includes in particular:

- 1) appointing and dismissing members of the Management Board,
- 2) establishing the rules of remuneration and the amount of remuneration for the members of the Management Board,
- 3) suspending members of the Management Board in performance of their duties, due to material reasons,
- 4) delegating members of the Supervisory Board to temporarily perform actions of the members of the Management Board who cannot perform their duties and establishing their remuneration subject to the provision that the total remuneration of the person delegated as the Supervisory Board's member as well as on account of being delegated to temporary performing actions of a member of the Management Board shall not exceed the remuneration established for the member of the Management Board, for whom the member of the Supervisory Board was delegated,
- 5) conducting recruitment proceedings for the position of a member of the Management Board,
- 6) conducting of a competition in order to select a person with whom an agreement to perform management in the Company shall be concluded,
- 7) granting permission to establish Company branches abroad,
- 8) granting permission to the members of the Management Board to take positions in governing bodies of other companies,
- 9) defining the way of performing the right of vote at the General Meeting or at the Shareholders' Meeting of companies in which the Company holds over 50% of stocks or shares, in matters concerning:
 - a) disposal and leasing of the Company enterprise or its organized part as well as establishing a limited proprietary right on them, if their value exceeds the equivalent of the amount of EUR 5,000,000 in PLN,
 - b) dissolving and liquidation of the Company.

5.9. Description of the procedure of amendment of the Company Articles of Association

Change of the Company's Articles of Association takes place by means of resolution of the General Meeting, at the majority of two thirds of the votes, under the presence of persons representing at least half of the capital, and then requires issuing a decision by a proper court on entering the change into the Register of Entrepreneurs. A consolidated text of the Company Articles of Association, including amendments passed by the General Meeting, shall be adopted by the Supervisory Board by means of a resolution.

5.10. Way of operating of the General Meeting, its fundamental authorities and description of shareholders' rights and mode of their performance

The way of operating of the Company General Meeting and its authorities are included in the Company Articles of Association and in the *Regulations of the General Meeting of TAURON Polska Energia S.A.* which are available at the Company website <http://www.tauron-pe.pl/>.

Way of operating of the General Meeting

The General Meeting is convened by announcement on the Company website and in the manner defined for providing current information by public companies. In case if the General Meeting is convened by an entity or body other than the Management Board on the basis of regulations of the Act of 15 September 2000 Code of Commercial Companies, and the convening of the General Meeting requires cooperation with the Management Board, the Management Board is obliged to perform all actions defined by law regulations in order to convene, organize and conduct the General Meeting. General Meetings take place either in the Company's seat or in Warsaw.

The General Meeting is opened by the Chairperson of the Supervisory Board, and in case of his/her absence to open the General Meeting shall be authorized the following persons in the following order: Vice-Chairperson of the Supervisory Board, President of the Management Board, a person appointed by the Management Board or a shareholder who registered at the General Meeting shares entitling him/her to perform the biggest number of votes. Then, among the persons entitled to take part in the General Meeting the Chairperson of the Meeting is selected.

The General Meeting shall pass resolutions irrespective of the number of shares represented at the Meeting, unless regulations of the Act of 15 September 2000 *Code of Commercial Companies* as well as provisions of the Company's Articles of Association shall state otherwise. The General Meeting may order a break in the meeting by the majority of two thirds of votes. In total, the breaks shall not exceed thirty days.

Competence of General Meeting

The following issues require Resolutions of the General Meeting:

- 1) examination and approval of financial statement for the previous financial year as well as the Management Board's report on the Company operations,
- 2) granting the acknowledgement of the fulfilment of duties to the members of the governing bodies of the Company,
- 3) profit distribution and coverage of loss,
- 4) appointing and dismissing of members of the Supervisory Board,
- 5) suspending members of the Management Board in performance of their duties,
- 6) establishing the amount of remuneration for the Members of the Supervisory Board, subject to the provision that members of the Supervisory Board are entitled to a monthly remuneration in the amount determined by the General Meeting, taking into consideration the binding legal regulations,
- 7) disposal and lease of the Company enterprise or its organized part as well as establishing a limited proprietary right on them,
- 8) concluding of a credit, loan, surety agreement or any other similar agreement by the Company with a member of the Management Board, Supervisory Board, proxy and liquidator or for any of these persons. Concluding of a loan, surety or any other similar agreement with a member of the Management Board, Supervisory Board, proxy, liquidator or for any by a subsidiary company,
- 9) increasing and lowering the share capital of the Company,
- 10) issuing convertible bonds or priority bonds as well as registered securities or bearer securities entitling its owner to subscribe or acquire the shares,
- 11) purchasing of treasury shares in cases required by the regulations of the Act of 15 September 2000, *Code of Commercial Companies*,
- 12) compulsory redemption of shares in accordance with the stipulations of art. 418 of the Act of 15 September 2000, *Code of Commercial Companies*,
- 13) creating, using and liquidation of reserve capitals,
- 14) using of supplementary capital,
- 15) provisions concerning claims to repair damage caused at establishing of the company or serving in the board or performing supervision,
- 16) merger, transformation and division of the Company,
- 17) redemption of shares,
- 18) amendment to the Articles of Association and change of the scope of the Company operations,
- 19) dissolving and liquidation of the Company.

In accordance with the Act of 15 September 2000, *Code of Commercial Companies*, issuing and redemption of shares lies within the competence of the General Meeting.

Description of shareholders' rights and mode of their execution

A shareholder or shareholders representing at least one twentieth of the share capital, may demand convening of the Extraordinary General Meeting. Such a demand shall include its concise justification. It can be submitted to the Management Board in writing or send in electronic form, to the Company e-mail address, indicated by the Company on its website in "Investor Relations" tab. The Company reserves the right to undertake appropriate steps to identify the Shareholder of Shareholders who request a demand.

The Shareholder or Shareholders representing at least half of the share capital or half of total votes in the Company may convene the Extraordinary General Meeting. The shareholder or shareholders shall appoint the Chairperson of such a General Meeting.

A shareholder or shareholders representing at least one twentieth of the share capital may demand including certain issues on the agenda of the nearest General Meeting. Such a demand, including a justification or a draft of resolution on the proposed point of agenda shall be submitted to the Management Board not later than 21 days before the given date of the General Meeting. Such a demand may be submitted in electronic form to the Company' e-mail address, or in writing to the Company address.

A shareholder or shareholders representing at least one twentieth of the share capital may, before the date of the General Meeting, submit drafts of resolutions on issues included on the agenda of the General Meeting or issues which are to be introduced into the agenda. Such a request can be made in electronic form to the e-mail address of the Company or in writing to the Company address.

The shareholder may become acquainted with the Shareholders' list in the Company's Management Board seat for three days preceding directly the General Meeting. The shareholder may demand sending him/her the list of Shareholders free of charge by electronic mail, providing address to which the list shall be sent. Such a demand may be submitted in electronic form to the Company e-mail address.

The right to take part in the General Meeting shall be given only to persons who are Shareholders sixteen days before the date of the General Meeting (registration date of participation in the General Meeting). In order to participate in the General Meeting such Shareholders should report the investment company holding their securities account a request to issue a certificate with their name on the right to take part in the General Meeting. Such a request shall be submitted not earlier than a day after the announcement on convening of the General Meeting and not later than on the first working day after the day of registering participation in the General Meeting.

The shareholder may take part in the General Meeting as well as perform the voting right in person or through a proxy. Persons co-authorized by means of shares may take part in the General Meeting and perform the voting right only through a joint representative (proxy). The proxy may represent more than one Shareholder and vote differently based on shares of each Shareholder.

Shareholders shall appoint the Chairperson the General Meeting. The Chairperson shall be selected among persons entitled to take part in the General Meeting. Each of the members of the General Meeting shall have the right to submit one candidacy to the post of the Chairperson. Persons, whose candidacies are submitted, shall be put on the list of candidates on condition that they agree to candidate. The election of the Chairperson takes place by secret voting, with an absolute majority of votes. In case when there is just one candidate to the Chairperson, the election can take place by acclamation.

Each Shareholder shall submit no more than three candidates to the member of Returning Committee, selected by the General Meeting and vote for maximum three candidates.

During the General Meeting the Shareholder shall have the right, until closing the discussion on a certain point of the agenda, to submit a proposal of changes to the content of a draft of resolution proposed for adoption by the General Meeting within a given item of the agenda or to put forward his/her draft of such a resolution. The proposal of changes or a new draft of the resolution shall be submitted with their justification. The proposal of changes or a draft of the resolution may be submitted to the Chairperson or orally to the minutes of the meeting.

The shareholder who was voting against a resolution, and after its adoption by the General Meeting wants to raise his/her objection shall immediately after passing this resolution (after the announcement of results of voting) raise his/her objection and demand its including in the minutes before proceeding to the next item of the agenda. In case of a later raising of objection, which however shall not take place later than until closing the General Meeting, the Shareholder shall indicate to which resolution passed at this General Meeting she/he is raising his/her objection. The shareholder raising his/her objection to the General Meeting's resolution may submit to the minutes of the General Meeting a concise justification of the objection.

5.11. Composition of managing and supervising bodies and their committees, its changes, description of performance

5.11.1. Management Board

The present, Third term of office of the Management Board, started on 6 May 2011, i.e. on the day of convening of the General Meeting of the Company approving the financial statement for the last full financial year of the tenure of the members of the Management Board of the second term, i.e for the year 2010. In accordance with the Company Articles of Association this is a joint term of office and it shall last for three years.

Personal composition of the Management Board as of 31 December 2011 and on the day of this report:

1. Dariusz Lubera – President of the Board
2. Joanna Schmid – Vice President of the Board, Chief Strategy and Business Development Officer
3. Dariusz Stolarczyk – Vice President of the Board, Chief Officer for Corporate Matters
4. Krzysztof Zamasz – Vice President of the Board, Chief Commercial Officer
5. Krzysztof Zawadzki – Vice President of the Board, Chief Financial Officer.

Changes in the Management Board composition:

In the period covered by the present report, no changes in the composition of the Management Board of the Company took place.

Due to the end of the 2nd term of the Management Board, on 24 February 2011, the Supervisory Board of the Company, as a result of the completed qualification procedure, passed resolutions on the appointment of members of the Management Board of the Company for the third term, becoming effective from the date of Ordinary General Meeting approving the financial statements for the last full financial year of the tenure of the members of the Management Board of the second term, i.e. for the financial year 2010. Information on appointment of the Management Board of the Company for the new term is also included in item 2.6 of this report.

Mode of operation

The Management Board of the Company operates on the basis of the Act of 15 September 2000 Code of Commercial Companies and other regulations of law, stipulations of the Company Articles of Association and provisions of the Bylaws of the Management Board of TAURON Polska Energia Spółka Akcyjna, which is available at the website of the Company <http://www.tauron-pe.pl/>. While performing their obligations the members of the Management Board are governed by regulations included in the Good Practices of Companies Listed at the WSE.

Cooperation of two members of the Management Board or one member of the Management Board together with a proxy is required for submitting statements on behalf of the Company. Should the Management Board be single person, one member of the Management Board or a proxy shall be entitled to submit statements on behalf of the Company.

Meetings of the Management Board are convened by the President of the Management Board or a Vice-President of the Management Board appointed by him/her. Meetings of the Management Board are also convened upon the motion of the majority of Vice-Presidents of the Company as well as upon the motion of the Chairperson of the Supervisory Board. The meetings take place in the Company's seat, on the date set by the person convening the meeting. In justified cases, the Management Board's meetings may take place outside the seat of the Company. President of the Management Board or a Vice-President appointed by him/her shall chair the meeting.

The Management Board votes in an open voting. The result of voting is recorded in the minutes of the meeting. The President of the Management Board orders a secret ballot upon the request of any member of the Management Board.

Resolutions of the Management Board are passed by an absolute majority of votes in the presence of 3/5 of the composition of the members of the Management Board. The Management Board may pass resolutions in a written mode or by using means of direct remote communication. Voting in the aforementioned modes is ordered by the President of the Management Board or the Vice-President appointed by him/her, defining the deadline to vote by the members of the Management Board. It is acceptable to submit a different opinion. It shall be recorded in the minutes together with justification. Decisions of the Management Board, regulating business as usual, not requiring a resolution, are recorded only in the minutes.

Under the circumstances when the number of Vice-Presidents of the Management Board is lower than the Divisions, the Vice-Presidents of the Management Board may join the capacity of directors of two divisions, or distribute the competence in any other way which would be in compliance with the distribution of responsibilities performed by the Supervisory Board.

In 2011, the Supervisory Board approved amendments to the Bylaws of the Management Board within which, among others, the hitherto names of positions of the members of the Management Board were changed, holding the following positions:

- 1) President of the Board
- 2) Vice-President of the Management Board for Corporate Matters
- 3) Vice-President of the Management Board, Chief Commercial Officer
- 4) Vice-President of the Management Board, Chief Strategy and Business Development Officer
- 5) Vice-President of the Management Board, Chief Financial Officer.

Scope of activities of the President of the Management Board covers competence in the area of operations of business units reporting to the Division of the President of the Board, in accordance with the organisational structure of the Company.

Scope of activities of the Vice-Presidents of the Management Board covers competence in the area of operations of business units reporting to the Divisions of the Vice-Presidents of the Board, in accordance with the organisational structure of the Company.

The structure of the divisions reporting to individual members of the Management Board is specified in the organisational chart of the Company, presented in item 1.3.2 of this report.

5.11.2. Supervisory Board

The present, Third term of office of the Supervisory Board, started on 6 May 2011, i.e. on the day of convening of the General Meeting of the Company approving the financial statement for the last full financial year of the tenure of the members of the Supervisory Board of the second term, i.e. for the year 2010. In accordance with the Company Articles of Association this is a joint term of office and it shall last for three years.

Personal composition of the Supervisory Board as of 31 December 2011 and on the day of this report:

1. Antoni Tajduś – Chairman of the Supervisory Board
2. Agnieszka Trzaskalska – Deputy Chairman of the Supervisory Board
3. Leszek Koziorowski – Secretary of the Supervisory Board
4. Jacek Kuciński – Member of the Supervisory Board
5. Włodzimierz Luty – Member of the Supervisory Board
6. Michał Michalewski – Member of the Supervisory Board
7. Jacek Szyke – Member of the Supervisory Board
8. Marek Ściążko – Member of the Supervisory Board

Changes in the Management Board composition:

In 2011, no changes in the personal composition of the Supervisory Board of the Company occurred.

Due to expiry of the term of the Supervisory Board on 6 May 2011, the Supervisory Board of the Company was appointed with the same personal composition. Information on appointment of the Supervisory Board of the Company for the new term is also included in item 2.6 of this report.

Personal composition of the Supervisory Board as of the day of this report:

Pursuant to personal authority of the State Treasury resulting from the Articles of Association of the Company, on 11 January 2012, the Member of the Supervisory Board, Michał Michalewski, was dismissed by the State Treasury, who had been appointed to the Supervisory Board as its Member on 6 October 2008.

As of 11 January 2012, Rafał Wardziński was appointed as the Member of the Supervisory Board for the Third Joint Term Pursuant to personal authority of the State Treasury resulting from the Articles of Association of the Company.

On 2 February 2012, the Supervisory Board introduced changes within the function of Vice Chairman of the Supervisory Board, replacing Agnieszka Trzaskalska, acting in this capacity so far, by Rafał Wardziński.

The personal composition of the Supervisory Board as of the day of this report was as follows:

1. Antoni Tajduś – Chairman of the Supervisory Board
2. Rafał Wardziński – Deputy Chairman of the Supervisory Board
3. Leszek Koziorowski – Secretary of the Supervisory Board
4. Jacek Kuciński – Member of the Supervisory Board
5. Włodzimierz Luty – Member of the Supervisory Board
6. Jacek Szyke – Member of the Supervisory Board
7. Marek Ściążko – Member of the Supervisory Board
8. Agnieszka Trzaskalska – Member of the Supervisory Board

Mode of operation

A detailed description of the mode of the Supervisory Board operation is included in the Company Articles of Association, By-laws of the Supervisory Board of TAURON Polska Energia S.A., which is available on the Company website <http://www.tauron-pe.pl/> as well as in the Act of 15 September 2000, Code of Commercial Companies.

The main form of performing supervision by the Supervisory Board over the Company's operations are meetings of the Supervisory Board. The Supervisory Board performs its obligations jointly. Meetings of the Supervisory Board are convened by the Chairperson of the Supervisory Board or Vice-Chairperson of the Supervisory Board by presenting a detailed agenda:

- 1) in accordance with decisions adopted by the Supervisory Board,
- 2) on his/her own initiative,
- 3) upon a written proposal of each member of the Supervisory Board,
- 4) upon a written proposal of the Management Board.

Meetings of the Supervisory Board take place in the Company's seat. In justified cases the venue of the meeting may be changed.

In order to convene a meeting, written invitation of all members of the Supervisory Board at least 7 days before the date of the Supervisory Board's meeting is required. Due to material reasons the Chairperson of the Supervisory Board may shorten this period to 2 days, defining the mode of giving the invitation. Notifications of the Supervisory Board meeting are sent by means of fax or electronic mail and are confirmed by phone. In the notification of the Supervisory Board meeting the Chairperson defines the date of the meeting, venue of the meeting as well as detailed draft of the agenda. The Supervisory Board shall meet when the need arises, however not less frequently than once every two months. The Supervisory Board may meet without convening a formal meeting if all members of the Supervisory Board are present and nobody appeals against the fact of holding the meeting or against the agenda.

A change of the proposed agenda may take place when all members of the Supervisory Board are present at the meeting and nobody appeals against the agenda. An issue not included on the agenda shall be included into the agenda of the next meeting.

Taking part in meetings of the Supervisory Board is the Supervisory Board Member's duty. A Member of the Supervisory Board shall give reasons of his/her absence in writing. Justification of the Supervisory Board Member's absence requires the Supervisory Board resolution. Members of the Management Board of the Company may take part in the Supervisory Board's meetings unless the Supervisory Board raises an objection. Participation of the Management Board members in the Supervisory Board meetings is compulsory if they were invited by the Chairperson of the Supervisory Board. Other persons may also take part in the meetings if they were invited in the above mentioned way.

The Supervisory Board may seek opinion of legal advisers who render regular legal advice for the Company, as well as, in justified cases, it may appoint and invite to meetings of the Supervisory Board appropriate experts in order to ask their advice and make an appropriate decision.

In the aforementioned cases the Supervisory Board shall pass a resolution concerning commissioning the work to a chosen expert (audit or consulting company) obliging the Company's Management Board to conclude an appropriate agreement.

Meetings of the Supervisory Board shall be chaired by the Chairperson of the Supervisory Board, and in the case of his/her absence by the Vice-Chairperson. Due to material reasons, with the consent of the majority of the members of the Supervisory Board present at the meeting, the person chairing the meeting is obliged to submit to voting a motion to stop the meeting and establish a new date of resuming the Supervisory Board meeting. The Supervisory Board makes decisions in the form of resolutions. The Supervisory Board resolutions are passed mainly at the meetings. The Supervisory Board passes resolutions if at least half of its members are present at the meeting and all its members were invited in the way defined in the Regulations. Subject to absolutely binding regulations of law, including the Act of 15 September 2000, *Code of Commercial Companies* as well as provisions of the Company's Articles of Association, the Supervisory Board passes resolutions by an absolute majority of votes of the persons present at the meeting, where the absolute majority of votes is understood as more votes submitted "for" than "against" and "abstain". Resolutions cannot be passed in issues not included in the agenda unless all members of the Supervisory Board are present and nobody voices an objection. It shall not apply to resolutions on justifying the Supervisory Board's member absence at the meeting. Voting of the resolutions is open. A secret ballot is ordered:

- 1) upon the request of at least one of the members of the Supervisory Board,
- 2) in personnel-related issues

The Supervisory Board, in accordance with the Articles of Association, may pass resolutions in writing or by using means of direct remote communication. Passing a resolution in such a mode requires a justification and a prior submitting of the draft of the resolution to all members of the Supervisory Board. Passing resolutions in this mode does not apply to the appointing the Chairperson, the Vice-Chairperson and the Secretary of the Board, appointing or suspending in the activities of a member of the Supervisory Board and dismissing these persons as well as other issues the settlement of which requires a secret voting. Voting on a resolution passed in the aforementioned mode, a member of the Supervisory Board indicates the mode of his/her voting, "for", "against" or "abstain". In case of failure to express the vote by a Member of the Supervisory Board in the time period defined by the Chairperson the resolution shall not be passed. Resolution with a note that it was passed in a written mode or by mode of voting using means of direct distance communication shall be signed by the Chairperson of the Supervisory Board. Resolutions passed in this mode shall be submitted at the first coming meeting of the Supervisory Board with announcing the result of the voting.

Members of the Supervisory Board shall take part in meetings and perform their duties in person, and while performing their duties they are obliged to exercise due diligence. Members of the Supervisory Board are obliged to keep information connected with the Company activity which they have acquired in connection with holding their seat or at other occasion secret. The Supervisory Board performs its obligations jointly.

The Supervisory Board may, due to material reasons, delegate particular members to perform certain actions independently for a defined period of time. The Supervisory Board may delegate its members, for a period not longer than three months, to temporarily perform duties of the members of the Management Board who have been dismissed, submitted their resignation or if due to other reasons they cannot perform their functions. The aforementioned delegation requires obtaining permission from the member of the Supervisory Board who is to be delegated.

The detailed description of activities of the Supervisory Board in the previous financial year is contained in the Report on Activities of the Supervisory Board, submitted on annual basis to the General Meeting and then published on the Company website <http://www.tauron-pe.pl/>.

The Supervisory Board may appoint among its members permanent or temporary working groups or committees to perform particular actions. The permanent committee of the Supervisory Board include the Audit Committee and Nominations and Remuneration Committee of TAURON Polska Energia S.A. (hereinafter referred to as Nominations and Remuneration Committee). Composition, tasks and rules of operation of the aforementioned committees are defined by regulations passed by the Supervisory Board.

5.11.3. Audit Committee

The Audit Committee was appointed on 13 May 2010 by the Supervisory Board among its members. At the time, the Audit Committee consisted of three Members.

Due to commencement of the Third Term of the Supervisory Board on 6 May 2011 and appointment of the members of the Supervisory Board of the new tenure, the Supervisory Board appointed the Audit Committee of the Supervisory Board, consisting also of three persons.

Personal composition of the Audit Committee as of 31 December 2011

1. Michał Michalewski – Chairman of the Audit Committee,
2. Marek Ściążko – Member of the Audit Committee,
3. Jacek Szyke – Member of the Audit Committee.

Changes in the Audit Committee personal composition:

As of 11 January 2012, Michał Michalewski who had acted in the capacity of the Chairman of the Audit Committee was dismissed from the Supervisory Board. As of 2 February 2012, the Supervisory Board appointed Jacek Kuciński and Włodzimierz Luty, who has been acting as the Chairman of the Audit Committee since 1 March 2012.

Personal composition of the Audit Committee as of the day of this report:

1. Włodzimierz Luty – Chairman of the Audit Committee,
2. Jacek Kuciński – Member of the Audit Committee,
3. Jacek Szyke – Member of the Audit Committee,
4. Marek Ściążko – Member of the Audit Committee.

Mode of operation

A detailed description of the Audit Committee operation is included in Regulations of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.

The Audit Committee is an advisory and opinion-making body acting jointly as a part of the Supervisory Board and it performs a support and advisory function towards the Supervisory Board. The tasks of the Audit Committee are carried out by submitting motions, recommendations, opinions and statements on the scope of its tasks to the Supervisory Board, by means of resolutions passed by the Audit Committee. The Audit Committee is independent from the Company Management Board. The Management Board may not issue binding orders to the Audit Committee concerning performing its duties.

The Audit Committee consists of three to five members. The activities of the Audit Committee are managed by its Chairperson. Meetings of the Audit Committee are convened by the Chairperson of the Audit Committee on his/her own initiative or upon the motion of a member of the Audit Committee or Chairperson of the Supervisory Board.

Meetings of the Audit Committee take place as the need arises, but at least once every quarter. The Chairperson of the Audit Committee may invite members of the Supervisory Board, who are not members of the Audit Committee, members of the Management Board and employees of the Company as well as other persons working or cooperating with the Company, including the chartered auditor to the meetings of the Audit Committee. The Chairperson of the Audit Committee or a person appointed by him/her submits motions, recommendations and reports to the Supervisory Board. Report on the Audit Committee operations shall be submitted to the Supervisory Board at least once every six months.

The Audit Committee passes resolutions if at least half of its members were present at the meeting and all its members have been duly invited. Resolutions of the Audit Committee are passed by an absolute majority of votes present at the meeting, where the absolute majority of votes is understood as more votes given "for" than "against" and "abstain". The Audit Committee may pass resolutions in writing or by using means of direct remote communication.

The Company Management Board shall be informed about recommendations and assessments submitted to the Supervisory Board by the Audit Committee. Every year, the Audit Committee provides public record information, through the Company, on the composition of the Audit Committee, number of meetings held and participation in the meetings during the year as well as on main activities. In particular, the Audit Committee confirms its positive assessment of the independence of financial audit process and submits a short description of steps taken to formulate such a motion.

The tasks of the Audit Committee cover:

- 1) monitoring of financial reporting process;
- 2) monitoring of the accuracy of financial information presented by the Company;
- 3) monitoring of the efficiency of internal control, internal audit and risk management systems existing in the Company;
- 4) monitoring of performing of financial revisions;
- 5) monitoring of independence and objectivity of chartered auditor and entity entitled to examine financial statements, including rendering by them services other than financial audit;
- 6) recommending of an entity entitled to examine financial statements to perform financial audit to the Supervisory Board.

In the financial year 2011, the Audit Committee was dealing, among others, with the following issues

- 1) monitoring and assessment of the efficiency of internal control, internal audit and risk management systems existing in the Company;
- 2) monitoring and assessment of independence of the financial revision process, including the objectivity of the chartered auditor examining unit financial statements of the Company and consolidated financial statements of TAURON Capital Group;
- 3) monitoring of financial reporting process;
- 4) analysis of reliability of financial information presented by the Company in Financial statement of TAURON Polska Energia S.A. in compliance with the International Financial Reporting Standards for the financial year ended on 31 December 2010 and recommendation for the Supervisory Board concerning assessment of the said report in relation to its compliance with the ledgers and documents as well as with the state of affairs;
- 5) analysis of reliability of financial information presented by the Company in Financial statement of TAURON Polska Energia S.A. Capital Group in compliance with the International Financial Reporting Standards for the financial year ended on 31 December 2010 and recommendation for the Supervisory Board concerning assessment of the said report in relation to its compliance with the ledgers and documents as well as with the state of affairs;
- 6) analysis of reliability of financial information provided by the Company in the extended consolidated semi-annual report of TAURON Capital Group for the 1st half of 2011;
- 7) analysis of reliability of financial information provided by the Company in the extended consolidated quarterly reports of TAURON Capital Group for the 1st quarter of 2011 and the 3rd quarter of 2011;

Detailed description of the activities of the Audit Committee in the previous financial year is contained in the Report on activities of the Audit Committee, constituting the attachment to the Report of the Supervisory Board, submitted on annual basis to the General Meeting and published at the Company website <http://www.tauron-pe.pl/>.

5.11.4. Nominations and Remuneration Committee

The Nominations and Remuneration Committee was established on 27 August 2010 by the Supervisory Committee from among its members. At that time, the Nominations and Remuneration Committee Audit Committee consisted of three Members.

Personal composition of The Nominations and Remuneration Committee in the period 1 January 2011 – 30 May 2011

1. Antoni Tajduś – Chairman of the The Nominations and Remuneration Committee
2. Agnieszka Trzaskalska – Member of The Nominations and Remuneration Committee
3. Włodzimierz Luty – Member of The Nominations and Remuneration Committee

Changes in the personal composition of The Nominations and Remuneration Committee

Due to commencement of the Third Term of the Supervisory Board on 6 May 2011 and appointment of the members of the Supervisory Board of the new tenure, the Supervisory Board appointed the Nominations and Remuneration Committee of the Supervisory Board, consisting of four persons.

Personal composition of The Nominations and Remuneration Committee in the period 30 May 2011 – 31 December 2011 and as of the day of this report

1. Antoni Tajduś – Chairman of the Nominations and Remuneration Committee
2. Agnieszka Trzaskalska – Member of The Nominations and Remuneration Committee
3. Włodzimierz Luty – Member of The Nominations and Remuneration Committee
4. Jacek Kuciński – Member of The Nominations and Remuneration Committee

Mode of operation

A detailed description of the Nominations and Remuneration Committee operation is included in *Regulations of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.*

The Nominations and Remuneration Committee is an advisory and opinion-making body acting jointly as a part of the Supervisory Board structure and it performs a support and advisory function towards the Supervisory Board. The tasks of the Nominations and Remuneration Committee are carried out by submitting motions, recommendations, opinions and statements on the scope of its tasks to the Supervisory Board, by means of resolutions passed by the Nominations and Remuneration Committee. The Nominations and Remuneration Committee acts independently from the Management Board of the Company. The Management Board may not give binding orders to the Nominations and Remuneration Committee on performing its duties.

The composition of the Nominations and Remuneration Committee consists of three to five members, including at least one independent member of the Supervisory Board. Activities of the Nominations and Remuneration Committee are managed by the Chairperson.

Meetings of the Nominations and Remuneration Committee are convened by the Chairperson of the Nominations and Remuneration Committee on his/her own initiative or upon the motion of a member of the Nominations and Remuneration Committee or upon the motion of the Chairperson of the Supervisory Board. Meetings of the Nominations and Remuneration Committee take place as the need arises. The Chairperson of the Nominations and Remuneration Committee may invite members of the Supervisory Board, who are not members of the Audit Committee, members of the Management Board and employees of the Company as well as other persons working or cooperating with the Company, including the chartered auditor to the meetings of the Audit Committee. The Chairperson of the Nominations and Remuneration Committee or a person appointed by him/her submits motions, recommendations and reports to the Supervisory Board.

The Nominations and Remuneration Committee passes resolutions, if at least half of its members have been present at the meeting and all its members have been duly invited. The resolutions of the Nominations and Remuneration Committee are adopted by an absolute majority of votes present at the meeting, where the absolute majority of votes is understood as more votes given “for” than “against” and “abstain”. The Nominations and Remuneration Committee may pass resolutions in a written mode or by using means of direct remote communication.

The Company Management Board shall be informed about recommendations and assessments submitted to the Supervisory Board by the Nominations and Remuneration Committee. Every year, the Audit Committee provides public record information, through the Company, on the composition of the Audit Committee, number of meetings held and participation in the meetings during the year as well as on main activities. The Nominations and Remuneration Committee submits to the Supervisory Board a report on its activities in a given financial year.

The tasks of the Nominations and Remuneration Committee include:

- 1) recommendations to the Supervisory Board on a recruitment procedure for the positions of members of the Company Management Board,
- 2) assessing candidates for members of the Management Board as well submitting an opinion in this scope to the Supervisory Board,
- 3) recommendations to the Supervisory Board on the form and contents of agreements concluded with members of the Management Board,
- 4) recommendations to the Supervisory Board on remuneration and bonus system of the members of the Management Board,
- 5) recommendations to the Supervisory Board on the need to suspend a member of the Management Board due to material reasons
- 6) recommendations to the Supervisory Board on the need to delegate a member of the Supervisory Board to temporarily perform the duties of members of the Management Board who cannot perform their duties together with a proposal of remuneration.

The Company Management Board provides the possibility to use the services of external advisers by the Nominations and Remuneration Committee in the scope required for performing the obligations of the Committee.

Detailed description of the activities of the Nominations and Remuneration Committee in the previous financial year is contained in the Report on activities of the Audit Committee, constituting the attachment to the Report of the Supervisory Board, submitted on annual basis to the General Meeting and published at the Company website <http://www.tauron-pe.pl/>.

5.12. Remuneration of key management and supervisory personnel

The total amount of remuneration understood as the value of salaries, awards and benefits received in cash, in kind or in any other form, disbursed by the Company to the Management Board Members for 2011 amounted to PLN 8,443 thousand. As the total amount of remuneration paid or due and awards for 2011, the gross value of remuneration paid or due for the period from January to December 2011 is provided.

The members of the Management Board of the Company are not covered by the incentive or bonus programme based on the capital of the Company, neither do they receive any remuneration or awards due to performance in governing bodies of subsidiaries of TAURON Capital Group.

Table No. 28 Remuneration of members of the Management Board for 2011 (data in PLN thousand)*

Surname and name	Period of holding the position in 2011	Remuneration and awards	Other benefits	Total
Lubera Dariusz	01.01.2011 – 31.12.2011	1,655	200	1,855
Schmid Joanna	01.01.2011 – 31.12.2011	1,238	129	1,367
Stolarczyk Dariusz	01.01.2011 – 31.12.2011	1,575	191	1,766
Zamasz Krzysztof	01.01.2011 – 31.12.2011	1,575	156	1,731
Zawadzki Krzysztof	01.01.2011 – 31.12.2011	1,575	149	1,724
Total		7,618	825	8,443

* No overheads.

Remuneration of members of the Supervisory Board for 2011 is presented in the table below.

Table No. 29 Remuneration of members of the Management Board for 2011 (data in PLN thousand)*

Surname and name	Period of holding the position in 2011	Remuneration and awards	Other benefits	Total
Tajduś Antoni	01.01.2011 – 31.12.2011	127	0	127
Koziorowski Leszek	01.01.2011 – 31.12.2011	104	0	104
Kuciński Jacek	01.01.2011 – 31.12.2011	93	0	93
Luty Włodzimierz	01.01.2011 – 31.12.2011	93	0	93
Michalewski Michał	01.01.2011 – 31.12.2011	93	0	93
Szyke Jacek	01.01.2011 – 31.12.2011	93	0	93
Ściążko Marek	01.01.2011 – 31.12.2011	93	0	93
Trzaskalska Agnieszka	01.01.2011 – 31.12.2011	116	0	116
Total		812	0	812

Members of the Supervisory Board of the Company in 2011 did not receive remuneration or awards from companies of TAURON Capital Group because they had not held any positions in supervisory boards or management boards of these companies.

5.13. Agreements concluded with managing persons which envisage compensation in case of their resignation or dismissal from the position held, without material reason, or if their dismissal or resignation is caused by merger of the Company through takeover

Between the Company and managing persons no agreements were concluded which envisage compensation in case of their resignation or dismissal from the position held, without material reason, or if their dismissal or resignation is caused by merger of the Company through takeover.

6. OTHER SIGNIFICANT INFORMATION AND EVENTS

6.1. Proceedings pending in the court, competent arbitration authority or public authority body

During the reporting period no proceedings were pending in the court, competent arbitration authority or public authority body (related to the Company or subsidiaries of TAURON Capital Group) whose single or aggregate value would exceed 10% of the equity of the Company.

6.2. Important achievements in research and development

Comparing to the European or world competition, TAURON Capital Group is undoubtedly a very young group. However, the first years of its operations occur in the period which is very specific for the European, and particularly, the Polish energy sector. The need for urgent recovery of power in the electric power system on the one hand, and challenges resulting from the Climate Package, make TAURON Capital Group face a very difficult task. In order to tackle this challenge, it has become necessary to develop effective mechanisms of cooperation between TAURON Capital Group and universities as well as research and development centres. This cooperation has resulted in involvement of TAURON Capital Group in scientific and research projects, the results of which should assist TAURON Capital Group in preparing to the forthcoming challenges. Such activities are implemented not only at national level (e.g. participation in projects co-financed by the National Research and Development Centre) but also at international level (e.g. participation in activities of the Knowledge, and Innovation Community KIC InnoEnergy). Below, the most important achievements in the scope of research and development which occurred in 2011 are presented.

In 2011, activities took place, aimed at formal settlement of rules of participation of the Company and its subsidiaries in implementation of projects within the Knowledge, and Innovation Community KIC InnoEnergy. On 8 July 2011, the deed on formation of the company CC Poland Plus sp. z o.o. was signed, whose shareholders, besides the Company, include: the University of Science and Technology (Akademia Górniczo-Hutnicza), The Technical University of Silesia (Politechnika Śląska), The Jagiellonian University (Uniwersytet Jagielloński), The Technical University of Wrocław (Politechnika Wroclawska), the Institute of Chemical Coal Processing (Instytut Chemicznej Przeróbki Węgla), the Central Mining Institute (Główny Instytut Górnictwa), and the European company KIC InnoEnergy SE. The Agreement provided basis for operations of the Polish node (one of six in the EU) of Knowledge, and Innovation Community KIC InnoEnergy, established to conduct research and coordinate activities in the area of the so-called clean coal technologies. These tasks also constitute the tasks of the newly established company. On 9 September 2011 the Agreement on Cooperation was also signed between the Company and CC Poland Plus, which regulates rules of participation of the Company in activities of KIC InnoEnergy, as the partner of the status of Associated Partner. The aforementioned actions enabled to conclude on, 20 September 2011, the Project Agreement based on which TAURON Wytwarzanie participates in implementation of the project "Coal Gas".

On 7 October 2011 the Company, as one of the shareholders, entered into Agreement on Cooperation in the form of the special purpose vehicle under the name of Pierwiastki i Surowce Krytyczne sp. z o.o. Other signatories of the agreement include: KGHM Polska Miedz, ZGH Boleslaw as well as the University of Science and Technology (Akademia Górniczo-Hutnicza). The goal of the company is to implement surveys, research and development in the area of production and processing of critical elements as well as production and sales of innovative solar panels. This project will enable the TAURON Capital Group to build additional competence in the scope of up-to-date technology for generating of green energy as well as to gain access to know-how on raw materials necessary to produce the solar panels.

In 2011 activities were continued involving research tasks implemented under the programme of research and development entitled Advanced Technologies of Acquisition of Energy, co-financed by the National Research and Development Centre. The Company, as the member of two consortia who won the project, participates in implementation of the first research task (Development of technologies for highly efficient, "zero-emission" coal units integrated with capturing CO₂ from exhaust) and the third research task (Development of technology of coal gasifying for highly efficient production of fuels and electric energy generation).

TAURON Wytwarzanie is also involved in the project (in both above-mentioned tasks and the second task: Development of oxygen combustion technologies for dust and fluidised bed boilers integrated with CO₂ capture) as well as PKW (within the third task). In relation to implementation of the first task, activities are continued aimed at production of mobile pilot installation for CO₂ capturing as well as conducting of surveys in facilities belonging to TAURON Wytwarzanie. In 2011, the base design of the installation was generated.

On 9 December 2011 the Agreement of HTRPL Consortium was signed on High temperature Nuclear Reactor in Poland. The Research – Industrial Consortium was established in order to participate in the competition announced on 4 November 2011 by the National Research and Development Centre (NCBiR) under the strategic research project Technologies supporting the development of safe nuclear power industry, within the scope of Research Task No. 1 entitled: Development of high temperature reactors for industrial application. The leader of the established Consortium is the University of Science and Technology (Akademia Górniczo-Hutnicza) in Cracow. In December 2011 the offer was prepared to implement the research task, which was submitted to the NCBiR at the beginning of January 2012. Participation of the Company is related to implementation of the stage: Analysis of experience of the energy operator in application of cogeneration systems, from the perspective of potential implementation of high temperature reactors technology.

Moreover, in 2011 the detailed process-technology- economic study was executed, entitled Crossing the technological and non-technological barriers hampering application of carbon capture and storage in power plants. The study will be helpful for decision-making concerning

directions of further activities of research and development character, conducted by TAURON Capital Group in the area of capturing and storage of carbon dioxide.

6.3. Issues concerning natural environment

The most important actions in the area of environmental protection

The most important actions in the area of environmental protection conducted in TAURON Capital Group in 2011:

- 1) completing of activities at block No. 2 in Jaworzno III Power Plant, aimed at reduction of NOx emission for units of 225 MW to the level of 200 mg/Nm³_v (deNOx) and performance of part of works at the unit No. 12 in Elektrownia Łaziska,
- 2) commencement of activities related to construction of generating unit OZE in Jaworzno III Power Plant – Elektrownia II.
- 3) implementation of projects under the EU *Operational Programme Infrastructure and Environment*; the projects refer to replacement of transformers WN/SN and SN/nN and they are implemented under the programme Effective energy distribution,
- 4) modernisation of hydro power plant EW Pilchowice I covering, among others, protection of river water against contamination with turbine oils,
- 5) construction of installation for ash removal of stone in the Mining Plant Janina.

Companies of TAURON Capital Group conduct the responsible policy in the scope of environmental protection and apply due diligence to ensure that the implemented investments are compliant with the requirements and consider the technological developments in the area of environmental protection.

Fees for economic use of the natural environment

In 2011 Companies of TAURON Capital Group incurred costs of fees due to economic use of the environment at the total amount of PLN 65,063 thousand.

The level of fees due to economic use of the environment paid in 2011 by individual companies is presented in the table below.

Table No. 30 The level of fees due to economic use of the environment paid in 2011 by individual companies is presented in the table below.

No.	Company enterprise	Fees due to economic use of the environment in 2011 (in thousand PLN)
1.	TAURON Wytwarzanie	50,706
2.	PKW	8,936
3.	TAURON Dystrybucja	136
4.	EC Nowa	3,719
5.	EC Tychy	1,004
6.	TAURON Ciepło	486
7.	Vattenfall Distribution Poland	3
8.	Vattenfall Network Services Poland	3
9.	KW Czatkowice	69
10.	TAURON EKOENERGIA	0.9
TOTAL		65,063

Simultaneously, in relation to compliance with the requirements of the use of the environment as well as the issue of regulating the formal and legal status in this area, it should be indicated that, due to unregulated issues of proprietary rights to lands on which the following hydro plants are located: Otmuchów, Głębinów and Turawa, the company TAURON EKOENERGIA did not hold permits for waste generation for the aforementioned hydro plants as well as permits for discharge of waste water to the water for EW Otmuchów and EW Głębinów.

The remaining companies of TAURON Capital Group covered by this report comply with the requirements concerning conditions of the use of environment and have regulated formal and legal status in this area.

Criminal sanctions for infringement of requirements in the area of environmental protection

Among companies of TAURON Capital Group, the following companies incurred criminal sanctions in 2011 due to infringement of the requirements in the area of environmental protection:

PKW

- 1) monetary fines at the level of PLN 6 thousand and PLN 56 thousand, in connection with detected exceeding of permissible values of the suspended matter and chemical oxygen demand in sewage discharged to the drainage system, charged by the Regional Enterprise of Water Supply and Sewage Systems,
- 2) additional fees at the level of PLN 54 thousand for exceeding of permissible values of parameters concerning the wastewater quality (general suspended matter and chemical oxygen demand) discharged to the sanitary drainage system, charged by the Regional Enterprise of Water Supply and Sewage Systems,
- 3) monetary fine at the level of PLN 1,363 thousand for exceeding of conditions for use of the environment detected in 2008, imposed on PKW Zakład Górniczy Janina in Libiąż, postponed to 30 June 2014.

EC Nowa:

- 1) monetary fine at the level of PLN 10 thousand for non-compliance with the regulations concerning waste management,
- 2) monetary fine at the level of PLN 99 thousand for exceeding of emission standards for dust, detected during the continuous measurements performed in 2009.

6.4. Policy on Corporate Social Responsibility (CSR)

Since 2009 in the Company, functional strategy of public relations and communication operates, the key element of which is focused on social responsibility of business.

Within the functional public relations strategy, the image of TAURON brand is built around four values: safety, care for local communities, sustainable development and ecology. In 2011, in acknowledgement that communication of CSR actions is particularly important in case of companies listed at stock exchange, for whom the image of socially responsible company is essential to attract investors and, simultaneously, to increase the value of the company, within the document *Strategy of TAURON Group for the years 2011–2015, with estimates up to the year 2020*, the need to develop and implement the CSR strategy, within integration of PR function, at the level of the Company and TAURON Capital Group.

One of the priorities set in 2011 was the establishment of TAURON Foundation. The Management Board of the Company established TAURON Foundation in November 2011, adopting the project of its statute and appointing its governing bodies. Activity of TAURON Foundation is to allow for even more effective implementation of CSR actions within the area of care for safety of local communities and actions for public benefit. Moreover, the mechanism of employees' voluntary activities will allow for creation of the structure of representatives of TAURON Foundation working pro bono for the benefit of implementation of TAURON Foundation goals and for integration of employees around the performed activities.

TAURON Capital Group, acting in the area of southern Poland, has a leading position in energy sales and generation. These conditions cause that the scope of actions conducted for the benefit of the communities in which companies of TAURON Capital Group operate, is very broad. Many projects are supported which are important for inhabitants of the regions of Upper and Lower Silesia, Opolskie, Małopolska and Podkarpacie. One of the priorities is the sponsoring of sport, culture and ecology. Companies of TAURON Capital Group get involved in many projects in favour of important ideas. They include, among others, charity concert for small hearts in favour of the Clinic of Children's Cardio-surgery in Cracow, supporting of the idea of blood and bone marrow donors during the Agata Mróz Olszewska memorial, or supporting of Iskierka Foundation acting for the benefit of children with cancer. Last year, one of the projects on promoting of sports activity and basketball among children and teenagers was the action "Basketmania in Orliki".

The Company is the signatory of the declaration signed on 17 June 2009 during the national conference of the cycle "Responsible Energy", covering the principles of sustainable development in energy sector in Poland. The objective of the document is to implement the principles of sustainable development in the sector, to guarantee the development of environmental protection and broadly understood social development.

An important aspect of CSR activities in TAURON Capital Group is the action "Houses of Positive Energy" addressed to 24-hours custody and caretaking facilities. In 2011, the edition of this action covered for the first time all the facilities within the area of operations of TAURON Capital Group. The main objective of this action is the improvement of living conditions of children from orphanages. The project attracted substantial interest, with 79 orphanages participating. On 13 December 2011, the ceremonial final of the action took place during which the winning orphanages (one from each of the provinces) received financial awards.

The Company also cooperates with the Volunteer Mountain Rescue Service (GOPR), the goal of which is to increase safety in the mountains. The Company is the strategic partner of the internet GOPR training concerning activity in the mountains, covering such issues as: summer activity (mountain bike, climbing, cave exploring), winter activity (skiing and snowboard, avalanches), travelling to high mountains (high mountain tourism, arrangement of trips, height, glaciers, actions of emergency services).

Companies of TAURON Capital Group, together with the Polish Society of Transmission and Distribution of Electric Energy, have been involved in the national action "Safer with the current" for six years. The project is aimed at raising awareness among children and teenagers concerning appropriate use of electric devices. Promoting of behaviours connected with appropriate dealing with electric

energy significantly reduces the accident risk. For some time, the issues of rational and ecological use of electric energy have also been incorporated into the programme, which contributes to improvement of the environmental conditions. The campaign is carried out under the patronage of the Minister of National Education, Children's Rights Ombudsman and President of URE.

Every year, within the campaign, national competitions (painting and photography) are organised, addressed to children and teenagers from primary and secondary schools as well as to teachers. Since the beginning, employees of TAURON Dystrybucja have been actively involved in the campaign "Safer with the current", providing classes in schools and kindergartens, teaching the youngest and the teenagers how to use electricity safely. Every year several dozen of educational facilities and several thousand children use this form of training.

The popularity of this action is increased due to competitions addressed to children and teenagers from primary and secondary schools. Younger children learn safe principles of using the electric devices and appropriate behaviour in the vicinity of electric energy infrastructure. Older children gain knowledge of electric energy, its generation, transmission, application and ways of use. Due to the action "Safer with the current", the image of TAURON Capital Group is strengthened, as the entity actively participating in the social life of the region, and the TAURON Capital Group is better recognisable among children and the youth.

6.5. Awards and distinctions

25 May 2011

The Company was ranked **10th in the List of 500 of "Rzeczpospolita" daily**, and in the **ranking of "The most valuable enterprises of the Rzeczpospolita"**, accompanying the List of 500, it was ranked at **18th position**. The Company was evaluated at almost 11 billion PLN. The Holding was also ranked at 23rd position in the ranking of companies which enhanced effectiveness.

26 June 2011

TAURON EKO Premium, the ecological product of the Company received the award **Ecolaur of the Decade of the Polish Chamber of Ecology**, which has been awarding projects and products friendly for environment for 10 years. TAURON EKO Premium is the first and currently the only energy from renewable sources in Poland, the origin of which is confirmed by the Polish Society of Energy Certification. The Product is offered within the system of Guarantee of Energy Sales. It confirms that energy comes totally from renewable sources (among others, from hydro power plants), and its production is performed in the environmentally-friendly way, without any adverse effects on the environment.

07 September 2011

The Council of the Economic Forum in Krynica acknowledged the Company as the leader on energy market, the **best company of Central and Eastern Europe**, which noted **the best debut at the stock exchange in 2010**. According to the jury, the Company proved that under difficult conditions of economy under transformation, it is possible to be successful, due to daring investment and good management. As the Council stressed – the success is even more significant as it was achieved during the economic crisis which has substantially deteriorated situation of many leading companies.

08 September 2011

TAURON Capital Group was ranked on **23rd position of the List of 500 biggest companies of Central and Eastern Europe** prepared by "Rzeczpospolita" and the consulting company Deloitte. In the **list of 20 biggest energy and raw material companies**, accompanying the ranking, TAURON Capital Group took the 13th position.

19 October 2011

The Company is the winner of **the award "New Impulse" for 2011**. "New Industry", granting the award, stated in the justification that the Company received this distinction, among others, for determination in implementing of the development strategy, strengthening its position on the market. According to "New Industry", TAURON also demonstrates the potential and capacity still held by the Polish energy industry, and by taking over GZE proves that the Polish corporation is not only able to develop organically, but also to build the company value through takeovers in competition with the foreign rivals.

21 October 2011

The Company was **awarded in the competition "The Best Annual Report 2010"** for the quality of the consolidated financial statement included in the report of TAURON Capital Group for 2010. Evaluating the annual report, members of the committee assessing the application of international accounting standards and international financial reporting standards stressed that the annual financial statement allows for transparent and aggregated way of assessing of the financial situation of the Company, its results and cash flows.

6.6. Investor relations

Since the beginning of its stock exchange listing, the Company pays particular attention to the quality of the implemented communication strategy. Communication with investors' environment is implemented with the use of obligatory activities, i.e. by communication of publicly available current and periodical reports as well as through participation in numerous investors' conferences, road shows as well as meetings with analysts and fund managers during which the data and information is discussed, as published by the Company within the current and periodical reports. In 2011 the Management Board and representatives of Investors' Relations Office participated in ten conferences and four road shows, during which over 120 meetings with about 170 managers were held. Meetings with corporate investors were held in main financial centres of Europe and North America, among others, in New York, London, Paris and Frankfurt.

Publication of periodical reports of the Company, the Company was combined with organisation of four conferences for analysts and managers, during which members of the Management Board discussed financial results published in the reports and presented key achievements in individual periods. The conferences were transmitted on Internet in Polish and in English. The investors also had a possibility to ask questions during the conference via electronic mail.

In 2011 the Company also undertook a number of actions addressed to other, extremely important group of shareholders – individual investors. The Company has become the strategic partner of the Programme "Citizens' Shareholding". The Programme, initiated by the Ministry of Treasury during the stock exchange debut of the Company, PZU SA and GPW, was supported by educational actions concerning safe investment at the capital market. The objective of the Programme was to encourage the Poles to active and aware participation in economic life of the country, through active saving and investing in shares of privatised companies and stock exchange instruments. Within the programme "Citizens' Shareholding", representatives of the Company participated in several dozen meetings with individual investors all over Poland, within which they delivered presentations and answered investors' questions concerning investors' relations, investing and operations of TAURON Capital Group. During the discussed period, the Company actively cooperated with the Association of Individual Investors – in April it participated in the project "Academy of investing", while in June – in the biggest conference for individual investors, "Wall Street" in Zakopane.

On 2–3 April 2011, the Investor's Days were organised, within which the analysts and managers invited had a possibility to get acquainted with selected assets of TAURON Capital Group and to participate in the cycle of presentations provided by members of the Management Board. About 40 analysts and managers participated in the event.

The useful tool for communication with investors is the Company website, within which the constantly updated section "investor relations" operates, containing, among others, information of the structure of shareholders, financial results, dividend policy, general meetings, analysts providing recommendations concerning the Company shares as well as video broadcasts of conferences summarising the quarterly reports.

Management Board of the Company

Katowice, 6 March 2012

Dariusz Lubera	– President of the Board	.....
Joanna Schmid	– Vice-President of the Board	.....
Dariusz Stolarczyk	– Vice-President of the Board	.....
Krzysztof Zamasz	– Vice-President of the Board	.....
Krzysztof Zawadzki	– Vice-President of the Board	.....

Schedule A: Glossary of terms and list of abbreviations

Below the glossary of trade terms and list of abbreviations most commonly used in this report, is presented

Table No. 31 Explanation of abbreviations and trade terms applied in the text of the report

Abbreviation and trade term	Full name/explanation
BELS INVESTMENT	BELS INVESTMENT sp. z o.o. with the seat in Jelenia Góra
CAO	Central Allocation Office GmbH with the seat in Freising, Germany
Cash pooling	Cash pooling operating in the Company – consolidation of balances of bank accounts through physical cross-posting of cash from accounts of TAURON Capital Group in the bank in which cash pooling operates to the bank account of Pool Leader whose function is fulfilled by the Company. At the end of each working day, from cash is cross-posted from the bank accounts of companies of TAURON Capital Group which show positive balance to the bank account of Pool Leader. At the beginning of each working day, bank accounts of companies of TAURON Capital Group are credited from the bank account of the Pool Leader with the amount demanded to maintain cash flow of the company of TAURON Capital Group on a given working day.
CC Poland Plus	CC Poland Plus sp. z o.o. with the seat in Cracow
CER	(Certified Emission Reduction – a unit of confirmed emission reduction – reduced emission of greenhouse gases or avoided emission of greenhouse gases, expressed as equivalent, obtained as a result of the project on mechanism of clean development
Certificates	Proprietary rights resulting from certificates of origin of energy generated in the way subject to support, the so-called coloured certificates: <ul style="list-style-type: none"> – green – certificates of origin of electric energy from renewable energy sources, – red – certificates of origin of electric energy from cogeneration (CHP certificates Combined Heat and Power), – yellow – certificates of origin of electric energy generated in cogeneration from sources of total installed capacity below 1 MW or gas-burning, – violet – certificates of origin of electric energy generated in cogeneration, burning methane released and captured during underground mining works in active, under liquidation or liquidated hard coal mines, or burning gas acquired from biomass processing. – white – certificates confirming gaining of energy savings within the meaning of the Act of energy effectiveness, – brown – certificates confirming forcing agricultural biogas to the network.
CSR	(Corporate Social Responsibility) social responsibility of business
EBIT	(Earnings Before Interest and Taxes) result on operating activity before taxing
EBITDA	(Earnings before Interest, Taxes, Depreciation and Amortization result on operating activity before taxing, increased by amortization and depreciation
EC Nowa	Elektrociepłownia EC Nowa sp. z o.o. with the seat in Dąbrowa Górnicza
EC Stalowa Wola	Elektrociepłownia Stalowa Wola S.A. with the seat in Stalowa Wola
EC Tychy	Elektrociepłownia Tychy S.A. with the seat in Tychy
EnergiaPro	EnergiaPro S.A. with the seat in Wrocław (currently: TAURON Dystrybucja)
ENION	ENION S.A. with the seat in Cracow (taken over by EnergiaPro)
ERU	(Emission Reduction Unit – unit of emission reduction – reduced emission of greenhouse gases or avoided emission of greenhouse gases, expressed as equivalent, or one mega gram (1 Mg) of absorbed carbon dioxide (CO ₂), obtained as a result of the execution of the joint implementation project
ESW	Elektrownia Stalowa Wola S.A. with the seat in Stalowa Wola (taken over by PKE)
EU ETS	(European Union Emission Trading System) the European system of CO ₂ emission allowances
EUA	(European Union Allowances) – authorisation to introduce the equivalent to the air, within the meaning of art. 2 item 4 of the Act of 17 July 2009 on the system of management of emissions of greenhouse gases and other substances, carbon dioxide (CO ₂), which is used for settlements of emission size within the system, which can be managed based on principles specified in the Act of 28 April 2011 on the system of greenhouse gases emission allowances trading (Journal of Laws No. 122, item 695)
GPW	Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.) with the seat in Warsaw
TAURON Capital Group	TAURON Polska Energia S.A. Capital Group
“TAURON Group”	TAURON Group established by the Management of the Company pursuant to the Code, comprising the Company and selected companies of TAURON Capital Group.
GUS	Chief Statistical Office (Główny Urząd Statystyczny)
GZE	Górnośląski Zakład Elektroenergetyczny S.A. with the seat in Gliwice

Abbreviation and trade term	Full name/explanation
IRGIT	Izba Rozliczeniowa Giełd Towarowych S.A. (Warsaw Commodity Clearing House) with the seat in Warsaw
IRIESD	instructions of transmission grid operation and maintenance
JWCD	Centrally disposed Generating Units
LTC	(Long-term contracts) – long-term contracts on sales of power and electric energy, listed in the Appendix No. 1 to the Act of 29 June 2007 on principles of covering of the costs incurred by producers due to the premature termination of long-term contracts for sales of power and electric energy (Journal of Laws No. 130, item 905, as amended)
Code	The document entitled <i>Code of TAURON Group</i> , adopted by the Management Board of TAURON Polska Energia S.A.
Audit Committee	Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.
Nominations and Remuneration Committee	Nominations and Remuneration Committee of the Supervisory Board of TAURON Polska Energia S.A.
Kompania Węglowa	Kompania Węglowa S.A. with the seat in Katowice
KSE	(National Power System)
KW Czatkowice	Kopalnia Wapienia Czatkowice sp. z o.o. with the seat in Krzeszowice
Lipniki	Lipniki sp. z o.o. with the seat in Wrocław
MEGAWAT MARSZEWO	MEGAWAT MARSZEWO sp. z o.o. with the seat in Jelenia Góra
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
NFOŚiGW	National Fund of Environmental Protection and Water Management with the seat in Warsaw
Business Area	Area of operations of subsidiaries included in TAURON Group, determined by the Company, constituting the business segment of TAURON Group
Management Area	Management Area indicated in the List of Management Areas, i.e. the document issued by the Management Board of the Company, pursuant to the Code, established based on Corporate Strategy and included in the business model of TAURON Group
DSO	Distribution System Operator
RES	Renewable Energy Sources
PEC Katowice	Przedsiębiorstwo Energetyki Ciepłej Katowice S.A. with the seat in Katowice (currently: TAURON Ciepło)
PEC in Dąbrowa Górnicza	Przedsiębiorstwo Energetyki Ciepłej w Dąbrowie Górniczej S.A. with the seat in Dąbrowa Górnicza (taken over by PEC Katowice)
PEPKH	Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. with the seat in Katowice
PGK	Tax Capital Group
GDP	Gross Domestic Product
PKE	Południowy Koncern Energetyczny S.A. with the seat in Katowice (currently: TAURON Wytwarzanie)
PKW	Południowy Koncern Węglowy S.A. with the seat in Jaworzno
PSE Operator	Polskie Sieci Elektroenergetyczne Operator S.A. with the seat in Konstancin-Jeziorna
(PŚZiPZ Elvita – Jaworzno III)	Przedsiębiorstwo Świadczeń Zdrowotnych i Promocji Zdrowia Elvita – Jaworzno III sp. z o.o. with the seat in Jaworzno
Organisational Regulations/Bylaws	Document entitled <i>Organisational Regulations of TAURON Polska Energia S.A.</i>
ROIC	(Return On Invested Capital) return on invested capital
RUS	Regulatory System Services – services provided by entities in favour of transmission system operator, required for adequate functioning of the National Power System, providing for maintenance of determined values of reliability and qualitative parameters
SPOT (SPOT Market)	In relation to electric energy, it is the place of concluding of trade transactions for electric energy, for which the period of delivery falls at the latest, three days after the date of transaction (usually one day before the date of delivery). Operating of SPOT market for electric energy is strongly related to operating of the Balancing Market provided by the Operator of Transmission Grid
Company	TAURON Polska Energia S.A. with its seat in Katowice
Corporate Strategy	The document entitled <i>Corporate Strategy of TAURON Group for 2011–2015 with estimates until the year 2020</i> , being the update of the document <i>Corporate Strategy of TAURON TAURON Polska Energia S.A. Capital Group for 2008–2012 with estimates until the year 2020</i>
TAURON Ciepło	TAURON Ciepło S.A. with its seat in Katowice

Abbreviation and trade term	Full name/explanation
TAURON Czech Energy	TAURON Czech Energy s.r.o. with its seat in Ostrava, Czech Republic
TAURON Dystrybucja	TAURON Dystrybucja S.A. with its seat in Cracow
TAURON EKOENERGIA	TAURON EKOENERGIA sp. z o.o. with its seat in Jelenia Góra
TAURON Obsługa Klienta	TAURON Obsługa Klienta sp. z o.o. with the seat in Wrocław
TAURON Sprzedaż	TAURON Sprzedaż sp. z o.o. with the seat in Cracow
TAURON Wytwarzanie	TAURON Wytwarzanie S.A. with the seat in Katowice
TGE	Towarowa Giełda Energii S.A. (Polish Power Exchange) with the seat in Warsaw
TPA	(Third-party Access) – the principle based on the owner or operator making available the grid infrastructure to the third parties in order to supply goods/services to clients of the third party (it may refer to transmission or sales of electric energy, telecommunication services or railway services)
EU	the European Union
UOKiK	Office for Competition and Consumer Protection (Urząd Ochrony Konkurencji i Konsumentów)
ERO	Energy Regulatory Office
Vattenfall Business Services Poland	Vattenfall Business Services Poland sp. z o.o. with the seat in Gliwice
Vattenfall Distribution Poland	Vattenfall Distribution Poland S.A. with the seat in Gliwice
Vattenfall Network Services Poland	Vattenfall Network Services Poland sp. z o.o. with the seat in Gliwice
Vattenfall Sales Poland	Vattenfall Sales Poland sp. z o.o. with the seat in Gliwice
Vattenfall Wolin-North	Vattenfall Wolin-North sp. z o.o. with the seat in Gliwice
Wdkj	Value of net financial result on operating activity of the generator, adjusted by amortization, available for servicing of equity and external capital for calendar year “j”, while the value of net financial result for the year, in which the longest long-term agreement for the specific generator expires, is decreased pro rata against the number of days of effectiveness of this agreement in this year, calculated in accordance with item 4 of the Act of 29 June 2007 <i>on principles of covering of the costs incurred by producers due to the premature termination of long-term contracts for sales of power and electric energy</i>
WFOŚiGW	Regional Fund of Environmental Protection and Water Management in Katowice
GM	General Meeting/Shareholders' Meeting
ZEC w Bielsku-Białej	Zespół Elektrociepłowni Bielsko-Biała

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**STATEMENTS OF THE MANAGEMENT BOARD OF
TAURON POLSKA ENERGIA S.A.**

STATEMENT

**of the Management Board of TAURON Polska Energia S.A.
on the compliance of the consolidated financial statements of
TAURON Polska Energia S.A. Capital Group
prepared in accordance with International Financial Reporting Standards
for the year ended 31 December 2011
and the Management Board's report on the activities
of TAURON Polska Energia S.A. Capital Group for the year 2011**

I, the undersigned, represent that, to my best knowledge, the consolidated financial statements of TAURON Polska Energia S.A. Capital Group prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2011 and comparable figures were prepared in accordance with applicable accounting rules and give the true and fair picture of the assets, financial standing and performance of TAURON Capital Group.

I also certify that the Management Board's report on the activities of TAURON Polska Energia S.A. Capital Group for the year 2011 gives the true picture of the development, achievements and situation of TAURON Capital Group, including the description of key risks and threats.

Management Board Members:

Dariusz Lubera	– President of the Management Board	.....
Joanna Schmid	– Vice-President of the Management Board	.....
Dariusz Stolarczyk	– Vice-President of the Management Board	.....
Krzysztof Zamasz	– Vice-President of the Management Board	.....
Krzysztof Zawadzki	– Vice-President of the Management Board	.....

6 March 2012

date

STATEMENT

**of the Management Board of TAURON Polska Energia S.A.
on the appointment of the entity authorised to audit financial statements
(Consolidated financial statements of TAURON Polska Energia S.A. Capital Group
prepared in accordance with International Financial Reporting Standards
for the year ended 31 December 2011)**

I, the undersigned, represent that the entity authorised to audit financial statements and examining the financial statements of TAURON Polska Energia S.A. Capital Group prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2011 was appointed in accordance with legal regulations, and this entity and auditors examining the statements have met conditions for developing an impartial and independent report on the review of the audited financial statements in accordance with applicable regulations and professional standards.

The Management Board Members:

Dariusz Lubera	– President of the Management Board	.....
Joanna Schmid	– Vice-President of the Management Board	.....
Dariusz Stolarczyk	– Vice-President of the Management Board	.....
Krzysztof Zamasz	– Vice-President of the Management Board	.....
Krzysztof Zawadzki	– Vice-President of the Management Board	.....

6 March 2012

date