



Report on activities of the Supervisory Board

***of TAURON Polska Energia S.A.
in the financial year 2016***

Katowice, 15 March 2017

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1. Introduction

Acting pursuant to Article 382 § 1 of the Commercial Companies Code and provisions of *Best Practice of WSE (Warsaw Stock Exchange) Listed Companies 2016* (hereinafter referred to as: *Best Practice 2016*), the Supervisory Board of TAURON Polska Energia S.A. (hereinafter referred to as: the Supervisory Board) hereby submits the *Report on activities of the Supervisory Board in the financial year 2016* to the Ordinary General Meeting (hereinafter referred to as: the Report).

While applying the recommendations and principles of *Best Practice 2016*, the Supervisory Board evaluated:

1. the situation of the company, taking into account the assessment of internal control systems, risk management, compliance and internal audit functions,
2. the method of fulfilment of information obligations by the Company, in relation to the application of corporate governance rules defined in the Regulations of the Exchange and provisions related to current and periodical information submitted by issuers of securities,
3. the rationality of sponsoring, charitable policy, or other similar policy pursued by the Company,
4. the fulfilment of independence criteria by Members of the Supervisory Board.

As a part of implementation of the rules defined in *Best Practice 2016*, the Supervisory Board presents the aforementioned evaluations, contained herein to the Ordinary General Meeting of the Company.

At the same time, in the framework of the Report, a detailed description of activity and operations of the Supervisory Board and its committees in the financial year 2016 is presented.

2. Information on the term of office of the Supervisory Board, personal composition of the Supervisory Board and functions fulfilled in it as well as changes in the composition of the Supervisory Board during the financial year

The term of office of the Supervisory Board is a joint term of office lasting three years, excluding the first term of office lasting one year (the Supervisory Board of the first term of office was appointed pursuant to the Memorandum of Association on 6 December 2006). The Supervisory Board consists of 5 to 9 members, appointed and dismissed by the General Meeting, subject to the following provisions:

- 1) in the period, in which the State Treasury, including subsidiaries of the State Treasury within the meaning of § 10(5) of the Articles of Association, holds a number of shares of the Company authorising to exercise at least 25% (twenty five per cent) of the total number of votes in the Company, the State Treasury is entitled to appoint and dismiss members of the Supervisory Board in the amount equal to a half of the maximum number of the composition of the Supervisory Board defined in the Articles of Association (if 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 determining of 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 submission of such a motion to the Management Board by a shareholder or shareholders holding a number of votes entitling to exercise at least 5% (five per cent) 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; however, this would not apply to the case when the Supervisory Board cannot act due to a composition minor than required under 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 this section,
- 2) in the period of time in which the State Treasury, including subsidiaries of the State Treasury within the meaning of § 10(5) of the Articles of Association, holds a number of Company shares entitling to exercise less than 25% (twenty five per cent) of total voting rights in the Company, the State Treasury, represented by a minister competent for the State Treasury affairs shall be authorised to appoint and dismiss one member of the Supervisory Board,

- 3) appointing and dismissing members of the Supervisory Board by the State Treasury pursuant to the procedure defined in clause 1 or 2 above takes place by means of a declaration submitted to the Company.

The table below presents personal composition of the Supervisory Board as at 31 December 2016 and as at the date of drawing up this Report.

Table no. 1 Personal composition of the Supervisory Board as at 31 December 2016 and as at the date of drawing up this Report

No.	Name and surname	Function
1.	Beata Chłodzińska	Chairwoman of the Supervisory Board
2.	Anna Mańk	Deputy Chairwoman of the Supervisory Board
3.	Jacek Szyke	Secretary of the Supervisory Board
4.	Stanisław Bortkiewicz	Member of the Supervisory Board
5.	Leszek Koziorowski	Member of the Supervisory Board
6.	Jan Płudowski	Member of the Supervisory Board
7.	Jacek Rawecki	Member of the Supervisory Board
8.	Stefan Świątkowski	Member of the Supervisory Board
9.	Agnieszka Woźniak	Member of the Supervisory Board

As at 1 January 2016 the Supervisory Board consisted of the following Members: Beata Chłodzińska (Chairwoman of the Supervisory Board), Anna Mańk (Deputy Chairwoman of the Supervisory Board), Jacek Szyke (Member of the Supervisory Board), Anna Biesialska (Member of the Supervisory Board), Michał Czarnik (Member of the Supervisory Board), Maciej Koński (Member of the Supervisory Board), Leszek Koziorowski (Member of the Supervisory Board), Wojciech Myślecki (Member of the Supervisory Board) and Renata Wiernik-Gizicka (Member of the Supervisory Board).

In the financial year 2016, the Supervisory Board operated as the Supervisory Board of the fourth term of office comprising a period 15 May 2014 to 15 May 2017.

The table below presents changes in the composition of the Supervisory Board during the financial year 2016.

Table no. 2. Changes in the composition of the Supervisory Board during the financial year 2016.

No.	Date	Changes in the composition of the Supervisory Board
1.	6 June 2016	Maciej Koński and Renata Wiernik-Gizicka submitted declarations on the resignation from their function of the Supervisory Board Member.
2.	8 June 2016	Pursuant to § 22(1) of the Company Articles of Association, the Ordinary General Meeting of the Company appointed <u>Jacek Rawecki and Stefan Świątkowski</u> as members of the Supervisory Board of the fourth joint term of office.
3.	14 November 2016	Wojciech Myślecki submitted the declaration on resignation from the function of the Supervisory Board Member.
4.	16 December 2016	The State Treasury, acting pursuant to its personal powers specified in § 23(1)(3) of the Company Articles of Association, appointed Agnieszka Woźniak as a Member of the Supervisory Board.
5.	30 December 2016	The State Treasury, acting pursuant to its personal powers specified in § 23(1)(3) of the Company Articles of Association, dismissed Michał Czarnik and Anna Biesialska from the Supervisory Board and appointed Jan Płudowski and Stanisław Bortkiewicz as members of the Supervisory Board.

3. Information on the fulfilment of independence criteria by Members of the Supervisory Board

At least two members of the Supervisory Board should meet the criteria of independence (hereinafter referred to as: independent members of the Supervisory Board). The definition of an *independent member of the Supervisory Board* means an independent member of the supervisory board within the meaning the Commission Recommendation of 15 February 2005, on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC) taking into consideration *Best Practice 2016*.

Members of the Supervisory Board provided the Supervisory Board and the Management Board of the Company with declarations concerning the fulfilment of the independence criteria.

The Supervisory Board performed the evaluation in terms of existence of relations and circumstances which may affect the fulfilment of independence criteria by a given member of the Supervisory Board.

The table below presents information on the fulfilment of independence criteria by Members of the Supervisory Board, in accordance with rule II.Z.4 of *Best Practice 2016* as at 31 December 2016 and as at the day of drawing up this report.

Table no 3. Fulfilment of independence criteria by Members of the Supervisory Board.

No.	Name and surname	Fulfilment of independence criteria referred to in rule II.Z.4 of <i>Best Practice 2016</i>	
		as at 31 December 2016 and as at the day of drawing up this report	
1.	Beata Chłodzińska	Does not fulfil independence criteria.	Does not fulfil independence criteria.
2.	Anna Mańk	Does not fulfil independence criteria.	Does not fulfil independence criteria.
3.	Jacek Szyke	Fulfils independence criteria.	Fulfils independence criteria.
4.	Stanisław Bortkiewicz	Fulfils independence criteria.	Fulfils independence criteria.
5.	Leszek Koziorowski	Fulfils independence criteria.	Fulfils independence criteria.
6.	Jan Płudowski	Fulfils independence criteria.	Fulfils independence criteria.
7.	Jacek Rawecki	Does not fulfil independence criteria.	Fulfils independence criteria.
8.	Stefan Świątkowski	Does not fulfil independence criteria.	Does not fulfil independence criteria.
9.	Agnieszka Woźniak	Does not fulfil independence criteria.	Does not fulfil independence criteria.

4. Information on significant issues dealt with by the Supervisory Board and the number of meetings held and resolutions adopted

The Supervisory Board performs its tasks based on specific powers granted by the Company Articles of Association and the By-laws of the Supervisory Board, as well as corporate governance rules defined in *Best Practice 2016*.

In the financial year 2016 the Supervisory Board held, in total, 10 meetings and adopted 98 resolutions. All Members of the Supervisory Board participated in the majority of meetings. Absences of individual Members of the Supervisory Board were excused by the relevant resolutions of the Supervisory Board.

While exercising its competence, the Supervisory Board permanently supervised operations of TAURON Polska Energia S.A. in all areas of its activity, in particular, in relation to the implementation of the new Strategy of TAURON Group, implementation of strategic investment of key importance for TAURON Capital Group, taking into account schedules of their implementation as well as the accuracy and effectiveness of spending funds associated with investment executed by the Management Board of the Company.

In the scope of activities, the Supervisory Board actively supported the Management Board in implementation of the strategic goals of the Company, considered motions of the Management Board related to issues requiring the approval of the Supervisory Board as well as reviewed other issues presented by the Management Board.

The table below presents the main issues considered by the Supervisory Board during its meetings in 2016.

Table no 4. Main issues considered by the Supervisory Board during its meetings in 2016

Main issues considered by the Supervisory Board during its meetings in 2016	
In the scope of its opinion-making / evaluation functions	
1.	it issued a positive opinion concerning the <i>Plan of conducting sponsoring activity in TAURON Group in 2016</i> and the amendments introduced thereto,
2.	it evaluated the <i>Consolidated financial statement of TAURON Polska Energia S.A. Capital Group, compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015</i> and the <i>Report of the Management Board on operations of TAURON Polska Energia S.A. Capital Group for the financial year 2015</i> , in the scope of their compliance with the ledgers, documents and the actual status,
3.	it adopted the <i>Report of the Supervisory Board of TAURON Polska Energia S.A. on evaluation of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group, compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015</i> and the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. Capital Group for the financial year 2015</i> ,
4.	it evaluated the <i>Financial statement of TAURON Polska Energia S.A., compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015</i> and the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. for the financial year 2014</i> , in the scope of their compliance with the ledgers, documents and the actual status,
5.	it evaluated the motions of the Management Board to the General Meeting concerning the procedure of covering the loss for the financial year 2015 and the use of the reserve capital of the Company through allocating its part for the payment of the dividend to shareholders,
6.	it adopted the <i>Report of the Supervisory Board of Tauron Polska Energia S.A. on evaluation of the Consolidated financial statement of TAURON Polska Energia S.A. Capital Group, compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015</i> , the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. Capital Group for the financial year 2015</i> and the <i>motion of the Management Board to the General Meeting concerning the procedure of covering the loss for the financial year 2015</i> ,
7.	it issued a positive opinion concerning the <i>Report on implementation of the Plan of conducting sponsoring activity in TAURON Group in 2015</i> ,
8.	it issued a positive opinion concerning the motions of the Management Board of TAURON Polska Energia S.A. to the General Meeting concerning the amendments to the <i>Company Articles of Association</i> and the <i>By-laws of the General Meeting of TAURON Polska Energia S.A.</i> aimed at incorporating the provisions and rules contained in the <i>Best Practice 2016</i> ,
9.	it issued a positive opinion concerning the <i>Corporate Strategy of TAURON Group for 2016-2025</i> adopted by the Company Management Board.
In the scope of decision-making competence	
1.	it adopted the <i>Report on activities of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2015</i> ,
2.	it introduced changes and supplemented the composition of Committees of the Supervisory Board,
3.	it approved the amendments to the <i>By-laws of the Management Board of TAURON Polska Energia S.A.</i> , aimed at, among others, introducing the recommendations and rules contained in the <i>Best Practice 2016</i> thereto,
4.	it adopted the amendments to the <i>By-laws of the Supervisory Board of TAURON Polska Energia S.A.</i> and the <i>By-laws of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.</i> , aimed at, among others, introducing the recommendations and rules contained in the <i>Best Practice 2016</i> thereto,
5.	it approved the amendments to the <i>Organisational Regulations of TAURON Polska Energia S.A.</i> aimed at distribution of the scope of assignments among individual Members of the Management Board of the Company and adjustment of the organisational structure of the Company to the current situation and needs,
6.	it approved the <i>Material and financial plan of TAURON Group for 2016</i> and the <i>Material and financial plan of TAURON Polska Energia S.A. for 2016</i> ,
7.	it selected the auditor to examine the separate and consolidated financial statement of TAURON Polska Energia S.A. for the financial year 2016,

Main issues considered by the Supervisory Board during its meetings in 2016

8. it adopted a uniform text of the Company Articles of Association comprising the amendments introduced under resolution of the Ordinary General Meeting No. 44 of 8 June 2016,
9. it adopted the *Framework work plan of the Supervisory Board of TAURON Polska Energia S.A. for 2017*,

In the scope of supervision of the current activities of the Company and TAURON Group

1. it decided to perform a legal audit, with participation of an independent third party law firm, comprising the implementation of an investment project called *the Construction of a new unit at Elektrociepłownia Stalowa Wola (450 MW)*, and subsequently, after its termination and adopting of the relevant recommendations and guidelines for the Company Management Board, it monitored the status of their implementation,
2. it adopted the *Best Practice 2016* for implementation, simultaneously indicating the recommendations and guidelines which are not applied by the Company,
3. it monitored the implementation of schedules of strategic investment of key importance for TAURON Capital Group,
4. it analysed the current economic and financial situation of the Company and TAURON Capital Group, including the implementation of the Material and financial plan,
5. it monitored the expenditure incurred by TAURON Group on advertising, sponsoring, cultural, social and charity activities,
6. it analysed the current information related to the liquidation process of the company - Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. in liquidation,
7. it monitored subjects considered under the agenda of General Meetings / Meetings of Shareholders of companies where TAURON Polska Energia S.A. holds stocks / shares,
8. it monitored the process of implementation of the social dialogue in the Company and in TAURON Capital Group,
9. it analysed information concerning the performance of advisory services for the previous years and for the current period,
10. it supervised the implementation of the schedule of activities in the scope of reorganisation of entities of TAURON Polska Energia S.A. Capital Group (subsidiaries and affiliates),
11. it analysed the report concerning the evaluation of the sponsoring activity for the previous years,
12. it monitored the status of implementation of the adopted *Effectiveness Improvement Programme*.

In the scope of its competence related to the Management Board

1. it submitted a motion to the Ordinary General Meeting to acknowledge the fulfilment of duties by Members of the Supervisory Board from duties performed by them in the financial year 2015,
2. in connection with the changing economic circumstances and market situation, as well as new challenges faced by the Company, it introduced changes in the composition of the Management Board of TAURON Polska Energia S.A.,
3. it accepted taking positions in governing bodies of other companies by Management Board Members of TAURON Polska Energia S.A.,
4. in connection with the adopted bonus scheme for Members of the Management Board of TAURON Polska Energia S.A., it conducted the analysis related to the level of implementation of indicators determining awarding of the bonus to Members of the Management Board of the Company for 2015 and determined non-financial targets to be implemented by Members of the Management Board in 2016,
5. under the execution of resolution No. 5 of the Extraordinary General Meeting of the Company of 15 December 2016, it determined the rules on development of remuneration of Company Management Board Members, adopted the template of the agreement for the provision of management services and determined a catalogue of management objectives the implementation of which will determine the level of the supplementary remuneration of Management Board Members.

In the scope of supervision over the accuracy and effectiveness of spending funds associated with implementation of investment by the Management Board of the Company, including the purchase of tangible fixed assets

1. It approved incurring contingent liabilities in the form of bank guarantees with the value exceeding the equivalent of EUR 5,000,000.00, issued under the framework Agreement for bank guarantees for companies of TAURON Group,
2. it monitored the process of issue of intra-group bonds and their disposal,

Main issues considered by the Supervisory Board during its meetings in 2016

3. it approved concluding of an annex to the agreement for establishing registered pledges and the financial pledge on 3,293,403 shares of TAMEH HOLDING sp. z o.o. Company held by TAURON, increasing the total collateral of one of the pledges,
4. it approved incurring conditional liabilities in the form of bank guarantees constituting the collateral on banks' receivables arising from loans granted to Elektrociepłownia Stalowa Wola S.A. for the financing of an investment project consisting in the construction of a new CCGT unit in Stalowa Wola,
5. it monitored expenditure on investment projects implemented within TAURON Capital Group, inter alia, through the analysis of the Material and financial plan, including the accomplishment of investment expenditure in individual Areas of TAURON Capital Group operations.

Based on the aforementioned activities, the Supervisory Board does not report any default in the scope of accuracy and effectiveness of spending funds associated with the implementation of investment by the Management Board of the Company in the financial year 2016, including the purchase of tangible fixed assets.

5. Information on implementation of resolutions of the General Meeting related to the activities of the Supervisory Board

In the financial year 2016, under the execution of resolutions of the General Meeting of TAURON Polska Energia S.A.:

- 1) on 26 July 2016, the Supervisory Board adopted a uniform text of the Articles of Association of TAURON Polska Energia S.A., taking into account the amendment to the Articles of Association adopted by the Ordinary General Meeting on 8 June 2016 and entered in the National Court Register by the District Court for Katowice - Wschód in Katowice, 8th Commercial Department,
- 2) on 19 December 2016, the Supervisory Board it determined the rules on development of remuneration of Company Management Board Members, adopted the template of the agreement for the provision of management services and determined a catalogue of management objectives the implementation of which will determine the level of the supplementary remuneration of Management Board Members, in accordance with the resolution of the Extraordinary General Meeting of the Company of 15 December 2016,

on 15 December 2016, the Extraordinary General Meeting of the Company adopted the resolution concerning the *rules on development of remuneration of Company Management Board Members*, changing the level of the remuneration. This resolution was exercised by the Company and as of 15 December 2016 Members of the Supervisory Board receive the remuneration in accordance with the aforementioned resolution.

6. Committees of the Supervisory Board

In execution of recommendations and rules defined in the *Best Practice 2016*, in the previous financial year the activity of the Supervisory Board was supported by the following committees: Audit Committee, Nominations and Remuneration Committee and Strategy Committee.

Committees of the Supervisory Board are advisory and opinion-making bodies acting collectively and performing the support and advisory functions towards the Supervisory Board. Tasks of the Committees of the Supervisory Board are carried out through presenting motions, recommendations, opinions and reports concerning the scope of their tasks to the Supervisory Board.

The table below presents tasks and competence of Committees of the Supervisory Board.

Table no 5. Tasks and competence of Committees of the Supervisory Board.

Tasks and competence of Committees of the Supervisory Board
<p>Audit Committee</p> <ol style="list-style-type: none"> 1. Monitoring of financial reporting process. 2. Monitoring of the accuracy of financial information presented by the Company. 3. Monitoring of the effectiveness of internal control, risk management systems, compliance and internal audit functions existing in the Company. 4. Monitoring of performance of financial auditing function. 5. Monitoring of independence and impartiality of the chartered accountant and the entity entitled to examine financial statements, including in case of their rendering services other than financial audit. 6. Recommendations to the Supervisory Board concerning an entity entitled to examine financial statements to perform the financial audit.
<p>Nominations and Remuneration Committee</p> <ol style="list-style-type: none"> 1. Recommendations to the Supervisory Board concerning the recruitment procedure for the positions of Members of the Company Management Board. 2. Assessment of 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 concerning the form and contents of agreements concluded with Members of the Company Management Board. 4. Recommendations to the Supervisory Board concerning the remuneration and bonus scheme for Members of the Company Management Board. 5. Recommendations to the Supervisory Board concerning the need to suspend a Member of the Company Management Board due to material reasons. 6. Recommendations to the Supervisory Board concerning 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, including the proposal of remuneration.
<p>Strategy Committee</p> <ol style="list-style-type: none"> 1. Assessment of the Corporate Strategy and presenting its results to the Supervisory Board. 2. Recommendations to the Supervisory Board concerning the scope and deadlines for submission of strategic multi-annual plans by the Management Board. 3. Assessment of impact of the planned and undertaken strategic investments on assets of the Company. 4. Monitoring of implementation of the strategic investment tasks. 5. Assessment of activities concerning the disposal of significant Company assets. 6. Issuing opinions on strategic documents submitted to the Supervisory Board by the Company Management Board.

The Committees of the Supervisory Board consist of three to five members. In case of the Audit Committee, in accordance with *Best Practice 2016*, the Chairperson should meet the independence criteria indicated in Annex II to the *European Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board* and, moreover, at least one member should meet the criteria of independence within the meaning of the *Act on statutory auditors, their self-government and the entities authorised to audit financial statements and public supervision* (i.e. Journal of Laws of 2016, item 1000 as amended) with competence in the field of accounting and finance.

At the first meeting members of Committees of the Supervisory Board elect among themselves a Chairperson to manage works of a given Committee and supervise drafting of the agenda, organisation of the distribution of documents and drafting minutes of the meetings.

The table below presents personal composition of the Committees of the Supervisory Board as at the date of drawing up this report.

Table no. 6 Personal composition of the Supervisory Board as at the day of drawing up this report

No.	Name and surname	Audit Committee	Nominations and Remuneration Committee	Strategy Committee
1.	Beata Chłodzińska	Member	Chairperson	Member
2.	Anna Mańk	-	-	Member
3.	Jacek Szyke	Member	-	Chairman
4.	Stanisław Bortkiewicz	Chairman	-	-
5.	Leszek Koziarowski	-	Member	-
6.	Jan Płudowski	Member	-	-
7.	Jacek Rawecki	Member	-	-
8.	Stefan Świątkowski	-	-	Member
9.	Agnieszka Woźniak	-	Member	-

In the financial year 2016: The Audit Committee held, in total, 10 meetings and adopted 25 resolutions; the Nominations and Remunerations Committee held, in total, 4 meetings and adopted 28 resolutions; the Strategy Committee held, in total, 9 meetings and adopted 6 resolutions.

The table below presents the main issues examined by Committees of the Supervisory Board during their meetings in 2016.

Table no 7. Main issues considered by the Committees of the Supervisory Board during their meetings in 2016.

Main issues considered by the Committees of the Supervisory Board during their meetings in 2016.	
Audit Committee	
1.	It adopted the <i>Report on activities of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2015</i> and the <i>Report on activities of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. in the first half of 2016</i> , and submitted them to the Supervisory Board,
2.	It analysed results of conducted audit tasks of strategic investment projects of TAURON Group, with special attention to the implementation of the investment project comprising the construction of the CCGT unit with the capacity of approximately 400 MWe with a heat component in Elektrociepłownia Stalowa Wola S.A., as well as adopted and presented recommendations concerning the results of the aforementioned audit tasks to the Supervisory Board,
3.	It issued a positive opinion concerning the <i>Material and financial plan of TAURON Polska Energia S.A. for 2016</i> and the <i>Material and financial plan of TAURON Group for 2016</i> and presented its opinions to the Supervisory Board,
4.	It monitored and evaluated the performance of the financial auditing function, including independence of the financial auditing process, independence and impartiality of the chartered auditor examining unit financial statements of the Company and consolidated financial statements of TAURON Group,
5.	It monitored and analysed the effectiveness of the internal control, risk management, compliance and internal audit functions existing in the Company and presented the recommendation concerning the evaluation of the aforementioned systems to the Supervisory Board,
6.	It evaluated the <i>Annual Audit Plan for TAURON Group for 2016</i> , and subsequently monitored its implementation, taking into account reports on individual tasks and recommendations issued,
7.	It presented the recommendation concerning the selection of the auditor to examine the separate and consolidated financial statements of TAURON Polska Energia S.A. for the financial year 2016 to the Supervisory Board,
8.	It presented the recommendation concerning the procedure for the selection of the auditor to examine the separate and consolidated financial statements and financial statements of selected companies of TAURON Polska Energia S.A. for 2017-2019 to the Supervisory Board,

Main issues considered by the Committees of the Supervisory Board during their meetings in 2016.

9. It monitored the financial reporting process, including the analysis of reliability of financial information presented by the Company in the following documents, in terms of their compliance with the books and documents as well as with the actual status and presented the relevant recommendations to the Supervisory Board concerning the performed evaluation of:
 - 1) the *Financial statement of TAURON Polska Energia S.A., compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015 and the Report of the Management Board on the operations of TAURON Polska Energia S.A. for the financial year 2015,*
 - 2) the *Consolidated financial statement of TAURON Polska Energia S.A. Capital Group compliant with International Financial Reporting Standards for the financial year ended on 31 December 2015 and the Report of the Management Board on operations of TAURON Polska Energia S.A. Capital Group for 2015,*
 - 3) *Extended consolidated quarterly report of TAURON Polska Energia S.A. Capital Group for the 1st quarter of 2016,*
 - 4) *Extended consolidated interim report of TAURON Polska Energia S.A. Capital Group for the 1st half of 2016,*
 - 5) *Extended consolidated quarterly report of TAURON Polska Energia S.A. Capital Group for three quarters of 2016,*
10. In connection with signing of the standstill agreement with Banks, related to financing of the investment project comprising the construction of the new CCGT unit, implemented by Elektrociepłownia Stalowa Wola S.A., the Audit Committee presented the recommendation to the Supervisory Board concerning the approval of incurring contingent liabilities in the form of bank guarantees as a collateral of banks' receivables arising from loans granted to Elektrociepłownia Stalowa Wola S.A. for financing of the aforementioned investment project.

Nominations and Remuneration Committee

1. It adopted the *Report on activities of the Nominations and Remunerations Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2015* and submitted it to the Supervisory Board,
2. It recommended determining and approval of non-financial targets to be implemented by Members of the Management Board of TAURON Polska Energia S.A. in 2016 to the Supervisory Board, in compliance with the adopted bonus system,
3. It performed the analysis and evaluation of indicators determining awarding of the annual bonus for 2015 to Members of the Management Board and presented the relevant recommendations to the Supervisory Board,
4. It performed the analysis and evaluation of indicators determining awarding of the semi-annual part of the Annual Bonus for 2016 to Members of the Management Board and presented the relevant recommendations to the Supervisory Board,
5. It proposed a catalogue of general management objectives the implementation of which will determine the level of the supplementary remuneration of Management Board Members to the Supervisory Board, as referred to in the Act of 9 June 2016 on the principles of developing the remuneration of persons managing certain companies (Journal of Laws of 2016 item 1202),
6. It presented the recommendation to the Supervisory Board concerning developing the remuneration of Members of the Management Board of TAURON Polska Energia S.A. in accordance with resolution no. 5 of the Extraordinary General Meeting of TAURON Polska Energia S.A. of 15 December 2016.

Strategy Committee

1. In order to implement the activities in the scope of reviewing the implementation status of strategic projects and investment tasks arising from the Strategy of TAURON Group and the Strategies of individual Business Areas, including, on the premises of a given investment, the Strategy Committee became acquainted with the implementation status of the following investment projects:
 - 1) *Construction of a coal-fired unit for supercritical parameters with the capacity of 910 MWe at Elektrownia Jaworzno,*
 - 2) *Construction of the CCGT unit of 450 MWe capacity at EC Stalowa Wola,*
2. It performed the analysis and evaluation of functioning of the Mining Area, getting acquainted with the most important problems associated with the operation of this area, in particular, with the issues related to coal mining, employment, profitability rate in ZG Janina, ZG Sobieski, ZG Brzeszcze coal mines as well as with the status of implementation of investment programmes related to mining.

Main issues considered by the Committees of the Supervisory Board during their meetings in 2016.

3. It performed the analysis and evaluation of functioning of the Distribution Area, getting acquainted with its organisation in the context of exploitation, elimination of failures and service of connected consumers, status of holding in the scope of grid maintenance, characteristic indicators describing the distribution grid, employment structure, capital and maintenance expenditure in the distribution grid, current situation in the scope of delimitation of grid services area, as well as the assessment of installation of smart grids and the horizontal integration process in the energy sector,
4. It performed the analysis and evaluation of functioning of the Sales Area, getting acquainted, among others, with risk factors of electricity retail sales in TAURON Capital Group, issued associated with the organisation of the said Area, with particular attention to the business process of retail sales and customer service in the business segment, as well as with the product strategy and sales support in the area of promotion, services and products,
5. It performed the analysis and evaluation of functioning of the Heat Area, getting acquainted with its organisation, with special attention to transmission capacity of heating networks, generated transmission losses, condition of heat generation equipment, heat balance within the area of the following cities: Katowice, Bielsko-Biała, Stalowa Wola, Będzin and Sosnowiec, expenditure for investment under implementation and planned,
6. It became acquainted with the status of works associated with the development of the TAURON Group strategy,
7. It adopted and submitted the *Programme of activities of the Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. in the second half of 2016* to the Supervisory Board.

7. Self-assessment of the Supervisory Board

The Supervisory Board of TAURON Polska Energia S.A., provides permanent oversight of the Company activities in all areas of its operations, in accordance with the obligations and powers defined in the Code of Commercial Companies and other legal regulations, provisions of the Company Articles of Association as well as the provisions of the By-laws of the Supervisory Board. Moreover, while performing their obligations Members of the Management Board were driven by the rules contained in the *Best Practice 2016*.

All Members of the Supervisory Board represent a high level of professional preparation and demonstrate the relevant substantive preparation, required to act in the capacity of the Member of the Supervisory Board.

All Members of the Supervisory Board applied due diligence while performing their obligations, using with commitment their best knowledge and experience in the scope of managing and supervising commercial law companies. Owing to high competence and commitment of individual Supervisory Board Members and efficient organisation, the Supervisory Board effectively implemented its statutory tasks, being driven by interests of the Company.

It should be mentioned that individual Members of the Supervisory Board participated in sessions of the General Meeting of the Company in order to enable substantive answer to questions asked during General Meeting sessions.

In accordance with the foregoing, the Supervisory Board applies for the acknowledgement of the fulfilment of duties by Members of the Supervisory Board of TAURON Polska Energia S.A. in the period from 1 January 2016 to 31 December 2016.

8. Evaluation of the situation of the Company, taking into account the assessment of internal control, risk management systems, compliance and internal audit functions

8.1. Evaluation of the situation of the Company and TAURON Capital Group

Evaluation of TAURON Polska Energia S.A. situation

Evaluating the financial situation of TAURON Polska Energia S.A., the Supervisory Board recognises that it is stable, which is confirmed by the rating of Fitch agency at the BBB level with a stable outlook. It should be indicated that the agency has revised the outlook from negative to stable taking into account measures to be undertaken by the Company with the aim of improvement of its financial profile in the nearest five years,

including a reduction of long-term planned capex and the plan of suspending dividend payment until 2019. The stable outlook also reflects the reduced risk of covenant breach and improved medium-term liquidity of the Company as compared to 4Q 2015 when the outlook was revised to negative.

The financial statement of TAURON Polska Energia S.A. drawn up for the financial year ended on 31 December 2016 indicated the negative net financial result in the amount of PLN 166 million. The main reason of the net loss was the necessity to recognise the results of impairment tests referring to stocks and shares as well as intra-group loans and bonds in subsidiaries, performed as at 30 June 2016 and 31 December 2016, in the financial statements. The necessity to apply the write down resulted from external circumstances affecting long-term maintaining of the Company capitalisation at a level below the carrying amount, including a decline in prices of energy certificates of origin from renewable sources, introduction of new regulations in the RES area, continuing unfavourable market conditions in terms of profitability of coal-fired power generation as well as growth in the risk-free rate.

In 2016, the process of centralisation of functions and taking over the competence of companies of TAURON Capital Group was continued, aimed at improvement of effectiveness. A new Business Model was also implemented, defining the assumptions of functioning of the Company and TAURON Capital Group and the distribution of tasks and responsibilities among defined units: Corporate Centre (holding activity), Business Areas (including the commercial activity of TAURON) and Centres of Common Services.

TAURON Polska Energia S.A., as a parent company in TAURON Group fulfils, in particular, the governing and the consolidating function. It also conducts activity in the scope of wholesale trading in electricity and other products of the energy market. In connection with the foregoing, the major sources of the Company income include dividends from subsidiaries as well as revenue on sales of electricity, coal, gas, property rights pertaining to electricity certificates of origin, CO2 emission allowances and commercial services.

In 2016, the Company recorded:

- 1) revenue on sales at a level of PLN 7,995 million, 12% lower than in 2015, mainly due to a lower volume of trading in electricity (among others, as a result of a reduced liquidity of forward products and a lower demand from sales companies of TAURON Capital Group),
- 2) revenue from operating activity at a level of PLN 1 million,
- 3) revenue on financial activity at a level of PLN 2,015 million, 2% higher than a year ago, mainly due to higher interest on bonds and loans; dividends from subsidiaries constituted 98% of the level achieved a year ago.

In 2016, the Company incurred:

- 1) cost of goods, materials and services sold at a level of PLN 7,838 million, lower by approximately 14% as compared to 2015, which was mostly affected by lower costs of electricity purchase arising from the lower electricity purchase volume,
- 2) costs of sales and overhead costs at a level of PLN 101 million, 14% lower YoY - the decline mainly referred to costs of wages and benefits as well as outsourced consultancy services.
- 3) costs of other operating activity at a level of PLN 93 million, much higher than a year ago, due to the necessity to create the provision for tax risks in connection with the pending control proceedings and to recognise a liability as a result of the Company declaration to make a contribution to the statutory fund of the Polish National Foundation,
- 4) costs of financial activity at a level of PLN 2,130 million, 60% lower than the level of last year due to recognising in 2016, similar to 2015, of impairment write downs against the value of shares and stocks in subsidiaries (in 2016 it amounted to the total of PLN 1,610 million, in relation to PLN 4,931 million in 2015).

As at 31 December 2016 the carrying amount of the Company amounted to PLN 27,672 million and it was higher by 5% (PLN 1,198 million) in relation to the status as at 31 December 2015. The most significant change refers to:

- 1) in assets - a growth in investment in bonds of subsidiaries and a growth in the status of receivables,
- 2) in liabilities: a growth in long-term liabilities, mainly due to the issue of bonds under the bond issue programme and the credit received from the EIB as well as a decline in short-term liabilities, due to the redemption of intra-group bonds.

In 2016, as compared to the status in 2015, the structure of assets did not change significantly - fixed assets constituted, respectively, 93% and 94% of the total carrying amount. In the structure of liabilities, equity constituted 60% as compared to 63% at the end of 2015. Financial liabilities represented the most significant item of liabilities - 37% of the total liabilities in 2016, as compared to 34% in 2015.

The status of cash gained from operating, investment and financial activities of the Company for 2016, after considering the status of opening balance of cash flows, amounted to PLN (1,045.4) million. The level of cash closing balance results from the adjustment of cash and pecuniary assets, consisting of balances of loans granted and received, implemented under cash pooling transactions, due to the fact that they do not constitute cash flows from investment or financial activities, therefore, being used mainly for management of current cash flows.

Shares of TAURON Polska Energia S.A. have been listed at the WSE Primary Market since 30 June 2010. In 2016, the price of TAURON shares was significantly affected by the external environment and ranged from PLN 2.38 to PLN 3.17 (according to closing prices).

The main reasons of the overall discount on valuation of domestic energy companies in 2016 included: regulatory uncertainty related to the future support system for renewable energy sources, write downs related to the impairment of assets in the electricity generation segment and risks associated with the involvement of energy companies in projects in the coal mining sector or related to building generation capacity based on hard coal.

It should be stressed that in 2016 the quotations of the biggest European energy groups also did not manage to lose the long-term downward trend.

The measures striving to guarantee financial stability of TAURON Capital Group in the forthcoming years supported quotations of TAURON shares in 2016. The most important measures included: the development of the new strategy, the implementation of consecutive Efficiency Improvement Programme for 2016-2018, raising the maximum level of the net debt/EBITDA covenant from 3.0x to 3.5x and the issue of hybrid bonds.

Evaluation of TAURON Capital Group situation

The situation of TAURON Group is stable.

TAURON Capital Group is a vertically integrated energy group and conducts its operations in all key segments of the energy market (excluding electricity transmission which is the sole responsibility of the Transmission System Operator), i.e. in the area of coal mining, generation, distribution and sales electricity and heat as well as other products of the energy market. The Group delimited operational segments corresponding to its areas of activity: Mining, Generation, Distribution, Sales and Other.

The EBITDA generated by TAURON Group in 2016 at a level of PLN 3,337 million was 5% lower than the EBITDA result obtained in 2015. Segments with the highest shares in EBITDA of TAURON Group include: Distribution, Generation and Sales.

In 2016, the Mining Segment recorded a negative EBITDA result (PLN -82 million), mainly due to the lower volume and price of coal sales, which was mostly affected by the market situation - the oversupply of coal in the domestic market and the associated price competition among market participants. The results were also affected by the acquisition of the Nowe Brzeszcze Grupa TAURON company which recorded a negative EBITDA level (PLN -46 million) in 2016.

In 2016, the Generation Segment recorded EBITDA at a level of PLN 545 million, lower by 28% than the level achieved in 2015, which was affected by higher costs of CO₂ reserve

- the effect of a higher deficit of free CO₂ emission allowances in relation to CO₂ emission YoY and higher prices of forward CO₂ contracting YoY. Other factors which had an adverse effect on the results achieved also included: lack of support to hydroelectric power plants with the installed electrical capacity over 5 MW_e and limitation of the support to co-burning (as of 1 January 2016) and lower production from RES YoY; (optimisation of performance of biomass units and worse wind conditions in relation to the previous year). On the other hand, the improvement of results YoY was affected by higher revenues from the ORM as the effect of a higher volume of available capacity (lower contracting sales of electricity YoY) and a higher unit rate of the ORM.

In 2016, the Distribution Segment maintained a stable EBITDA level (PLN 2,395 million, a growth by 1% YoY), mainly as a result of the growth in the volume of sales of distribution services, with a lower average rate and reduction of grid losses costs. Factors positively influencing the results obtained included a one-off event - the necessity to reduce the underwriting provision due to the harmonisation of the Company Collective Bargaining Agreement in companies of the Distribution Segment as well as the lowering of the retirement age.

In 2016, EBITDA of the Sales Segment was higher by 29% than in 2015 (PLN 490 million in relation to PLN 380 million), which was mostly affected by lower costs of property rights redemption (low market prices, in particular, PM OZE) and the provision created in 2015 for agreements giving rise to liabilities with the joint venture - EC Stalowa Wola, in the total amount of PLN 182.9 million. In 2016, the provision was increased by PLN 16 million due to reversal of the discount.

In 2016, the Other Segment achieved the EBITDA result at a level of PLN 115 million, higher by 14% in relation to 2015, which was mostly affected by recognising the result of the KOMFORT-ZET company in 2016, in connection with its covering by consolidation in accordance with the Accounting Policy of TAURON Group, as well as gaining a higher margin on sales of limestone and derivatives.

The consolidated financial statement of TAURON Capital Group drawn up for the financial year ended on 31 December 2016 indicated:

- 1) the operating result at a level of PLN 802 million, in relation to PLN -1,901 million in 2015,
- 2) the net financial result at a level of PLN 370 million, in relation to PLN -1,804 million in 2015.

Both in 2016 and in 2015, the financial results (in own cost of sale at an operational level) comprised results of impairment tests of tangible fixed assets, in accordance with IAS 36 Impairment of assets which indicated that a part of assets of the Generation Segment should be covered by an additional write down. In 2016, a partial reversal of write downs on tangible fixed assets, created earlier also occurred. The necessity to perform write downs resulted primarily from market conditions that have been unfavourable for electricity generators and the resulting application of more conservative forecasts of electricity prices and reduced generation volumes in future.

In the reporting period ended on 31 December 2016, TAURON Capital Group generated revenues lower by 3.4% as compared to the values achieved in 2015, due to lower revenue on sales of:

- 1) electricity - a lower volume of retail sales (by 10.8%), partly set off by the growth in the volume of sales on the wholesale market (by 3.5%),
- 2) distribution service - a rate for distribution services delivered to end consumers lower by 2.9% and lower revenues on connecting fees,
- 3) certificates of origin - a decline in prices and volume.

In 2016, costs of activity of TAURON Capital Group amounted to PLN 16.8 billion, which means that their level was lower by 16.4% than costs incurred in 2015. The above difference results from recognition and reversal of write downs on tangible fixed assets at a level significantly lower than the write down created in the year ended on 31 December 2015.

Should the aforementioned one-off events be disregarded in the results, the level of TAURON Capital Group costs in 2016 would be lower than costs incurred in the corresponding period of 2015 by over 3.3%, which results from the following factors:

- 1) commencement of activity of the new company, ZG Brzeszcze in the Mining Segment as of 1 January 2016, which affected the growth in operating costs YoY,
- 2) a decline in the consumption of materials and energy, in connection with lower prices of fuel purchase and lower electricity production,
- 3) a growth in costs of taxes and fees, which is associated with higher costs of CO₂ reserve as a result of a higher deficit of free CO₂ emission allowances in relation to CO₂ emission YoY and higher costs of term CO₂ contracting YoY,
- 4) a growth in costs of distribution services, mainly as a result of higher purchase costs of transmission services due to a higher rate of the qualitative fee applied to higher electricity consumption, and the RES fee introduced as of July 2016,
- 5) lower costs of electricity sold resulting from a lower volume,
- 6) lower costs of amortisation and depreciation - the effect of write-offs due to the impairment in the value of tangible fixed assets and intangible assets,
- 7) accomplishment of commercial coal sales below the volume of coal produced, which did not take place in the corresponding period of the previous year. In 2015, TAURON Capital Group carried out sales of coal from reserves, which resulted from limited production as a result of geological and mining disturbances and deterioration in the qualitative parameters of the dredging spoils.

As at 31 December 2016 the statement of financial situation of TAURON Capital Group indicates a balance sheet total lower by o 4.3%, as compared to the status at the end of 2015.

Despite the application of impairment write downs, the value of tangible fixed assets of TAURON Group increased by PLN 1,024 million (3.6%), which is the resultant of the following events:

- 1) a growth in the value of tangible fixed assets as a result of investments in tangible fixed assets carried out in companies of TAURON Capital Group (mainly in TAURON Wytwarzanie, TAURON Dystrybucja and TAURON Ciepło) and intangible assets (mainly TAURON Dystrybucja and TAURON Obsługa Klienta),
- 2) reclassification of electricity certificates of origin property rights and greenhouse gases emission allowances acquired in previous years to current assets, in connection with the requirement to fulfil the legal obligation of their redemption.

In the analysed period, as compared to the status at the end of 2015, the value of current assets increased (by PLN 361 million, i.e. 9%), which was mainly determined by: a growth in the value of electricity certificates of origin and rights to CO₂ greenhouse gases emission and the growth in the value of inventory (the effect of purchase of CO₂ emission allowances with the intention of their resale, which did not take place in 2015).

In 2016, similar to previous years, equity was the predominant funding source of TAURON Capital Group assets, the share of which in the total liabilities amounted to almost 50%.

In relation to the status at the end of 2015, the value of long-term liabilities of TAURON Capital Group increased (by PLN 3,836 million, 78%), mainly due to the issue of bonds with the nominal value of PLN 4,285 million in the reporting period. On the other hand, the value of short-term liabilities of TAURON Capital Group decreased (by PLN 2,630 million, i.e. 35%), which was mainly determined by the redemption of bonds with the nominal value of PLN 3,300 million throughout 2016.

In the statement of cash flows for 2016, TAURON Capital Group generated a positive flow on operating activity at a level of PLN 3,064 million (90.5% of the 2015 level). A decline in the gross financial result had the highest impact on the change in this position (excluding the revaluation write down) and depreciation as a non-monetary factor by PLN 248 million and the payment of income tax higher than in 2015.

The value of cash flows on investment activities in 2016 was negative and it was lower by approximately 8% than the investment expenditure recorded in 2015 (return of public aid in the amount of PLN 131 million

executed by Nowe Brzeszcze Grupa TAURON company, and lower expenditure on the purchase of fixed assets and intangible assets).

The positive value of cash of financial nature results from the issue of bonds performed in 2016, with the total nominal value of PLN 4,285 million and from the redemption of bonds issued in previous years, with the nominal value of PLN 3,330 million and the repayment of credits and loans in amount of PLN 140 million.

TAURON Capital Group continues the development process and keeps strengthening its market position. It should be stressed that the value of operating flows shows a positive balance, consequently enabling TAURON Capital Group to finance its current operations independently. The ratio of current liquidity and the net debt to EBITDA ratio remain at a safe level.

In 2016, TAURON Capital Group incurred the capital expenditure of PLN 3,817 million, i.e. lower by 8.6% than expenditure incurred in 2015, which amounted to PLN 4,175 million. It results mainly from the decline of expenditure in the Generation and Distribution Segments.

The most important investment projects implemented in 2016:

- 1) in the Mining Segment: the construction of the 800 m level at ZG Janina (PLN 61 million), the construction of Grzegorz shaft at ZG Sobieski (PLN 24 million), the investment programme of ZG Brzeszcze (PLN 100 million),
- 2) in the Generation Segment: the construction of new capacity of 910 MW at (PLN 1,237 million), the construction of the flue gas de-nitrification installation and modernisation of 200 MW units in El. Jaworzno III (PLN 11 million), the construction of new capacity of 50 MW in co-generation at EC Tychy (PLN 107 million), the construction and modernisation of hydroelectric power plants (PLN 18 million),
- 3) In the Distribution Segment: the construction of new connections (PLN 591 million), the modernisation and replacement of grid assets (PLN 953 million).

8.2. Evaluation internal control systems, risk management, compliance and internal audit functions

Taking into account *Best Practice of WSE Listed Companies 2016*, the Supervisory Board evaluated the effectiveness of the internal control system, risk management, compliance and internal audit functions, including all significant control mechanisms, in particular, those related to financial reporting and operating activity.

In accordance with recommendation III.R.1. of *Best Practice 2016*, entities responsible for the systems and functions indicated above were separated, whereas in accordance with rule III.Z.2 of *Best Practice 2016*, persons responsible for risk management, compliance and internal audit report directly to the President of the Management Board or other Member of the Management Board.

Evaluation of internal audit functioning

The internal audit system existing in TAURON Polska Energia S.A. is evaluated as effective. The organisational unit of the Executive Director for Audit is located in the organisational structure of TAURON Polska Energia S.A. and reports directly to the President of the Management Board, which ensures independence and enables proper implementation of the functions. The scope of obligations and powers defined in internal regulations as well as the adopted methods of work and resources available to the Internal Audit Team enable effective accomplishment of the goals. In 2016, 36 audit tasks were carried out, including 15 planned tasks and 21 ad-hoc inspections. The results of those works comprised observations and recommendations which contributed to the improvement of the internal control system in TAURON Polska Energia S.A. as well as in the entire TAURON Group. The level of implementation of the recommendations is monitored on an on-going basis by the Internal Audit Team. The scope of audit plan adopted for 2017 comprises significant issues and areas of the internal control system from the point of view of TAURON Polska Energia S.A. as well as the entire TAURON Group.

The goal of the Internal Audit Team is to plan and implement the auditing tasks, among others, of advisory nature, as well as to perform the commissioned ad hoc inspections. The procedures and rules of its operation

are defined in the Regulations of Internal Audit in TAURON Capital Group as well as in the rules of cooperation applicable in individual companies of TAURON Capital Group. While implementing the internal audit function, the Company acts in compliance with the Code of Ethics and International Standards of Internal Audit Professional Practice.

The table below presents the basic internal audit functions in TAURON Capital Group.

Table no 8. Basic internal audit functions in TAURON Capital Group.

No.	Basic internal audit functions in TAURON Capital Group
1.	Supporting TAURON Capital Group in accomplishing the adopted strategic goals.
2.	Supporting TAURON Capital Group in the process of ensuring the accurate and effective functioning of organisational and process solutions constituting its corporate governance.
3.	Contributing to the improvement of risk management processes and supporting the process of risk identification and assessment.
4.	Supporting TAURON Capital Group in maintaining of the effective internal control system and promoting the continuous improvement of the internal control system.
5.	Contributing to corporate culture building serving for effective counteracting of abuse.

The Executive Director of Internal Audit implements its tasks through annual audit plans comprising both TAURON Polska Energia S.A. and other companies of TAURON Capital Group. Results of internal audit activities contain recommendations adjusting control mechanisms operating in the Company (TAURON Capital Group) as well as suggesting changes of effectiveness nature.

Evaluation of compliance management

The compliance management system existing in TAURON Polska Energia S.A. Should be evaluated as optimal and complex. The system ensures the company performance in compliance with the broadly understood regulatory requirements as well as elimination of risk of unfavourable behaviours and activities. The proper and comprehensive operation of the compliance management system in TAURON Polska Energia S.A. is demonstrated, in particular, at a level of cooperation with customers (through the elimination of a possibility to establish or pursue cooperation with entities of doubtful reliability) as well as within current operational activities of individual company units (through a possibility of inquiries submitted by those units concerning the compliance as well as the submission of potential infringement cases). Structuring of the *compliance* system in TAURON Polska Energia S.A. consists in separating the Office of Compliance Representative within the company, whose tasks comprise, in particular, compliance management in the Company in order to develop the actual status in the organisation, where the risk of occurrence of irregularities will be minimised. In accordance with the recommendations contained in section III.R.1. of *Best Practice 2016*, the Company separated a unit responsible for the execution of tasks in the scope of compliance in its structure. The Office of Compliance Representative was established as of 1 May 2016 (in connection with the entry into force of a new organisational structure and business model of TAURON Polska Energia S.A.) as a result of transformation of an independent position - a compliance representative.

The specific functions of the Office of Compliance Representative comprise:

- 1) implementation of the compliance management system,
- 2) implementation of tasks ensuring the compliance of activities of TAURON Group with the legal regulations and standards with the purpose of minimisation of events posing an adverse impact on operations of TAURON Group,
- 3) co-creation of the internal control system.

The functions of the Office of Compliance Representative are implemented through: preventive measures (consisting in creating the relevant structures and methodology in order to prevent abuse) and remedying measures (aimed at elimination of existing irregularities).

The compliance management takes place in three areas:

- 1) compliance with the law – *sensu largo*, i.e. both the unconditionally binding regulations of the national and international law as well as any standards and guidelines of regulatory bodies, in particular, the European Union authorities, e.g. *Guidance, Regulatory Technical Standards, Questions & Answers* issued by ACER (*Agency for Cooperation of Energy Regulators*) and ESMA (*European Security Market Authority*),
- 2) compliance with the internal and intra-corporate regulations binding in TAURON Polska Energia S.A. and TAURON Group,
- 3) compliance with the ethical and moral standards.

Within the framework of compliance oversight pursued by the Office of Compliance Representative, the TAURON Group's Code of Ethics is binding in TAURON Group, reflecting the directions set out in the TAURON Group's Sustainability Strategy streamlining its activity in the off-balance sheet area. On the other hand, in individual companies of TAURON Group, Ethical Commissions operate which examine all cases of behaviours contrary to the law, internal and intra-corporate regulations or ethical standards. Moreover, in accordance with the recommendations contained in section III.Z.2. of Best Practice of WSE Listed Companies 2016, the Office of Compliance Representative reports directly to the member of the management board - Vice-President of the Management Board for Corporate Management, simultaneously ensuring a possibility of reporting to the President of the Management Board and the Supervisory Board.

In 2016, activities of the Office of Compliance Representative comprised, besides answers to current questions related to compliance originating from business units of the company, participation in projects associated with the adjustment of operations of TAURON Polska Energia S.A. and TAURON Group to multiple obligations arising from the European Union regulations, including:

- 1) reporting obligations resulting from Regulation of the European Parliament and of the Council (EU) No. 1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency (REMIT) and Commission Implementing Regulation (EU) No. 1348/2014 of 17 December 2014 on data reporting implementing Article 8(2) and Article 8(6) of REMIT,
- 2) change of publication method of so-called internal information (i.e. information concerning scheduled and unscheduled capacity shortages) covered by Regulation of the European Parliament and of the Council (EU) No. 1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency (REMIT),
- 3) Obligations associated with the entry into force of Regulation of the European Parliament and of the Council (EU) No. 596/2014 of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (MAR),
- 4) implementation in TAURON Group of the requirements arising from Directive of the European Parliament and of the Council 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MIFID II) and Regulation of the European Parliament and of the Council (EU) no. 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MIFIR Regulation).

Moreover, the Office of Compliance Representative pursued on an on-going basis a process of reliability examination of (potential) customers and evaluated them in accordance with the Procedure of *Customer Reliability Assessment* effective in TAURON Polska Energia S.A.

In 2017, the modernisation and extension of the compliance management system operating in TAURON Group is planned. It will consist, in particular, in the development of the compliance programme (policy) for TAURON Group specifying in retail areas covered by special compliance monitoring,

including the methodology and structures related to operational cooperation between the Office of Compliance Representative and such areas.

Moreover, detailed rules in the scope of scope of the so-called corporate compliance will be developed, i.e. functioning of compliance management in individual companies included in TAURON Group. In 2017, the amendment to the TAURON Group’s Code of Ethics applicable in TAURON Group is also planned, in the context of corporate values currently adopted in TAURON Group. Moreover, the *Procedure of Customer Reliability Assessment* of TAURON Polska Energia S.A. will be amended in order to adapt it to the latest guidelines of regulatory authorities related to the assessment of customers’ reliability and extend it to all companies included in TAURON Group.

In the context of project activities associated with the entry into force of the European Union regulations, among others, works with the following objectives will be carried out:

- 1) adjustment of operations of TAURON Group to the requirements arising from Directive of the European Parliament and of the Council 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MIFID II) and Regulation of the European Parliament and of the Council (EU) no. 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MIFIR Regulation) - in connection with postponing of the entry into force of the said directive from 3 January 2017 to 3 January 2018 by the European regulator,
- 2) implementation of the obligations arising from Regulation of the European Parliament and of the Council (EU) No. 596/2014 of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (MAR), in the scope of publication of classified information related to greenhouse gases emission allowances.

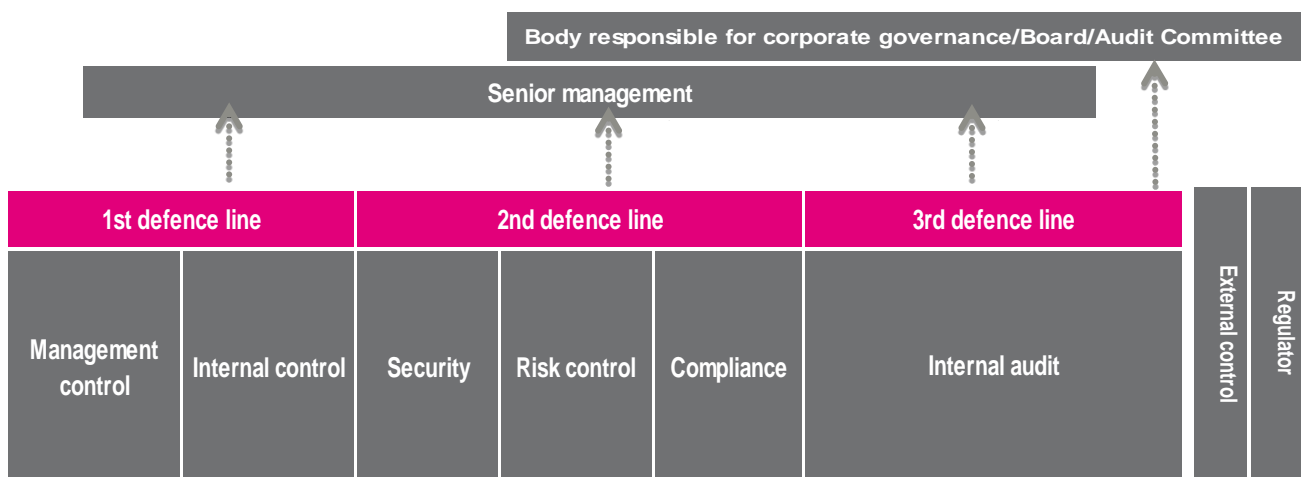
Considering the foregoing, it should be stated that the compliance management system existing in TAURON Polska Energia S.A. ensures the performance of the organisation in the manner corresponding to regulatory requirements where the risk of occurrence of irregularities is limited to minimum. This effect is achieved through complex operation of the system, comprising both the preventive aspect (counteracting irregularities and adjustment of the company operations to regulatory requirements emerging on an on-going basis) and the recovery aspect (elimination of existing cases of abuse).

Risk management in the “Model of three defence lines”

In order to ensure security of the organisation functioning, the model of “three defence lines” operates in TAURON Capital Group, comprising internal control, independent control within the second defence line and institutional control. In particular, the risk management function co-creates a system of internal control in TAURON Capital Group constituting an element of the second defence line, next to the function of ensuring the compliance and security management.

The figure below presents the “Model of three defence lines”.

Figure no. 1. Model of three defence lines



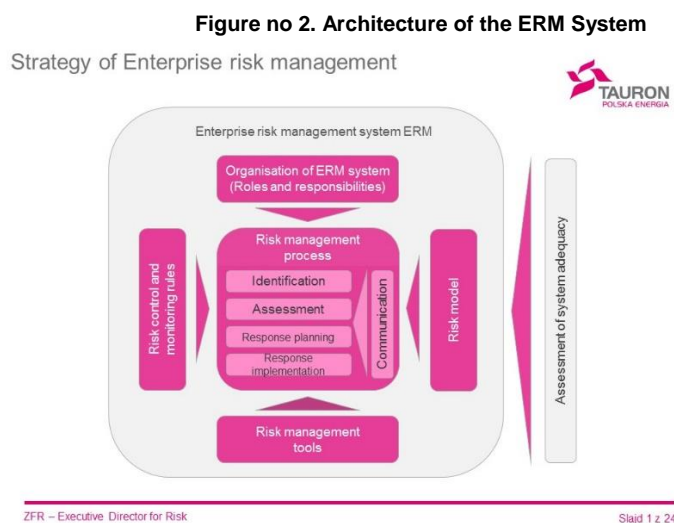
Functions of individual defence lines:

- First Line of Defence** Business units obliged to perform ongoing control embedded in implementing tasks and the functional control.
- Second Line of Defence**
 - the function of risk management implemented in accordance with the adopted *Corporate risk management strategy in TAURON Group* and detailed policies related to main risk categories,
 - the function of assuring the compliance understood as adjustment of the organisation to the applicable legal regulations,
 - the function of ensuring information security and technical safety.
- Third Line of Defence** internal audit responsible for creating the internal control system and adequate functioning of the three defence lines model.

Risk management system

At a level of the Capital Group, a complex enterprise risk management system (ERM) has been implemented whose overriding objective is to support the implementation of TAURON Group’s Strategy. The central element of system architecture is the process of enterprise risk management means continuous measures comprising continuous activities in the scope of risk identification, risk assessment, planning of risk response, implementation of the adopted risk response and communication between risk management process participants. The implementation of this process, in particular, ensures increasing the predictability of achieving the strategic goals, including sustainable creation of the financial result. Moreover, the architecture of the ERM system comprises elements ensuring its effective functioning of the process, including: risk management tools, risk model, principles of risk control and monitoring and the organisational structure of the ERM system.

The figure below presents the architecture of the ERM system.



The ERM system operating in the Group ensures comprehensive and consistent risk management rules linked with each other in terms of methodology and information. The architecture of the risk management system stipulates centralisation of the function of risk assessment, monitoring and control, simultaneously ensuring consistent rules of risk management and a possibility to assess the full risk profile in the organisation,

Moreover, the operating rules are implemented at a level of all significant processes, comprising all elements of the value chain of TAURON Capital Group simultaneously. This allows for comprehensive and adequately early risk identification in areas of the Group and, as a consequence, ensures a possibility to undertake effective risk response.

In addition, the effectiveness of the risk management system is supported through functional and organisational separation of the function of risk taking and management from risk control

and monitoring, which takes place from the level of risk area centralised at a level of the Group, located in the structure of the parent Company. In accordance with the requirements of the *Best Practice of WSE Listed Companies*, the Executive Director for Risk responsible for coordination of the risk measurement and control function reports directly to the member of the Management Board and has a possibility of direct reporting to the audit committee.

The figure below presents the independence of the risk measurement and control function.

Figure no 3. Independence of the risk measurement and control function



The risk management system operating in the Group is a systematic process and it is subject to continuous improvement in order to adjust it to the specific nature and organisational structure of TAURON Capital Group as well as the changing environment. In 2016, a comprehensive review of the system architecture was performed, as a result of which the central *Enterprise Risk Management Strategy in TAURON Group* was developed and implemented. This Strategy introduces consistent and fundamental risk management rules, in order to ensure a consistent approach in individual areas of Capital Group operation. Subsequently, based on the said strategy, detailed rules for the management of key risk categories are created in the form of Policies.

The figure below presents the risk management Strategy.

Figure no 2. Risk Management Strategy

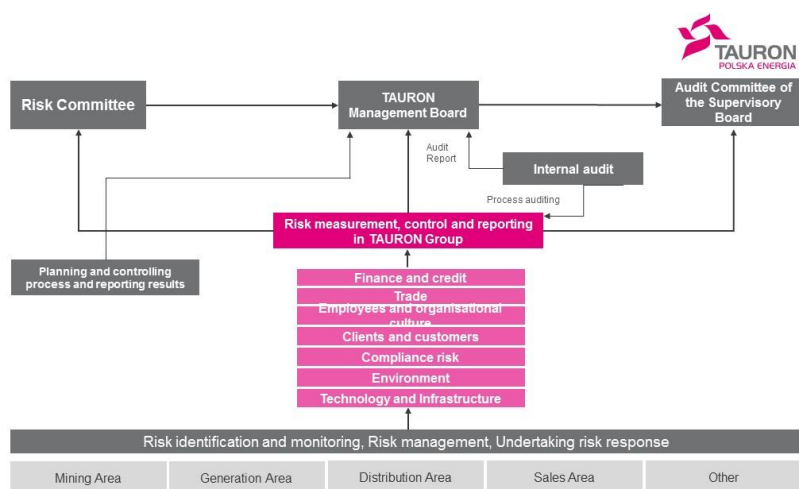


In the framework of the implementation of the risk control and monitoring functions, the Management Board of TAURON approves the risk Tolerance, taking into consideration the specific nature and scope of operations of TAURON Capital Group. The level of the tolerance is determined as a value and the rules of measurement of individual risks in the organisation ensure the consistency of risk measurement with the applied tolerance definition. The risk tolerance constitutes basis for allocation of its level to the global limits dedicated to a single risk or many specific risks, which may subsequently be allocated to operating limits within specific risk management. The early warning system constituting a set of Key Risk Indicators (KRI) defined for all risks identified at a level of individual Group areas is a supplementary tool, used for risk monitoring and control. Subsequently, at the system level, Early Warning Indicators (EWI) are separated, subject to permanent control in terms of prudential thresholds determined for them, i.e. the threshold of acceptance, mitigation and escalation.

Within the framework of the ERM system organisation, roles and responsibilities of risk management process participants in TAURON Capital Group were defined. Activities within the implementation of the process are undertaken on a continuous and regular basis, observing the principle of significance and explicitly assigned responsibility (risk ownership) and activity of the process participants. Within the risk management process the Risk Committee fulfils a special role, as a team of experts which permanently and continuously initiates, analyses, monitors, controls, supports and supervises the performance of the ERM enterprise risk management system in TAURON Capital Group. The Risk Committee comprises persons with relevant knowledge on the Company and its environment as well as the required qualifications and powers. The role of the Risk Committee is to define risk management norms and standards in TAURON Capital Group and to supervise the effectiveness of the risk management process. Within the Risk Committee two separate teams were established for the commercial risk area and for the financial and credit risk area.

The figure below presents the participants of the risk management process.

Figure no 3. Participants of the risk management process



ZFR – Executive Director for Risk

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Considering the foregoing, the Supervisory Board evaluates the risk management system operating in TAURON Polska Energia S.A. provides the relevant level of operational security. Moreover, the Company actively manages all risks aiming at maximum reduction or elimination of their potential adverse effects, in particular on the financial result of TAURON Capital Group.

9. Assessment of the method of fulfilling information obligations related to the application of corporate governance rules by the Company

In 2016, the Company was subject to the corporate governance rules, described in the document *Best Practice 2016*, constituting the Annex to Resolution of the WSE Board No. 27/1414/2015 of 13 October 2015. The said rules entered into force as of 1 January 2016.

In connection with the entry into force of the set of *Best Practice 2016* as of 1 January 2016, the Management Board of the Company adopted the recommendations and rules defined in the aforementioned document for application, excluding the rules defined in: IV.Z.2, VI.Z.1, VI.Z.2.

At the same time, the Management Board recognised that the following recommendations and rules of *Best Practice 2016* do not apply to the Company: I.Z.1.10, III.Z.6, IV.R.2.

Other rules specified in the *Best Practice of WSE Listed Companies 2016* were applied by the Company.

The obligations related to the application of corporate governance rules are defined in §20 of the Regulations of the Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.) and in § 91(5)(4) of the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information provided by issuers of securities and on conditions under which information required by legal regulations of a third country may be recognised as equivalent.

In accordance with §29 of the Exchange Regulations, should a specific detailed corporate governance rule not be applied on a permanent basis or be breached incidentally, the issuer shall publish a report containing information about which rule is not applied at all or has not been applied, under what circumstances and for what reasons and how the issuer intends to remove effects, if any, of not having applied a given rule on an occasion or what steps it intends to take to mitigate the risk of the rule not being applied in the future. The report should be published at the issuer's official website and in the way analogous to that applied to submission of current reports. The obligation to publish the report should be performed as soon as the issuer becomes reasonably convinced that a given rule will not be applied at all or on an occasion, in any case promptly after an event representing a breach of a detailed corporate governance rule occurs.

In connection with the provisions of § 29 of the Exchange Regulations, the Company published:

- 1) on 2 January 2013, the current report No. 1/2013, via the EBI system, containing the information on the waiver of application of the rule contained in Section IV item 10 of the document *Best Practice of WSE Listed Companies*,
- 2) on 1 February 2016, via the EBI system, the report concerning the application of best practice of Warsaw Stock Exchange Listed Companies, containing detailed information related to the application or failure to apply individual rules of *Best Practice 2016*. The text of the report is also available on the Company website in the section: Investor Relations/ Information on the Company/ Corporate Governance.

Another legal act defining the information obligations associated with the application of corporate governance rules is the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information provided by issuers of securities and on conditions under which information required by legal regulations of a third country may be recognised as equivalent (hereinafter referred to as: The Regulation).

In accordance with the provisions of §91(5) the report on the issuer's activity should contain, among others, the declaration on the application of the corporate governance rules containing at least the following information:

- 1) indicating:
 - a) the set of corporate governance rules the issuer is subject to and the venue where the text of the set of rules is available to the public, or
 - b) the set of corporate governance rules the issuer could have decided to apply on a voluntary basis and the venue where the text of the set is available to the public, or
 - c) any relevant information related to corporate governance practice used by the issuer, going beyond the requirements stipulated under the national law, including the presentation of information on corporate governance practice used by it,

- 2) to the extent the issuer has waived the provisions of the set of corporate governance rules, indicating such provisions and explaining the reasons for such waiver.

Pursuant to § 91(5) of the Regulation, the Company published the following information and documents on its website: declarations on the application of the corporate governance rules for 2010, 2011, 2012, 2013, 2014, 2015, as a part of reports of the Management Board on operations of TAURON Polska Energia S.A. for the respective year.

According to the assessment of the Supervisory Board of TAURON Polska Energia S.A., in 2016 the Company accurately fulfilled information obligations referring to the application of corporate governance rules.

10. Assessment of rationality of the Policy pursued by the Company in the scope of sponsoring, charity or other similar activities

The activity associated with corporate social responsibility is conducted by TAURON Polska Energia S.A. and companies of TAURON Group based on and in compliance with the Sustainability Strategy. In 2016, activities in the scope of corporate social responsibility were carried out in accordance with the *Sustainability Strategy of TAURON Group for 2016-2018 with the outlook up to 2020* effective as of 1 January 2016.

The Sustainability Strategy of TAURON Group for 2016-2018 with the outlook up to 2020 is based on five strategic directions - two primary (ensuring energy supply security, customer orientation) and three secondary (ethical culture and engaging workforce, environment protection and social and business partnership). The first review of this type will be published in mid-2017.

Moreover, TAURON Polska Energia S.A. publishes the annual social report prepared in accordance with the highest standards presenting activities of TAURON Group in the area of corporate social responsibility to stakeholders. In 2016, for the first time, the Sustainability Report for 2015 was integrated with the Annual Report of TAURON Group (the integrated report).

Projects in the area of corporate social responsibility carried out in 2016 by TAURON Polska Energia, companies of TAURON Group and TAURON Foundation respond to the directions of the Strategy, in particular, the direction supporting the social and business partnership.

In 2016, TAURON Polska Energia S.A. carried out sponsoring activity based on detailed internal regulations of this area comprising:

- 1) Rules of conducting sponsoring activity in TAURON Polska Energia S.A. Group,
- 2) Research methodology of selection, planning, analysis and reporting of effectiveness of sponsoring activities,
- 3) Strategy of TAURON brand.

Since 2009, the sponsoring activity of TAURON Group has been subject to regulations and in its primary version it implemented the provisions of Ordinance no. 5 of the Minister of Treasury of 13 February 2009.

Regulations of this area were created in cooperation with entities in the area of sponsoring specialised in the Polish market.

The conducted sponsoring activity is monitored, analysed and reported on an on-going basis, through detailed reports on the implementation of sponsoring agreements, surveys and analyses conducted in quarterly and annual cycles by specialised external entities and the supervision provided by organisational units of companies of the Group. In particular, in accordance with the adopted procedures, the Plan of sponsoring activity and the annual report on conducting of this activity is created, adopted under the resolution of the Management Board and submitted for opinion of the Supervisory Board. Moreover, the content of the sponsoring agreement is standardised.

The implemented procedures enable the assessment of effectiveness of the activities conducted through opinion surveys, measurement of the value and size of brand exposure in media, in the context of the activities conducted, measurement of implementation of sales targets, with reporting to the governing bodies of TAURON Polska Energia S.A.

In 2016, in connection with the publication of *Best Practice in the scope of pursuing sponsoring activity by companies with the State Treasury shareholding* by the Ministry of Treasury, a review and adjustment of existing regulations to the new requirements was launched. It is foreseen that the process should end in 2017 by adoption of revised rules of sponsoring area operation in TAURON Group. In the scope of this process, legal clauses indicated in the Best practice, so far not used, were immediately introduced into the practice of concluding sponsoring agreements.

As a result of the promotion effectiveness measurement, an independent research entity estimated the advertising equivalent achieved in relation to activities completed in 2016. Comparing the summarised value obtained in this way to the sum of all expenditure arising from sponsoring agreements the ROI ratio at a level of approximately 6.34. was obtained. It means that each zloty spent for that purpose generated promotional benefits to TAURON Capital Group whose preliminary value is independently, preliminarily estimated at approximately PLN 6.34.

The confirmation of the financial effectiveness of conducted activities is the high positioning of TAURON brand in an independent research report, Sponsoring Monitor 2016, which is the only source of this type of information on the Polish market. According to this report, TAURON occupies the 9th position in the TOP 10 sponsors ranking.

The charity activity in TAURON Polska Energia S.A. is implemented through TAURON Foundation whose statutory goal is to act to the benefit of public welfare, mainly in the scope of education, upbringing and teaching, and additionally, in the scope of health protection, development of economy, culture and arts, social welfare and social care, sport and recreation, environmental protection, protection of cultural assets and national heritage as well as promotion and organisation of volunteer activities. The Foundation operates on the basis of funds acquired mainly from companies of TAURON Group and charity activities of employees within employee voluntary service. The aid is granted based on the preliminary budget of the foundation for a given year, prepared by the Management Board and consulted with the Supervisory Board, according to the procedures defined in the Regulations on aid granting to beneficiaries.

In 2016, the Foundation implemented its goals, in particular, through co-managing and financing of the *Houses of Positive Energy* action and supporting natural and legal persons, institutions and organisations in their activity consistent with the Foundation goals.

Katowice, 15 March 2017

Chairwoman of the Supervisory Board -	Beata Chłodzińska
Vice-Chairwoman of the Supervisory Board -	Anna Mańk
Secretary of the Supervisory Board -	Jacek Szyke
Member of the Supervisory Board -	Stanisław Bortkiewicz
Member of the Supervisory Board -	Leszek Kozirowski
Member of the Supervisory Board -	Jan Płudowski
Member of the Supervisory Board -	Jacek Rawecki
Member of the Supervisory Board -	Stefan Świątkowski
Member of the Supervisory Board -	Agnieszka Woźniak