



**Report on the activities of the Supervisory Board
of TAURON Polska Energia S.A.
in the financial year 2018**

Katowice, 2 April 2019

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1. Introduction

Acting pursuant to Article 382 § 1 of Commercial Companies Code and § 20(1)(4) of the Articles of Association of TAURON Polska Energia S.A. (hereinafter referred to as the Company) and the 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 2018* (hereinafter referred to as: the Report) to the Ordinary General Meeting.

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

- 1) the Company's standing, including the assessment of the internal control, risk management systems, compliance and internal audit functions, comprising all significant control mechanisms, including, in particular those related to financial reporting and operational activity,
- 2) method of fulfilment of disclosure obligations by the Company, in relation to the application of corporate governance principles defined in the Rules of the Warsaw Stock Exchange (hereinafter referred to as the WSE Rules) and provisions related to current and periodical information submitted by issuers of securities,
- 3) 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 this Report, a detailed description of activity and performance of the Supervisory Board and its committees in the financial year 2018 is presented

2. Information on the term of office of the Supervisory Board, composition of the Supervisory Board and functions fulfilled therein 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 current, fifth term of office of the Supervisory Board, started on 29 May 2017, i.e. on the day of convening of the Ordinary General Meeting of the Company approving the financial statements for the last full financial year of the term of office of the members of the Supervisory Board of the fourth term, i.e. for the financial year 2016. In accordance with the Company Articles of Association this is a joint term of office and it shall last for three years.

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 authorizing 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 number 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 to that 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 together with subsidiaries of the State Treasury within the meaning of § 10(5) of the Articles of Association, holds a number of Company shares authorizing it 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 authorized 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 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 2018 and as at the date of drawing up this Report.

Table 1. Composition of the Supervisory Board as at 31 December 2018 and as at the date of drawing up this Report

No.	Name and surname:	Function
1.	Beata Chłodzińska	Chairwoman of the Supervisory Board
2.	Teresa Famulska	Deputy Chairwoman of the Supervisory Board
3.	Jacek Szyke	Secretary of the Supervisory Board
4.	Radosław Domagalski-Łabędzki	Member of the Supervisory Board
5.	Barbara Łasak - Jarszak	Member of the Supervisory Board
6.	Paweł Pampuszko	Member of the Supervisory Board
7.	Jan Płudowski	Member of the Supervisory Board
8.	Marcin Szlenk	Member of the Supervisory Board
9.	Agnieszka Woźniak	Member of the Supervisory Board

As at 1 January 2018 the Supervisory Board consisted of the following persons: 1) Beata Chłodzińska (Chairwoman of the Supervisory Board), 2) Teresa Famulska (Deputy Chairwoman of the Supervisory Board), 3) Jacek Szyke (Secretary of the Supervisory Board), 4) Radosław Domagalski - Łabędzki, 5) Barbara Łasak - Jarszak, 6) Paweł Pampuszko, 7) Jan Płudowski and 8) Agnieszka Woźniak.

The table below presents changes in the composition of the Supervisory Board during the financial year 2018.

Table no. 2. Changes in the composition of the Supervisory Board during the financial year 2018

Date	Changes in the composition of the Supervisory Board
16 April 2018	Ordinary General Meeting, acting pursuant to § 22(1) of the Company's Articles of Association appointed Mr. Marcin Szlenk to the Supervisory Board of TAURON Polska Energia S.A. of the fifth joint term of office.

Until the day of submission of this report, no other changes in the composition of the Supervisory Board occurred.

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

The term „independent Supervisory Board member” 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*. At least two members of the Supervisory Board should meet the criteria of independence as understood under the above Recommendation (hereinafter: independent Supervisory Board members).

Members of the Supervisory Board submitted declarations concerning the fulfilment of independence criteria to the Supervisory Board and to the Management Board of the Company.

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 2018 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 as at 31 December 2018 and as at the date of drawing up this report
1.	Beata Chłodzińska	Fulfils independence criteria
2.	Teresa Famulska	Fulfils independence criteria
3.	Jacek Szyke	Fulfils independence criteria
4.	Radosław Domagalski-Łabędzki	Fulfils independence criteria
5.	Barbara Łasak - Jarszak	Fulfils independence criteria
6.	Paweł Pampuszko	Fulfils independence criteria
7.	Jan Płudowski	Fulfils independence criteria
8.	Marcin Szlenk	Fulfils independence criteria
9.	Agnieszka Woźniak	Does not fulfil independence criteria

4. Information on significant issues considered 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's Articles of Association and the By-laws of the Supervisory Board of TAURON Polska Energia S.A., as well as corporate governance rules defined in *Best Practice 2016*.

In the financial year 2018 the Supervisory Board held, in total, 9 meetings and adopted 84 resolutions. At four meetings all Members of the Supervisory Board participated. 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 *TAURON Group's 2016-2025 Strategy*, including: goals, strategic initiatives and Efficiency Improvement Program, generated economic and financial results of the Company and TAURON Capital Group and the performance of the material and financial plan, 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 investments executed by the Management Board of the Company.

Within its 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 matters presented by the Management Board.

Table no. 4. Major issues considered by the Supervisory Board during its meetings in 2018

Main issues considered by the Supervisory Board during its meetings in 2018
<i>In the scope of its opinion-making / evaluation functions</i>
<ol style="list-style-type: none"> 1. it issued a positive opinion concerning the <i>Plan of conducting sponsoring activity in TAURON Group in 2018</i> and the amendments introduced thereto, 2. It evaluated the <i>Consolidated Financial Statements of TAURON Polska Energia S.A. Capital Group compliant with International Financial Reporting Standards approved by the European Union for the year ended on 31 December 2017, Report of the Management Board on operations of TAURON Polska Energia S.A. Capital Group for the financial year 2017 and the Consolidated Report of TAURON Polska Energia S.A. Capital Group on payments to governments for the year ended on 31 December 2017</i> in the scope of their compliance with books and documents as well as with the actual state of affairs; <i>it evaluated the Consolidated financial statements of TAURON Polska Energia S.A. in Capital Group, compliant with International Financial Reporting Standards for the financial year ended on 31 December 2017, the Report of the Management Board on the operations of TAURON Polska Energia S.A. Capital Group for the financial year 2017 and the Consolidated report on payments to governments for the financial year ended on 31 December 2017</i> in the scope of their compliance with the ledgers and documents as well as with the actual state of affairs 3. it evaluated the <i>Financial statements of TAURON Polska Energia S.A., compliant with International Financial Reporting Standards for the financial year ended on 31 December 2016</i> and the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. for the financial year 2016</i>, in the scope of their compliance with the books and documents as well as with the actual state of affairs; it evaluated the <i>Financial Statements of TAURON Polska Energia S.A. compliant with International Financial Reporting Standards for the year ended on 31 December 2017</i> and the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. for the financial year 2017</i> in the scope of their compliance with the books and documents as well as with the actual state of affairs, 4. it performed the evaluation of the Management Board's motion to the General Meeting of TAURON Polska Energia S.A. concerning division of net profit for the financial year 2017, 5. it adopted the <i>Report of the Supervisory Board of TAURON Polska Energia S.A. on the evaluation of the Consolidated financial statements of TAURON Polska Energia S.A. Capital Group and the Report of the Management Board on operations of TAURON Polska Energia S.A. Capital Group and the Consolidated report on payments to governments for the financial year ended 31 December 2017,</i>

Main issues considered by the Supervisory Board during its meetings in 2018

6. It adopted *the Supervisory Board Report on evaluation of the Financial Statements of TAURON Polska Energia S.A. and the Report of the Management Board on the operations of TAURON Polska Energia S.A. for the year ended 31 December 2017 and the motion of the Management Board concerning the method of distributing net profit for the financial year 2017,*
7. it issued a positive opinion concerning the *Annual Report on implementation of the Plan of conducting sponsoring activity in TAURON Group in 2017,*
8. it issued a positive opinion on *the Report of TAURON Polska Energia S.A. on representation expenses, expenses on legal services, marketing services, public relations and social communication services as well as on advisory services related to management for the year ended on 31 December 2017,* submitted to the General Meeting,
9. it approved *the Report of the Management Board of TAURON Polska Energia S.A. on the supervision over the implementation of investment projects for the year ended on 31 December 2017,*
10. it adopted the *Report of the Supervisory Board of TAURON Polska Energia S.A. on the supervision of the implementation by the Management Board of investments, including the purchase of fixed assets for the year ended on 31 December 2017* and issued a positive opinion and did not raise any objections as to the accuracy and effectiveness of cash expenditure related to the implementation by the Management Board of investments in the financial year 2017, including the purchase of fixed assets,
11. it adopted information on the introduction of amendments to the *Remuneration Policy of the subsidiaries' governing bodies.*

In the scope of decision-making competence

1. it adopted the *Report on activities of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2017 containing:*
 - 1) *the evaluation of the Company standing including an assessment of internal control, risk management and compliance systems and the internal audit function,*
 - 2) *the assessment of the Company's fulfilment of the disclosure obligations concerning the compliance with the corporate governance principles,*
 - 3) *assessment of the rationality of the policy of sponsorship, charity or other similar activities carried out by the Company,*
 - 4) *the assessment of compliance with the criteria of independence by members of the Supervisory Board,*
2. it adopted the amendments to the *Organizational Regulations of TAURON Polska Energia S.A.,* adjusting the distribution of the assignments among individual Members of the Management Board of the Company to undertaken reorganization measures and ensuring proper functioning of individual areas,
3. it approved the *Material and financial plan of TAURON Group for 2018 and the Material and financial plan of TAURON Polska Energia S.A. for 2018,*
4. it appointed new member of the Audit Committee to fill a vacancy in the Committee,
5. it granted consent to the conclusion of agreements for the implementation of sponsoring projects, agreements on corporate social responsibility (CSR), agreements for legal services and their amendments, where the remuneration exceeded PLN 500 thousand net on an annual basis,
6. it defined the method of exercising the voting right at General Meetings / Meetings of Shareholders of companies in relation to which TAURON Polska Energia S.A. is a dominant undertaking within the meaning of Article 4(3) of the *Act of 16 February 2017 on the protection of competition and consumers* in cases related to the amendments of articles of association / statutes of such companies, purchase of fixed assets, changes in the rules of remuneration of members of management boards and supervisory boards, increase in the share capital,
7. it adopted the *Framework work plan of the Supervisory Board of TAURON Polska Energia S.A. for 2019.*

In the scope of appointment of certified auditor, W zakresie wyboru firmy audytorskiej, zlecenia ekspertyz

1. it selected the company Ernst & Young Audyt Polska sp. z o.o. spółka komandytowa, as the auditor to examine the separate and consolidated financial statements of TAURON Polska Energia S.A. for the financial year 2018 and the review of the interim semi-annual separate and consolidated financial statements of the Company for the period ended on 30 June 2018,

Main issues considered by the Supervisory Board during its meetings in 2018

2. it selected Ernst & Young Audyt Polska sp. z o.o. spółka komandytowa as the audit firm to perform the audit and review the financial statements and consolidated financial statements of TAURON Polska Energia S.A. for the years 2019-2021,
3. it obligated the Management Board to select and award the contract to a consulting company to carry out analytical work in the field of cost optimisation in TAURON Group companies affecting the level of electricity bills (in connection with the speech of the Minister of Energy).

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

1. it analysed the current economic and financial situation of the Company and TAURON Capital Group, including the implementation of the material and financial plan,
2. it met with the statutory auditor in order to discuss the results of the audit of the Company financial statements and the consolidated financial statements of the TAURON Group for the financial year 2017,
3. it analysed current information concerning key corporate risks and risks specific in TAURON Group,
4. it analysed current information concerning the status of implementation of TAURON Group's 2016-2025 Strategy, including the achievement of goals, strategic initiatives and the Efficiency Improvement Program,
5. it consulted current information concerning completed and ongoing audit tasks in the TAURON Group,
6. it consulted information on the adaptation of generating units in TAURON Group to the BAT conclusions,
7. it consulted current information concerning the area of compliance management,
8. it analysed the current information related to court disputes of the company - Polska Energia - Pierwsza Kompania Handlowa sp. z o.o.,
9. it consulted current information concerning TAURON Group's participation in the capacity market, discussed the strategy adopted and the process and results of main auctions on the capacity market for the delivery years 2021-2023,
10. it analysed the status and planned activities related to the Strategic Research Agenda,
11. it monitored subjects covered under the agenda of General Meetings / Meetings of Shareholders of companies where TAURON Polska Energia S.A. holds shares/equity,
12. It monitored the acquisition/taking up of shares in other commercial law companies by TAURON and the companies of the TAURON Group,
13. it monitored the process of implementation of the social dialogue in the Company and in TAURON Capital Group,
14. it analysed the implementation of the program of issuing intragroup bonds and their management,
15. it familiarised itself with issues related to the adaptation of the TAURON Group to the requirements arising from Regulation of the European Parliament and of the Council on the protection of personal data (GDPR),
16. it consulted information on representation expenses, marketing services, human relations (PR) and social communication services, as well as management consulting services in 2014-2017.

In the scope of its competence related to the Management Board

1. it submitted a motion to the Ordinary General Meeting concerning granting the discharge to Members of the Management Board of the Company with regard of their performance of duties in the financial year 2017,
2. it concluded agreements with members of the Management Board concerning refund of overpaid VAT,
3. it granted the consent to Management Board Members of TAURON Polska Energia S.A. for planned taking up functions in governing bodies of other commercial companies and for participation in program,
4. in connection with the adopted remuneration system of Management Board Members of TAURON Polska Energia S.A., it specified the management objectives for Members of the Company's Management Board for accomplishment in 2018, including determining of the weight of those objectives and impartial criteria of their implementation and settlement,
5. it performed the analysis of the implementation level of indicators determining awarding of the bonus to Members of the Company Management Board for 2017 and awarded the specified bonuses.

Main issues considered by the Supervisory Board during its meetings in 2018

In the scope of oversight of the accuracy and effectiveness of spending funds associated with implementation of investments by the Management Board of the Company, including the purchase of fixed assets

1. it gave its consent to conclude with the Investment Funds represented by Polski Fundusz Rozwoju S.A. and Nowe Jaworzno Grupa TAURON sp. z o.o. an Investment Agreement defining the terms and conditions of capital investment of the Funds in the shares of the above mentioned company and the Partnership Agreement of this company, as well as to authorise TAURON to exercise legal actions resulting from these agreements, and annexes to the above-mentioned agreement concerning the amendment of the Articles of Association,
2. it approved the purchase of real estate situated in Katowice at ul. Lwowska 23, including perpetual usufruct of land, with the total value exceeding the equivalent of EUR 5,000,000 in PLN,
3. it accepted the amendment to the Shareholders' Agreement of PGE EJ 1 sp. z o.o. with respect to extending the deadline by which financing of the company may be provided and increasing the accumulated amount up to which the company may be financed by TAURON,
4. it accepted the submission of a binding offer in the project of potential purchase of wind farms, currently under implementation,
5. it gave its consent to incurring contingent liabilities by concluding three surety agreements with Polskie Sieci Elektroenergetyczne S.A. in order to secure financially the achievement by Nowe Jaworzno Grupa TAURON sp. z o.o. of the so-called operating milestone and the performance of the capacity agreement,
6. it gave its consent to amend the earlier decision of the Supervisory Board on granting consent to incurring contingent liabilities in the form of bank guarantees to secure receivables of Bank Gospodarstwa Krajowego under a loan agreement to be executed by Elektrociepłownia Stalowa Wola S.A. with Bank Gospodarstwa Krajowego in connection with the change in the ECSW financing structure and the main financing document, i.e. the loan agreement instead of the credit agreement,
7. it approved the conclusion of the Framework Investment Agreement with, among others, PFR NCBR CVC FIZAN,
8. It monitored expenditure on investment projects implemented within the TAURON Capital Group, including through the analysis of the implementation of the material and financial Plan,
9. it reviewed the implementation status of the schedule for investment projects of key importance for the TAURON Group, in particular: construction of a 910 MW supercritical power unit in the Jaworzno Power Plant, construction of a 449 MW_e CCGT unit with a 240 MW_t district heating unit in Stalowa Wola, construction of the "Grzegorz" shaft including infrastructure construction and associated workings, construction of the 800 m level in the Janina Mining Plant, Brzeszcze investment programme, development of heat component of unit no. 10 and construction of peak load/reserve boilers in Łagisza, Low Emissions Liquidation Programme (PLNE) in the Silesia-Dąbrowa Górnicza Conurbation.

The Supervisory Board does not report any default in the scope of accuracy and effectiveness of spending funds associated with the implementation of investments by the Management Board of the Company in 2018, 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 2018, in the scope of execution of Resolution no. 5 of the Extraordinary General Meeting of TAURON Polska Energia S.A. of 15 December 2016 *concerning the development of remuneration of Management Board Members of TAURON Polska Energia S.A. (with amendments)* on 26 February 2018 and on 8 August 2018 defined details of the management objectives for Members of the Management Board of TAURON Polska Energia S.A. to be accomplished in 2018 including determination of the weights of those objectives and measurable criteria of their implementation and settlement.

6. President of the Management Board

While implementing the recommendations and rules defined in the *Best Practice 2016* in the financial year 2018, the activity of the Supervisory Board was supported by the following committees: Audit Committee, Nominations and Compensation 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
Audit Committee
<ol style="list-style-type: none"> 1. Monitoring of the financial reporting process in the Company, effectiveness of internal control systems, risk management, compliance and internal audit, including in the scope of financial reporting, performing financial revisions, in particular performing an audit by an audit firm, taking into account any conclusions and findings of the Audit Supervision Committee stemming from an audit performed in an audit firm. 2. Controlling and monitoring the independence of the certified auditor and the audit firm, in particular in the case where the audit firm provides services other than auditing to the Company. 3. Assessing the independence of the certified auditor and granting the consent for provision by it of permitted services in the Company, other than auditing. 4. Developing the policy for selecting the audit firm to perform the audit. 5. Developing a policy related to the provision of permitted services other than auditing by the audit firm, entities related to the audit firm and by a member of the audit firm corporate network; 6. Defining the procedure for selecting the audit firm by the Company. 7. Presenting to the Supervisory Board the recommendations, for the purpose of selecting the audit firm responsible for performing the statutory audit or the review of financial statements, referred to in Article 130(2) and (3) of the Act of 11 May 2017 on <i>statutory auditors, audit firms and public oversight</i> and in Article 16(2) of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 <i>on specific requirements regarding statutory audit of public-interest entities...</i>, in line with policies referred to above in paragraphs 4 and 5. 8. Informing the Supervisory Board of audit results and explaining how the audit contributed to the reliability of financial reporting in the Company as well as what was the role of the Audit Committee in the audit process. 9. Submitting recommendations aimed at ensuring the reliability of the financial reporting process in the Company. 10. Performing other activities assigned to the responsibilities of audit committees pursuant to the Act, the Regulation and the <i>Accounting Act</i> of 29 September 1994.
Nominations and Compensation Committee
<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 Company Management Board as well presenting opinions 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.

Tasks and competence of Committees of the Supervisory Board

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 Company Management Board who cannot perform their duties, including the proposal of compensation.

Strategy Committee

1. Assessment of the Corporate Strategy of TAURON Group 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 the 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, with the exception of the Strategy Committee which can comprise from three to seven members. In the case of the Audit Committee, at least one member of the Audit Committee should have knowledge and skills in the scope of accounting and financial statement auditing and at least one member of the Audit Committee should have knowledge and skills in the scope of the sector of the Company activities, or its individual members should have knowledge and skills in the scope of this sector in defined areas. Moreover, the majority of the Audit Committee members, including the Chairperson of the Audit Committee, should meet the independence requirement within the meaning of Article 129(3) of the Act of 11 May 2017 *on certified auditors, audit firms and public oversight* (the Act).

The composition of the Audit Committee of the Supervisory Board is compliant with the requirements defined in Article 129(3) of the Act. All Members of the Audit Committee meet the statutory independence criteria, including the Chairwoman of the Audit Committee. Two members of the Audit Committee have knowledge and skills both in the scope of accounting and auditing of financial statements, including the Chairwoman of the Audit Committee. Two members of the Audit Committee have knowledge and skills in the scope of Energy, i.e. the sector in which the Company operates.

Members of the Supervisory Board Committees have elected from among themselves the Chairpersons who manage works of a given Committee and supervise preparation of the agenda, development and distribution of documents to other members of the Committees as well as drafting minutes of the meetings.

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

Table no. 6. Composition of the Supervisory Board Committees as at 31 December 2018

No.	Name and surname:	Audit Committee	Nominations and Compensation Committee	Strategy Committee
1.	Beata Chłodzińska	-	Chairwoman	Member
2.	Teresa Famulska	Chairwoman	-	-
3.	Jacek Szyke	Member	-	Chairman
4.	Radosław Domagalski-Łabędzki	Member	-	-

No.	Name and surname:	Audit Committee	Nominations and Compensation Committee	Strategy Committee
5.	Barbara Łasak - Jarszak	-	Member	-
6.	Paweł Pampuszko	-	-	Member
7.	Jan Płudowski	Member	-	Member
8.	Marcin Szlenk	Member	-	-
9.	Agnieszka Woźniak	-	Member	Member

In the financial year 2018: The Audit Committee held, in total, 8 meetings and adopted 20 resolutions; the Nominations and Compensation Committee held, in total, 2 meetings and adopted 8 resolutions; the Strategy Committee held, in total, 5 meetings and adopted 3 resolutions. In order to review and perform the assessment of the implementation status of strategic projects and investment tasks arising from the *TAURON Group's 2016-2025 Strategy* and Strategies of individual Business Areas of the Capital Group, the Strategy Committee held four meetings on the premises of companies of TAURON Capital Group.

Table no. 7. Main issues considered by the Committees of the Supervisory Board during their meetings in 2018

Main issues considered by the Committees of the Supervisory Board during their meetings in 2018	
Audit Committee	
1.	it recommended to the Supervisory Board the selection of an audit firm to audit financial statements for the financial year 2018 and waiving of the earlier resolution of the Audit Committee in this respect,
2.	it accepted initiation of contract awarding procedure on "Audit and review of separate and consolidated financial statements of TAURON Polska Energia S.A., audit of financial statements of selected subsidiaries of TAURON Polska Energia S.A. and provision of other services permitted for the years 2019-2021", appointment by the Management Board of the Company of the Tender Committee and approval of the Terms of Reference of the Contract and recommended the selection of the audit firm,
3.	it approved the "Report containing conclusions on the procedure of selecting an audit firm to audit and review financial statements and consolidated financial statements of TAURON Polska Energia S.A. for the years 2019 - 2021" submitted by the Management Board,
4.	it cooperated with the statutory auditor in the scope of: <ul style="list-style-type: none"> - audit of the Company financial statements and consolidated financial statements of the Capital Group for the financial year 2017 (discussion of the statutory auditor's report on the audit, discussion of the additional report prepared by the auditor for the Audit Committee, getting acquainted with the statement on meeting the independence requirements by the audit firm and members of the team performing financial audit activities and information on non-performing services which are not financial audit services by the audit firm for the Company and companies of the TAURON Capital Group), - review of the interim condensed financial statements of the Company and the consolidated financial statements of the TAURON Capital Group for the first half of 2018 (discussion of the results of the review and getting acquainted with the statement on maintaining independence from the audited entity in the period from the date of submission of the previous statement on independence, - the process of auditing the Company financial statements and the consolidated financial statements of the TAURON Capital Group for the financial year 2018 (discussion of the general assumptions of the audit process, the audit strategy and non-financial reporting, as well as the results of the preliminary audit in the Company and its subsidiaries),
5.	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 ledgers and documents as well as with the actual state of affairs and presented the relevant recommendations to the Supervisory Board concerning the performed evaluation of:

- “Consolidated Financial Statements of TAURON Polska Energia S.A. Capital Group for the financial year ended on 31 December 2017, compliant with International Financial Reporting Standards approved by the European Union”, “Report of the Management Board on operations of TAURON Polska Energia S.A. Capital Group for 2017” and the “Consolidated Report of TAURON Polska Energia S.A. Capital Group on payments to governments for the year ended on 31 December 2017”,
 - “Consolidated Financial Statements of TAURON Polska Energia S.A. for the financial year ended on 31 December 2017, compliant with International Financial Reporting Standards approved by the European Union”, “Report of the Management Board on operations of TAURON Polska Energia S.A. for the financial year 2017”,
 - “Extended consolidated quarterly report of TAURON Polska Energia S.A. Capital Group for the first quarter of 2018”,
 - “Extended consolidated semi-annual report of TAURON Polska Energia S.A. Capital Group for the first half of 2018”,
 - “Extended consolidated quarterly report of TAURON Polska Energia S.A. for three quarters of 2018”,
 - motion of the Management Board to the General Meeting concerning the distribution of the net profit achieved by TAURON Polska Energia S.A. for the financial year 2017,
6. it presented to the Supervisory Board a positive assessment of the independence of the financial audit process based on the statement of independence of the audit firm and team members performing the audit of the separate and consolidated financial statements of the Company and the TAURON Group for the financial year 2017, information on the performance of non-financial audit services by the audit firm and other network companies for the Company and TAURON Group companies as well as a statement that no prohibited services other than financial audit services were provided by the audit firm and other network companies,
 7. it recommended to the Supervisory Board a positive assessment of the Company standing including the assessment of effectiveness of internal control, risk management and compliance systems and the internal audit function,
 8. it accepted the provision by the above-mentioned auditing firm Ernst & Young Audyt Polska Spółka z ograniczoną odpowiedzialnością Sp. k. of the following service to the subsidiary, TAURON Dystrybucja S.A.: "Conducting agreed procedures in relation to the requirement to estimate the Asset Regulatory Value (WRA) for the purpose of determining the reasonable return on capital employed by the Energy Regulatory Office", after prior assessment of the risks and securities of the independence of the statutory auditor and the audit firm.
 9. it monitored issues related to internal audit and internal control systems, and in particular, it discussed the implementation of the annual Audit Plan for the TAURON Group for 2017, the implementation of the audit tasks plan for the TAURON Group adopted for 2018 and ad hoc checks in individual quarters,
 10. it analysed and evaluated quarterly risk management, including key corporate and specific risks in the TAURON Group concerning: finance and loans, trade, employees and corporate culture, clients and contractors, compliance, environment, technology and infrastructure,
 11. it read and analysed information on the area of compliance management in the TAURON Group (including: the discussion of "TAURON Polska Energia S.A. Compliance Report for 2017", it got acquainted with the basic assumptions to the developed "TAURON Group Compliance Policy" and "TAURON Group Compliance Plan for 2018"),
 12. it discussed the membership of companies of TAURON Group in structures, institutions and trade organisations, focusing on benefits gained and costs incurred,
 13. it discussed proposed amendments to the "Policy related to the provision of permitted services other than auditing by the audit firm performing the audit of the financial statements and consolidated financial statements of TAURON Polska Energia S.A., entities related to the audit firm and by a member of the audit firm corporate network",
 14. it reviewed and evaluated positively the amendments to the "Accounting policy of TAURON Polska Energia S.A. Capital Group",
 15. it reviewed the Management Board's information on the procedures in place to enable the immediate and regular collection within the TAURON Group of information confirming the TAURON Group's compliance with the requirement of independence of the audit firm carrying out the audit,
 16. it consulted quarterly information on the results of procurement procedures (it analysed selected key public and non-public procedures in TAURON Group companies),
 17. it adopted the "Report on activities of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2017" and submitted it to the Supervisory Board,
 18. it adopted the "Work plan of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. for the financial year 2019".
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Nominations and Compensation Committee

1. it recommended that the Supervisory Board should conclude agreements with the Members of the Management Board of the Company on the reimbursement of part of the remuneration constituting the input VAT in connection with the confirmation by the Director of the National Revenue Information that the remuneration due to the Members of the Management Board of TAURON Polska Energia S.A. of the fifth joint term of office is not subject to VAT,
2. it recommended the Supervisory Board to adopt detailed management objectives for Members of the Company Management Board for accomplishment in 2018, including determining of the weight of those objectives and measurable criteria of their implementation and settlement,
3. it adopted the *Report on activities of the Nominations and Compensation Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2017* and submitted it to the Supervisory Board,
4. it performed the analysis and evaluation of indicators determining awarding of the annual bonus for 2017 to Members of the Management Board and presented the relevant recommendations to the Supervisory Board,
5. it recommended to the Supervisory Board the amount of Variable Remuneration to be paid to the Management Board Members for 2017,
6. it recommended to the Supervisory Board the granting of the Annual Bonus for 2017 to a former Member of the Management Board.

Strategy Committee

1. it familiarized itself with the activity and functioning of the Mining Area, with particular emphasis on: the basic technical and economic parameters of individual mines, the planned and accomplished level of extraction for the period of two years 2016-2017, together with an explanation of deviations from the adopted plan, geological and architectural problems, the state of implementation of investment plans in individual mining plants, evaluation of the area and planned projects and strategic initiatives, as well as the policy of managing the assets of the area, diagnosis of the current state and the effectiveness growth plan,
 2. it adopted the *Report on activities of the Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2017* and submitted it to the Supervisory Board,
 3. it adopted the *Framework work plan of the Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. in 2018*,
 4. it familiarized itself with the activity and operation of KW "Czatkowice" sp. z o.o., with particular emphasis on general information, extraction volume, sales structure, economic and financial results achieved in the years: 2015-2017, potential raw material resources and mining capacities as well as production outlook for the next years,
 5. it discussed the information submitted by the Management Board of TAURON Wytwarzanie S.A. concerning the procedure of selecting a contractor for the preparation of the preliminary feasibility study *Production of raw gas for the power unit (gasification technologies integrated with the existing power unit)*,
 6. it familiarized itself with the activities and functioning of the RES Area, including, among others: technical parameters and production capacity of individual hydroelectric power plant units and wind farms, key financial and operational data, production volume, HR and payroll issues, implementation of the adopted strategy in the part concerning this area, implementation of investment and modernization plans,
 7. it reviewed the information on occupational health and safety in the TAURON Group companies, with particular emphasis on: information on occupational health and safety in the TAURON Group companies, accident characteristics in TAURON Wydobycie S.A., accident rates at the construction site of the 910 MW unit in Jaworzno, as well as key initiatives to promote occupational health and safety in the TAURON Group,
 8. it consulted the information on human resources management in the TAURON Group in the context of the generational and competence gap,
 9. it discussed the assumptions for developing an updated *Strategy of TAURON Group for 2016-2025*, including the existing strategic documents: *Asset Management Policy of the TAURON Group and Investment Strategy of the TAURON Group for 2017-2025*,
 10. it discussed the economic and financial situation of the TAURON Group, including expenditure on activities other than related to the core business of the Group (non-core) and outlook for increasing the effectiveness of the TAURON Group, including in particular the measures taken,
 11. it discussed issues related to electricity production and failure rates of power units in TAURON Wytwarzanie S.A., including in particular the 460 MW unit in the Łagisza Power Plant Branch in Będzin,
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12. it discussed the coal supply policy of the generation units of the TAURON Group companies (internal suppliers and other contractors, volume of supplies, prices, parameters, coal quality, current structure of supply of individual power units and planned for the coming years),
 13. it familiarised itself with the activities and functioning of the Heat Area with particular emphasis on: financial results for the period from 2016 to the end of the first half of 2018 and planned results for the period to 2024, HR and payroll issues, implementation of the Low Emissions Elimination Programme (PLNE) in the Silesia-Dąbrowa Górnicza conurbation, issues related to heat demand in 2018-2019, implemented investments in the heating system in 2016-2017 and investment plans for 2018-2024, as well as development strategies and development activities under implementation,
 14. it- discussed issues related to updating the *TAURON Group Strategy for 2016-2025*, building the Group's value through the reconstruction of generation and distribution assets,
 15. it familiarized itself with the activities and operation of the Distribution Area, with particular emphasis on: KPI implementation, financial results, electricity supply, SAIDI, SAIFI, CRP, implementation of the investment plan, a potential for rebuilding distribution assets and issues related to the wiring of medium voltage lines.
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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 *Commercial Companies Code* and other legal regulations, provisions of the *Company Articles of Association* as well as the provisions of the ***Bylaws of the Supervisory Board***. Moreover, while performing their obligations, Members of the Supervisory Board follow 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, in particular, chairpersons of individual Committees, participated in sessions of the Ordinary 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 2018 to 31 December 2018.

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.'s standing

The Financial standing of TAURON Polska Energia S.A. (hereinafter referred to as: TAURON, the Company) is stable, which is confirmed by the current rating of Fitch - at the BBB level, with a stable outlook. The agency maintained its rating outlook given the dominant share of regulated activities in the Group's results and the reduction in capital expenditures after the expected launch of the 910 MW unit in Jaworzno in 2019, which will reduce the pressure on debt ratios. In addition, dividend payments were

suspended until 2019, in 2016-2018 the Effectiveness Improvement Programme was implemented with a total value of PLN 1.3 billion, and subordinated bonds with a value of EUR 190 million were issued. In addition, TAURON signed agreements with bondholders whereby they will be obligated to attend any bondholders' meeting related to these bonds and vote against a resolution permitting the Company to demand early redemption of bonds due to exceeding the net debt/EBITDA ratio of 3.0x. The agreements protect TAURON against the risk of demanding early redemption of bonds, as the adoption of a resolution by the bondholders' meeting on demanding early redemption of bonds requires obtaining a majority of 66 and 2/3 of votes of the bondholders present at the meeting.

The financial statements of TAURON drawn up for the financial year ended on 31 December 2018 indicated a positive operating result of PLN 23 million and a negative net financial result in the amount of PLN (1710) million. The factor of significant impact on the net financial result were the results of impairment tests, which demonstrated the legitimacy of creating and reversal of revaluation write-downs on the value of shares and interests of the subsidiary Companies in the total amount of PLN 2,469 million.

TAURON, as a parent entity in TAURON Group fulfils, in particular, the governing and the consolidating function. In accordance with the adopted Business Model and centralization of the functions, it operates in the field of wholesale trade in electricity and other energy market products. The adopted solution is aimed at securing purchase and sales positions of entities of the TAURON Capital Group, acting as a Market Operator and the entity responsible for commercial balancing of the TAURON Capital Group companies and optimal management of, among others, property rights and CO₂ emission rights. Moreover, as a result of the implementation of the central financing model and the TAURON Group's liquidity management policy, including the cash pooling operating within the TAURON Capital Group, TAURON effectively manages the finances of all the TAURON Capital Group companies.

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 2018, the Company recorded:

- 1) revenue on sales at a level of PLN 8,619 million, higher by 11% than in 2017, mainly due to:
 - a) higher revenues from electricity sales as a result of higher electricity sales prices (14%) compared to 2017
 - b) growth in revenues on sales of greenhouse gas emission allowances (sales to companies of TAURON Capital Group for the purpose of redemption of allowances in connection with the fulfilment of the obligation arising from greenhouse gas emission) as a result of growth in sales prices of greenhouse gas emission allowances,
 - c) higher revenues from natural gas sales due to higher prices and sales volumes,
 - d) lower revenues from the sale of property rights of energy origin due to the completion of property rights trading.
- 2) revenue on other operating activity at a level of PLN 1.7 million,
- 3) revenue on financial activity at a level of PLN 1,196 million, 2% higher than a year ago, mainly due to lower dividends from subsidiaries and interest on bonds and loans and other financial revenues.

In 2018, the Company incurred:

- 1) cost of goods, materials and services sold at a level of PLN 8,473 million, higher by approximately 14% as compared to 2017, which was mostly affected by higher costs of electricity purchase arising from the growth in electricity purchase volume,

- 2) sales costs and overheads of PLN 119 million, 7% higher than in 2017, which is related to the centralisation of functions by TAURON, according to the implemented business model,
- 3) costs of financial activity at a level of PLN 2,951 million, 475% higher compared to 2017 due to recognising in 2018 the created and reversed revaluation allowances for the value of shares, interests and loans in subsidiaries in an amount higher than in 2017. The surplus of the reversed revaluation allowance amount recognised for shares and interests and loans in 2018 reached the total of PLN 2,469 million, against PLN 134 million in 2017.

As at 31 December 2018, the Company's balance sheet total amounted to PLN 29,513 million and was 3% lower than as at 31 December 2017. The change in the value of assets is a result of the increase in shares and stocks as a consequence of the capitalisation of subsidiaries and the revaluation or reversal of the revaluation allowance for the value of shares, interests and loans in subsidiaries as a result of their repayment by TAURON Wytwarzanie S.A., TAURON Dystrybucja S.A. and TAURON Ekoenergia sp. z o.o. and an increase in the value of loans granted. The change in the value of liabilities results from the decrease in the level of equity due to the negative net result in 2018 and the increase in short-term liabilities, mainly due to the issue of subordinated bonds.

As at 31 December 2018, the structure of assets did not change significantly against the status as at 31 December 2017 - fixed assets constituted, respectively, 92% and 90% of the total assets. In the structure of liabilities, equity constituted 52% as compared to 57% at the end of 2017. Debt liabilities represented the most significant item of liabilities with the share of 44% of the total liabilities at the end of 2018, as compared to 40% at the end of 2017.

The status of cash gained as at 31 December 2018 was negative amounted to PLN (1,560) million which 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, 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 2018, the price of the Company shares was significantly affected by the external environment and ranged from PLN 1.67 to PLN 3.28 (according to closing prices).

Despite the good economic situation in Poland and the economy developing at the highest pace since 2011, the situation on the Warsaw Stock Exchange was not favourable. In 2018, shares listed on the WSE followed a downward trend, which affected almost all the main indices of the WSE. Throughout the year WIG fell by 9.5%, WIG20 by 7.5% and WIG-Energy by 19.4%. In terms of sectors, only the WIG-Paliwa index ended the year on the positive side.

According to the published opinions of stock exchange analysts, the negative trend recorded on the Warsaw Stock Exchange in 2018 was a result of external factors such as the risk of a trade war between the United States and China and uncertainty about Brexit, as well as internal factors, including the GetBack case, which significantly undermined investors' confidence in investing in the capital market. In addition, the fact that Poland was classified as a developed country by FTSE Russell did not affect the improvement of the investment sentiment on the WSE.

Evaluation of TAURON Capital Group situation

TAURON Capital Group is a vertically integrated energy group and it 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 of electricity and heat as well as other products of the energy market. TAURON Capital Group determined operational segments corresponding to its areas of activity: Mining, Generation, Distribution, Sales and Other activities.

The EBITDA result generated by TAURON Capital Group in 2018 at a level of PLN 3,375 million was 7% lower than the result obtained in 2017. Segments of TAURON Capital Group with the highest shares in EBITDA include: Distribution, Sales and Generation.

In 2018, the Mining segment achieved a negative EBITDA result of PLN (207) million, lower than the result achieved in 2017. Factors influencing the above result include:

- 1) sales of lower volume of each of the coal assortments by 22% on average - mainly as a result of lower production of commercial coal and sale of part of the coal from stocks in 2017,
- 2) higher average price of products sold by 12% on average, which is a result of the situation on the coal market, as a consequence of increased demand for this raw material,
- 3) higher unit cost of coal produced, which is a result of a 22% decrease in the volume of coal produced and lower direct variable costs, while maintaining the value of fixed costs at 2017 level. The decline in direct variable costs results from lower costs of energy consumption and settled costs of preparatory works, which is related to lower extraction level,
- 4) recognition in the assets of the balance sheet in 2018 of a part of coal produced and not sold, whereas in 2017 the company accomplished a part of sales from the production of the previous period.

In 2018, the Generation Segment recorded EBITDA at a level of PLN 731 million, higher by 36% than the level achieved in 2017. Factors affecting the above result include:

- 1) lower margin on electricity, mainly due to a higher electricity sales price y/y,
- 2) lower margin on heat - lower volume of sales of heat and transmission services (effect of higher external temperature and higher unit costs of heat generation (increase in coal and biomass prices y/y)),
- 3) higher costs of the redemption obligation for CO₂ emission allowances, which is a resultant of:
 - a lower number of free CO₂ emission allowances (in 2017 1.7 million free CO₂ emission allowances were settled, while in 2018 there were no free CO₂ emission allowances),
 - lower volume of CO₂ emissions (lower electricity and heat production y/y),
 - higher prices of CO₂ emission allowances y/y,
- 4) reversal of the provision for employee benefits (cash equivalent for reduced use of electricity (employee tariff), jubilee awards and the Company Social Benefits Fund) in TAURON Wytwarzanie - a one-off event,
- 5) other (mainly lower costs of property tax on wind farms and lower costs of employee bonuses and the Voluntary Redundancy Programme y/y).

In 2018, the Distribution Segment generated EBITDA of PLN 2,517 million, higher by 10% than that generated in 2017, mainly due to an increase in the volume of deliveries to customers, in particular among customers in groups A and B, as a result of a favourable economic situation and an increase in production, and a decrease in labour costs as a result of lower employment, making it realistic to charge indirect costs for investments in the economic system and the effect of the Voluntary Redundancy Programme,

In 2018, the Sales Segment generated EBITDA of PLN 321 million, which was lower by 62% y/y, mainly due to the fact that in the current reporting period the companies recognized provisions for agreements generating charges in the amount of PLN 214 million, related to the entry into force of the Act amending the Excise Duty Act and certain other acts. In addition, in 2017 the provision for burdening contracts with a joint venture was terminated. In addition, the significant factors affecting the result included a

lower margin on electricity sales as a result of a higher rate of increase in purchase prices as compared to sale prices, which results from a high share of customers with fixed sale prices and higher costs of redemption of property rights, which is a result of a higher obligation of their redemption as a result of an increase in the level of obligation for certificates and a lower purchase price.

In 2018, the Other Activity Segment generated the EBITDA result at a level of PLN 135 million, 14% higher in relation to 2017.

The consolidated financial statement of TAURON Capital Group drawn up for the financial year ended on 31 December 2018 indicated:

- 1) the operating result at a level of PLN 790 million, in relation to PLN 1,879 million in 2017,
- 2) the net financial result at a level of PLN 207 million, in relation to PLN 1,383 million in 2017.

Both in 2018 and in 2017, 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 Mining Segment (in 2018) and the Generation Segment (in 2018 and 2017) should be covered by an additional write-down and a part of write-downs should be reversed. The requirement to apply the revaluation on write-downs resulted from:

- proceedings concerning the provisions of the winter package, including the emission standard, which adversely affects the possibility of participation in the coal unit capacity market after 1 July 2025,
- long-term maintaining of the market value of Company net assets at a level below the carrying amount,
- changes in global prices of commodities, energy and CO₂ emission allowances,
- significant volatility of energy prices on the futures market and persistent liquidity problems,
- the introduction of very high price caps on the wholesale energy market,
- regulatory action to limit the increase in energy prices for end customers,
- high variability of mining and geological conditions,
- unfavourable layout of the mining front (short wall runs) generating additional costs of changeovers,
- limited competition on the market of mining materials and services resulting in a significant increase in their prices,
- the results of the capacity market auctions for the delivery years 2021, 2022 and 2023,
- continuing unfavourable market conditions in terms of profitability of conventional power industry,
- increase in risk-free rate.

In the reporting period ended on 31 December 2018, TAURON Capital Group generated revenue on sales lower by 4% as compared to the values gained in 2017, mainly due to:

- 1) higher revenues from electricity sales - as a result of a 12% increase in the electricity sales price on average, a 1% decrease in the volume of electricity retail sales and a 8% increase in the volume of wholesale sales,
- 2) higher revenues from gas sales due to a 16% increase in gas sales prices and a 24% increase in volume.

- 3) lower revenues from sales of heat - lower sales volume of heat and transmission services due to higher ambient temperatures compared to 2017,
- 4) lower revenues from distribution services sales - decrease in the rate of sales of distribution services to end users following the introduction of IFRS 15 and exclusion from revenues of the transitional fee in 2018,
- 5) lower revenues from coal sales - decrease in coal sales volume by 37%, while coal sales price increased by 16%.

In 2018, the operating costs of the TAURON Capital Group amounted to PLN 17.5 billion, which means that their level was 12% higher than the costs incurred in 2017. One of the reasons for the increase in costs was the creation in 2018 of write-offs for the impairment in the carrying amount of cash generating units (CGUs) included in the Mining Segment and the creation and reversal of revaluation write-downs for the the impairment in the carrying amount of cash generating units (CGUs) included in the Generation Segment, of which the Company informed in current reports No. 25/2018 and No. 2/2019. The total value of revaluation write-downs created and reversed amounted to PLN 855 million.

Apart from the above one-off events, the following factors influenced the level of costs of the TAURON Capital Group in 2018:

- 1) increase in electricity purchase costs, mainly due to the growth in electricity prices by 13% on average,
- 2) increase in the costs of materials and energy consumption, mainly as a result of higher costs of fuels used in production,
- 3) increase in gas purchase costs, due to an average increase in prices by 19%,
- 4) decrease in the costs of distribution services as a result of lower costs of purchase of transmission services following the introduction of IFRS 15,
- 5) higher costs of the obligation to redeem emission allowances, mainly due to the y/y increase in prices,
- 6) lower labour costs, primarily as a result of reversal of the provision for employee benefits (cash equivalent for reduced use of electricity (employee tariff), jubilee awards and the Company Social Benefits Fund) in TAURON Wytwarzanie, in accordance with changes in the provisions of the Company Collective Labour Agreement,
- 7) inclusion in the assets of the TAURON Capital Group of coal which was not sold in 2018, whereas in 2017, due to the increase in the demand, part of the sale of coal was performed based on the stocks held,
- 8) recognition in the current reporting period of provisions for burdening contracts in the amount of PLN 214 million related to the entry into force of the Act amending the Excise Duty Act and certain other acts,
- 9) recognition in 2017 of the effects of reversal of provisions for agreements generating burdens with the joint venture in the net amount of PLN 201.2 million,
- 10) an increase in the cost of manufacturing services for the entity's own needs, which results from an increase in the involvement of own resources in the executed investments in the TAURON Capital Group.

Despite the revaluation write-down (surplus of creation over reversal), the value of fixed assets of TAURON Group increased by PLN 1,463 million (5%), which is the resultant of the following events:

- 1) a growth in the value of tangible fixed assets as a result of investments in fixed assets ongoing in companies of TAURON Capital Group (mainly in AURON Dystrybucja S.A., TAURON Wytwarzanie S.A., Nowe Jaworzno Grupa TAURON sp. z o.o. and TAURON Ciepło sp. z o.o.) and intangible assets (mainly TAURON Dystrybucja S.A.),
- 2) purchase of property rights to certificates of electricity origin and greenhouse gases emission allowances in connection with the requirement to fulfil the legal obligation of their redemption.

In the analysed period, as compared to the end of 2017, the value of current assets decreased (by PLN 231 million, 5%), which is a result of a decline in the value of certificates of origin, loans granted to joint ventures and cash and an increase in the value of receivables from customers, inventories and other financial assets.

In 2018, 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%.

As compared to the status as at 31 December 2018, the long-term liabilities of the TAURON Capital Group decreased by PLN 1,358 million, i.e. by 11%, mainly due to the issue of bonds of PLN 1,350 million and reclassification of bonds of a total value of PLN 2,259 million to short-term financial liabilities due for payment in 2019 issued in previous years. Additional factors affecting this balance sheet item included the release of the provision for employee benefits (cash equivalent for reduced use of electricity (employee tariff), jubilee awards and the Company Social Benefits Fund) in TAURON Wytwarzanie S.A. in accordance with changes in the provisions of the Company Collective Labour Agreement and the transfer of the balance of deferred income from connection fees for tasks completed before 1 July 2009 to the equity item, which results from the entry into force of IFRS 15 Revenues from contracts with customers.

The value of TAURON Capital Group's short-term liabilities increased (by PLN 2,259 million, 45%), which results from the reclassification of long-term financial liabilities due for payment in 2019 issued in previous years. Moreover, in relation to the status as of 31 December 2017, the following developments were recorded:

- reduction of the value of provisions, which results from partial fulfilment of the obligation to submit certificates of origin of electricity for redemption already in 2018, resulting from the provisions of the Energy Law Act of 10 April 1997, and CO₂ emission allowances,
- increase in other financial liabilities due to an increase in the value of liabilities due to negative measurement of derivative instruments as a result of the TAURON Capital Group's recognition of open pattern valuation of forward transactions, i.e. a single contract, and an increase in the value of variation margins, mainly related to greenhouse gases emission rights delivery transactions concluded on foreign exchange markets.

In the statement of cash flows for 2018, TAURON Capital Group generated a positive flow on operating activity at a level of PLN 2,057 million (58% of the 2017 level). The largest impact on the change in operating cash flows was caused by the increase in inventories, purchase of CO₂ emission allowances and energy certificates of origin in the amount higher than in 2017, payment of higher income tax in 2018 as a result of advance payments for income tax for 2018 and tax for 2017. In addition, in 2017 the TAURON Capital Group received a refund of the overpaid income tax.

The value of cash flows on investment activities in 2018 was negative and it was higher by approximately 17% than the investment activity flows recorded in 2017, mostly as a result of purchase of tangible fixed assets. The highest expenditures were incurred by the Generation and Distribution Segments.

The positive value of cash of financial nature results from the issue of bonds conducted in 2018, with the total value of PLN 1,350 million. In 2018, the TAURON Capital Group repaid loans and borrowings contracted in the previous years in the amount of PLN 169 million. On the other hand, in 2017, TAURON Capital Group issued bonds with the total nominal value of PLN 2,707 million, redeemed bonds issued in previous years with the nominal value of PLN 1,650 million and repaid loans and borrowings in the amount of PLN 155 million.

In 2018, TAURON Group incurred capital expenditure of PLN 3,672 million, i.e. lower by 6% than the expenditure incurred in 2017, which amounted to PLN 3,474 million. The above increase results mainly from higher expenditures in the Distribution and Mining Segments.

The most important investment projects implemented in 2018:

- 1) in the Mining Segment: the investment programme of ZG Brzeszcze (PLN 87 million), the construction of Grzegorz shaft at ZG Sobieski (PLN 68 million), the construction of the 800 m level at ZG Janina (PLN 34 million),
- 2) in the Generation Segment: construction of new capacity of Jaworzno 910 MW (PLN 991 million), replacement and modernization expenditures and repair components in TAURON Wytwarzanie S.A. (PLN 76 million), investments related to the connection of new facilities (PLN 28 million) and the development and maintenance of district heating networks (PLN 17 million),
- 3) in the Distribution Segment: modernisation and replacement of grid assets (PLN 1,118 million), construction of new connections (PLN 676 million).

As at 31 December 2018 the statement of financial standing of TAURON Capital Group indicates a balance sheet total higher by 3%, as compared to the status at the end of 2017.

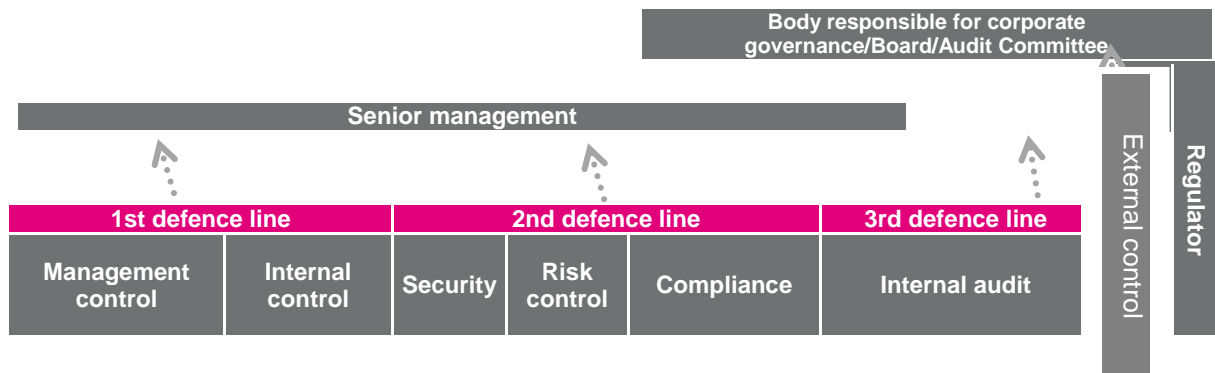
8.2. Evaluation of effectiveness of internal control, risk management systems, Compliance and internal audit functions

Taking into account *Best Practice 2016*, the Audit Committee 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, internal audit and compliance report directly to the President of the Management Board and have a possibility of direct reporting to the Supervisory Board and the Audit Committee.

In order to ensure security, the TAURON Capital Group operates a "Three Lines of Defence Model" which includes functional internal control, independent control within the second line of defence, consisting of risk management, compliance and security management functions, as well as institutional control, i.e. audit within the third line of defence.

Figure no. 1. Model of three lines of defence



Functions of individual lines of defence:

- First Line** – business units required to perform functional control as part of their business processes,
- Second Line** –
 - risk management function implemented in accordance with the adopted *Corporate risk management strategy in TAURON Group* and detailed policies related to main risk categories,
 - function of assuring the compliance understood as adjustment of the organisation to the applicable legal regulations,
 - function of ensuring information security and technical safety.
- Third Line** – internal audit function responsible for planning and implementation within the TAURON Capital Group, audit tasks of a verification and advisory nature, as well as performing planned and ad hoc inspections.

FIRST LINE OF DEFENCE

Assessment of the design of the internal control system implemented by the business units of TAURON Polska Energia S.A.

Based on the results of the self-assessment carried out in 2018 by the business units of TAURON Polska Energia S.A., it is estimated that the designed and implemented internal control system in the Company within the first line of defence will enable the control of selected business processes within the functioning process management. The self-assessment exercise was based on the COSO (Committee of Sponsoring Organizations of the Treadway Commission) model and included the following elements of internal control:

- I. Control environment.
- II. Risk assessment.
- III. Control activities.
- IV. Information and Communication.
- V. Monitoring.

The results of the self-assessment were verified by the Internal Audit in terms of the consistency of the response as regards the correctness of the design of the internal control system.

The average of the assessments carried out on a 3-step scale (0 - the requirement is not met, 1 - the requirement is partially met, 2 - the requirement is fully met) was 180. In the areas assessed below 2 (the requirement is fully met), measures are implemented to further improve the internal control system.

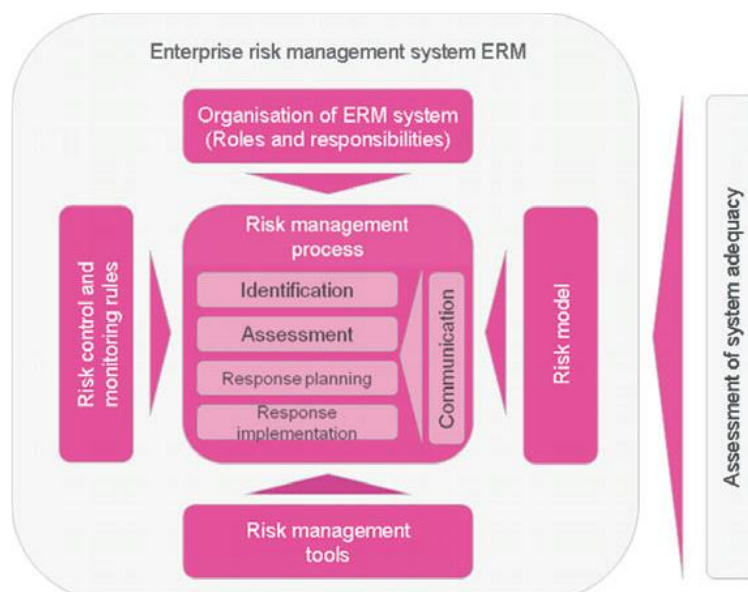
The internal control system functioning in the TAURON Capital Group includes in particular control mechanisms concerning financial reporting.

SECOND LINE OF DEFENCE

Risk management assessment

The TAURON Capital Group, taking care of the implementation of the existing *TAURON Group Strategy for 2016 - 2025*, implemented a comprehensive enterprise risk management system - ERM and implements the risk management process in its operations. Its overriding objective is to ensure the broadly understood security of the TAURON Capital Group's operations. In particular, risk management shall ensure that TAURON supports the implementation of *TAURON Group Strategy for 2016 - 2025* by increasing the predictability of achieving strategic goals and thus stable creation of the financial result. The central element of the ERM system architecture is the process of risk management 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. In addition, the architecture of the ERM system comprises elements ensuring its effective operation, including: risk management tools, risk models, rules of risk control and monitoring and the ERM system organisational structure.

Rysunek nr 2. Architektura systemu ERM



The ERM system operating in TAURON Capital Group ensures comprehensive and consistent risk management rules linked with each other in terms of methodology and information. The operating risk management system architecture ensures centralising of the measurement, monitoring and risk control functions as well as a possibility of assessment of the full risk profile in the organisation and consistent principles of its management.

The rules of the ERM system are implemented at a level of all significant processes, comprising simultaneously all elements of TAURON Capital Group's value chain, which enables a comprehensive and adequately early risk identification in TAURON Capital Group areas and, as a consequence, provides a possibility to undertake effective risk response.

The effectiveness of the ERM system is simultaneously supported by functional and organisational split of the function of risk taking and risk management as well as its control and monitoring which takes place from the centralised level, at a level of TAURON Capital Group of risk area located in the structures of the parent entity. In accordance with the requirements of the *Best Practice 2016*, 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.

Moreover, the operating ERM system ensures a clear distribution of competence and responsibility, in particular, through introducing of the risk ownership function which is simultaneously an active process targeted at adequately early identification of threats, enabling undertaking of preventive measures.

Figure no. 3. Risk management as a function of the second line of defence



The risk management system operating in the TAURON Capital 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 to the changing environment. It puts strong emphasis on building risk management awareness, training and encouraging employees to use knowledge on risks in their daily activities.

The aforementioned system is regulated by the *Corporate risk management strategy in TAURON Group*, operating at a level of the Capital Group, updated at the turn of 2016 and 2017 as a result of the comprehensive review of the risk management system architecture. The Strategy defines fundamental risk management rules, in order to ensure a uniform approach in individual areas of the TAURON Capital Group operation. Based on the said strategy, detailed rules for the management of key risk categories were created in the form of Policies.

In 2018, the development of the most important risk management tools, defined within the framework of the existing strategy, i.e. risk control indicators with particular emphasis on early warning indicators aimed at the measurement of risk causes and the establishment of prudential thresholds for the adopted indicators in order to better control and monitor risk, was continued. For the TAURON Capital Group's defined list of key risks, the need to prepare a Risk Response Plan in the form of a separate document was agreed and the actions within the adopted response plan and their intensification depend on the current level of the EWI indicators.

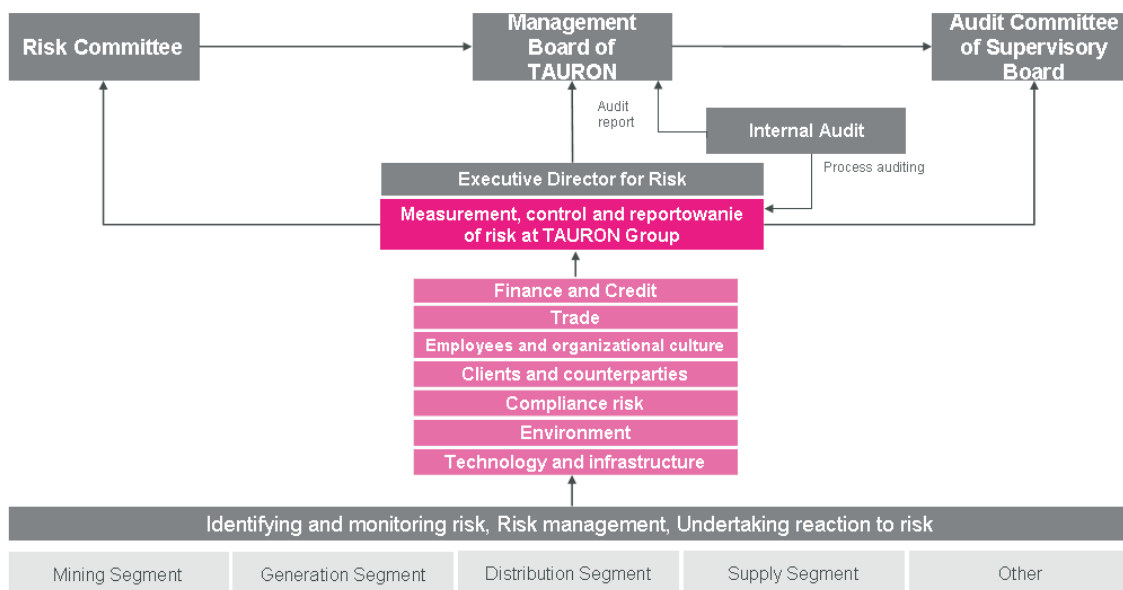
Figure no. 4. Risk Management Strategy



The key assumption of the risk management system is a clear and precise division of tasks and responsibilities, ensuring that no conflict of interest arises and at the same time guaranteeing independence of the risk taking function from its control and monitoring. In the framework of the implementation of the risk control and monitoring functions, the Management Board of TAURON approves the risk Tolerance, simultaneously 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. Subsequently, global limits are allocated to operating limits within the specific risk management. The Early Warning System based on 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 its control. At the system level, Early Warning Indicators (EWI) are separated as those which are subject to permanent control in terms of prudential thresholds determined for them.

Within the framework of ERM system organisation, roles and responsibilities of risk management process 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 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 Risk Committee directly supervises the implementation of the enterprise risk management process.

Figure no. 5. Participants of risk management process



In the opinion of the Supervisory Board, the TAURON risk management system ensures an appropriate level of business security. The risk management process is compliant with the best market practice and the regulatory requirements and the organisation of the process itself ensures independence of control functions from the business activity. Moreover, TAURON continues to develop the existing ERM system, adapting it to the current needs and actively managing risks, aiming at early identification of threats and maximum reduction or elimination of their negative impact, in particular on the financial result of the TAURON Capital Group.

Evaluation of compliance management

The Compliance Management System applicable in the TAURON Capital Group is a tool integrated into structures and processes to create a factual situation in the companies of the TAURON Capital Group in which the risk of non-compliance is reduced to a minimum.

The objective of the Compliance Management System in the TAURON Group is to counteract the risk of non-compliance, which means the risk of incurring a loss due to non-compliance with the law, internal and corporate regulations, rules of ethics and standards of conduct adopted by the organisation. The compliance management system is aimed at mitigating the risk of sanctions, financial losses as well as as loss of reputation, simultaneously contributing to building and consolidating the positive image of TAURON Capital Group.

The tasks providing for compliance in 2018 were performed by the Compliance Officer of TAURON Polska Energia S.A. with the support of the Compliance Team.

The position of the compliance unit in the organisational structure of TAURON is compliant with section III.Z.2. of Best Practices 2016 and the provisions of the Standards recommended for the compliance management system in the area of anti-corruption and whistleblower protection in companies listed on the markets organized by the Warsaw Stock Exchange S.A.

The activities carried out in 2018 by the Compliance Officer with the support of the Compliance Team were crucial for further development of the Compliance Management System in the TAURON Group.

These activities were carried out on three levels within the framework of:

- 1) conceptual works concerning the development of assumptions and organization of an optimal Compliance Management System in the TAURON Group,
- 2) project activities related to the participation of the Compliance Officer in the work of working groups dedicated to changes in the regulatory environment related to the activities of the TAURON Capital Group,
- 3) as part of the ongoing activities arising from the performance of current duties.

The activities related to the construction of the Compliance Management System in the TAURON Capital Group comprised, among others:

- 1) adoption and implementation of the *TAURON Capital Group Compliance Policy*,
- 2) development of the TAURON Capital Group Compliance Plan for 2019, including the annual programme of activities of the Compliance Officer, the Compliance Team and the Compliance Coordinators to be implemented in 2019,
- 3) development and implementation of the amended *Procedure for assessing the credibility of contractors in the TAURON Group*,
- 4) development and implementation of *the Procedures for counteracting document counterfeiting in the TAURON Group* and *Procedures for counteracting tender collusion in the TAURON Group*,
- 5) draft *Rules for Receiving and Giving Gifts in the TAURON Group*,
- 6) building awareness of the *Responsible Business Code in the TAURON Group*,
- 7) developing and conducting an information and promotional campaign on the *Anti-Corruption Policy of the TAURON Capital Group*.

Project activities carried out by the Compliance Officer and the Compliance Team included, among others:

- 1) participation in the activities of working teams established in the TAURON Capital Group, whose task is to ensure proper implementation in the TAURON Capital Group of the requirements resulting from EU and national regulations, including for example: work in the permanent Working Group aimed at implementation of the requirements resulting from the REMIT Regulation,
- 2) participation in work on the application of the *split payment* mechanism in the TAURON Capital Group.

Current activities carried out by the Compliance Officer and the Compliance Team in 2018 included, among others:

- 1) testing the credibility of contractors in accordance with the applicable Procedure for Assessing the Credibility of Contractors of TAURON Polska Energia S.A. - total number of reports issued: 143,
- 2) monitoring the reliability of suppliers of the TAURON Capital Group companies - number of verified entities 1150,
- 3) conducting the process of evaluation of external entities with which the companies of the TAURON Capital Group implement PR and marketing projects - total number of opinions issued: 579,
- 4) responding to staff inquiries regarding compliance - total number of responses given: 17,
- 5) issuing of conformity messages - total number of messages issued: 11,
- 6) detection, verification and clarification of reported (potential) cases of non-compliance (*whistleblowing*),

7) issuing opinions and participation in the development of regulations created in TAURON Capital Group linked with the compliance management area, including, inter alia:

8) conducting and participation in training in the scope of compliance-related issues.

The assessment of the functioning of the Compliance Management System in the TAURON Group in 2018 was influenced by both the main CMS building activities in the TAURON Capital Group described above and the current tasks performed by the Compliance Officer in that period. These activities were undertaken in order to ensure compliance of the TAURON Capital Group's operations with the new regulatory requirements, as well as to protect the brand, good name and reputation of the TAURON Capital Group.

The practical operation of the Compliance Management System in TAURON is manifested in particular on the level of cooperation with contractors (by eliminating the possibility of establishing or conducting cooperation with entities with doubtful credibility), as well as in the current operations of individual organisational units of the Company (by ensuring the possibility of addressing the Compliance Officer and reporting possible cases of abuse).

Referring to the adequacy of the Compliance Management System in the TAURON Group, it should be stated that the organisational chart presented in the TAURON Group Compliance Policy and the rules of its operation are appropriate, optimal and proportional to the scale and scope of the TAURON Capital Group's activities.

When assessing the effectiveness of the Compliance Management System in the TAURON Group in 2018, one should bear in mind that the scope of tasks performed by the Compliance Officer has been significantly extended and there has been a significant development in building the culture and awareness of *compliance* in the organisation, resulting in particular from actions taken to establish compliance units in the TAURON Capital Group companies.

TAURON's Compliance Management System is a tool to ensure balance in the organisation and to support employees in performing their daily tasks in accordance with regulatory requirements and ethics, using proportionate measures to eliminate the risk of undesirable behaviours and activities.

Moreover, the catalogue of measures, tools and tasks implemented by the Compliance Officer was diversified and comprehensive, which ensured due performance of the protective, advisory and information and control function.

Taking into account the foregoing, it should be stated that in 2018 the objective of the CMS applicable in TAURON Capital Group, i.e. ensuring the compliance of TAURON Capital Group's activities with legal regulations, internal regulations and ethical norms in order to mitigate events negatively affecting its functioning, was implemented through various activities which do not only represent the response to irregularities but should be mainly preventive.

THIRD LINE OF DEFENCE

Assessment of internal audit function

The internal audit function existing in TAURON, which is a part of the Company's internal control system, is assessed as effective. Nevertheless, due to the dynamic development of the internal audit system organisation is continuously improved adequately to the ongoing changes.

The organisational unit headed by the Executive Director for Internal Audit and Internal Control is located in the TAURON organisational structure under the direct authority of the President of the Management Board, which ensures independence, objectivity and proper performance of the audit function. The scope of duties and powers defined in the internal regulations, as well as the adopted working methods and resources available to the Internal Audit allow for effective implementation of the objectives set for the audit, which in turn translates into the achievement of the objectives of the TAURON Capital Group.

Internal Audit plans and implements tasks of audit and control nature, including performance of ordered ad hoc controls, as well as conducts advisory and opinion-forming activities. Methods and rules of functioning of the Internal Audit are defined in the Process Documentation of the Megaprocess 1.5 Audit along with the related document called: Regulations of Internal Audit in TAURON Group. The introduction of the aforementioned Megaprocess was a consequence of the adoption of the *Business Model of TAURON Capital Group* by the Management Board of the Company. 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 functions of internal audit and internal control (institutional control) in the TAURON Capital Group.

Table no. 8. Basic functions of internal audit and internal control in the TAURON Group

No. Basic functions of internal audit and internal control in the 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 for Internal Audit and Internal Control carries out his tasks through annual audit and control plans covering both TAURON and other companies of the TAURON Capital Group. Results of Internal Audit activities contain recommendations adjusting control mechanisms operating in TAURON (TAURON Capital Group) as well as suggesting changes of effectiveness nature.

In 2018, 31 audit tasks of both planned and ad hoc nature were conducted in TAURON Capital Group. This work resulted in observations, conclusions and recommendations which contributed to the improvement of the internal control system in TAURON and in the entire TAURON Capital Group.. Both the progress of implementation of the recommendations issued and the final deadline for their performance is monitored on an on-going basis by the Internal Audit supported in this scope by the implemented MRA IT tool.

The internal audit and internal control plan for 2019 adopted for implementation covers important issues and areas of the internal control system from the point of view of TAURON and the entire TAURON Capital Group.

In the opinion of the Supervisory Board, the TAURON risk management system operating at TAURON ensures an appropriate level of business security. The risk management process is compliant with the best market practice and the regulatory requirements and the organisation of the process itself ensures independence of control functions from the business activity. Moreover, TAURON continues to develop the existing ERM system, adapting it to the current needs and actively managing risks, aiming at early identification of threats and maximum reduction or elimination of their negative impact, in particular on the financial result of the TAURON Capital Group.

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

In 2018, the Company was subject to corporate governance rules, described in the document *Best Practice of WSE Listed Companies 2016 (Best Practice 2016)*, which was adopted for application by the WSE Board on 13 October 2015.

In the period covered by this report, the Company applied the recommendations and rules contained in *Best Practice 2016*, excluding the following rules:

- 1) IV.Z.2. concerning ensuring of publicly available real-time broadcasts of general meetings, due to the lack of the relevant provisions of the Articles of Association enabling the aforementioned broadcast. In order to enable the application of the rule, the Company Management Board requested the Ordinary GM of the Company to adopt the relevant amendment to the Company Articles of Association ensuring publicly available real-time broadcast of general meetings. However, the Ordinary GM of the Company held on 8 June 2016 did not adopt the amendment to the Company Articles of Association in this scope, as proposed by the Company Management Board.
- 2) VI.Z.1. concerning the construction of incentive schemes in a way necessary, among others, to tie the level of remuneration of members of the Company's management board and key managers to the actual long-term financial standing of the Company and long-term shareholder value creation as well as the Company's stability. This rule was not applied due to the remuneration and bonus system applicable in TAURON in relation to members of the Management Board of the Company and its key managers which stipulates that the level of remuneration will be tied to the financial situation of the Company within the annual perspective, in conjunction with the implementation of strategic objectives,
- 3) VI.Z.2. Concerning tying the remuneration of members of the management board and key managers to the company's long-term business and financial goals. The period between the allocation of options or other instruments linked to the company's shares under the incentive scheme and their exercisability should be no less than 2 years. This rule was not applied due to the remuneration and bonus system applicable in TAURON in relation to Members of the Management Board of the Company and its key managers does not provide that remuneration should be tied to instruments linked with the Company shares.

In 2018 the following rules did not apply to the Company:

- 1) I.Z.1.10. concerning placing financial projections on the Company website - if the company has decided to publish them - published at least in the last 5 years, including information about the degree of their implementation - due to the fact that financial forecasts are not published,
- 2) III.Z.6. stating that where the Company has no separate internal audit function in its organisation, the audit committee (or the supervisory board if it performs the functions of the audit committee) should review on an annual basis whether such function needs to be separated - due to the fact that the Company has a separate Internal Audit Department in its organisational structure.

In 2018, the document entitled *Diversity Policy in the TAURON Group* was in force, developed and introduced for use in 2017, described the applied diversity policy in relation to the Company's governing bodies and its key managers, referred to in the principle marked as I.Z.1.15. of *Best Practice 2016*.

Obligations related to the application of corporate governance rules are set out in § 29 of the *WSE Rules* and § 70.6(5) of the *Regulation of the Minister of Finance of 29 March 2018 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 the "Regulation").

In accordance with §29 of the *WSE Rules*, 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 wording of § 29 of *the WSE Rules* and the entry into force of *Best Practices 2016*, the Company published on 1 February 2016, through the EBI system, a report on their application. Since then, the Company has not recorded any cases of violations of *Good Practices 2016*.

According to the wording of § 70(6)(5) of the Regulation, the report on the issuer's activity should include, inter alia, a separate part of the report on the application of corporate governance, which should include 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.

Taking into account the requirements of *the Regulation*, the Company published on its website statements on corporate governance principles, which are a part of the Management Board's reports on TAURON's activities for the years 2010-2017.

According to the assessment of the Supervisory Board of TAURON, in 2018 the Company duly fulfilled its information obligations related to the application of the corporate governance rules, defined in the *GPW Rules* and the regulations concerning current and periodical information submitted by issuers of securities as well as explanations and comments published by the Company, related to the corporate governance set, will present the functioning of the Company governing bodies in a reliable, transparent and due manner.

10. Assessment of rationality of sponsoring, charitable policy, or other similar policy pursued by the Company

The main idea behind the TAURON Capital Group's activity in the field of corporate social responsibility is the conviction that in the modern world, entrepreneurs are not only important elements of economic life, but also social life, and each of them has an impact on the surrounding reality. Moreover, in the long term, the success of the TAURON Group and the potential for value creation will be determined by actions strengthening the foundations of sustainable development. Their proper shaping helps to respond to challenges and exploit emerging opportunities.

The document *TAURON Group Sustainable Development Strategy for 2017-2025*, which constitutes the framework for the TAURON Capital Group's corporate social responsibility activities, was adopted by the TAURON Management Board in 2017 and was developed in full compliance with the *TAURON Group's Strategy for 2016-2025*, taking into account the opinions of the environment as well as current and future challenges facing the energy sector.

The structure of the Strategy is based on five directions - two primary (*Customer orientation and Reliability and quality of supplies of products and services to customers*) and three secondary: *Work safety, ethical culture and engaging workforce, Environmental protection* and *Social and business partnership*. On the other hand, within each of the directions, obligations to be fulfilled by TAURON Group have been formulated. Key initiatives including measures allowing for the measurement of the implementation level have been assigned to each obligation. Initiatives and measures were submitted by individual companies of the Group and business units of TAURON Polska Energia S.A. Which consequently became responsible for the fulfilment of individual obligations.

All projects implemented in 2018 by the companies of the TAURON Capital Group and the TAURON Foundation in the area of corporate social responsibility are in line with the directions of the Strategy, in particular the directions supporting: social and business partnership and work safety, ethical culture and employee involvement.

The scope of actions conducted for the benefit of the communities in which companies of TAURON Capital Group operate, is very broad. The scale of initiatives carried out varies: from one-off activities at the local level, to long-term, systemic programmes and solutions. However, regardless of the scope and duration of their activities in the field of sustainable development, all activities have a common denominator, i.e. they fit into the company's core values, mission and vision as a signpost in conducting business activities.

Being aware of functioning in a specific reality, the TAURON Capital Group takes responsibility for the impact it has on the environment. For this reason, many projects are supported which are important for inhabitants of the regions of Upper and Lower Silesia, Opolskie, Małopolska and Podkarpacie Regions. In 2018, as part of the commemoration of the 100th anniversary of Poland's regaining independence, the TAURON Capital Group carried out its own project called TAURON Energetyczny Junior Cup - a series of tournaments in which one hundred children's football clubs took part. During the three elimination tournaments held in Kraków, Wrocław and Dąbrowa Górnicza, nearly 1,000 players aged 8 to 10 competed on the pitch. The best 8 teams from each location were promoted to the Grand Final, which took place at the beginning of 2019 in Kraków. TAURON Energetyczny Junior Cup was held under the auspices of the Minister of Sport and Tourism, Minister of Energy and Voivodes of Małopolska and Śląsk.

In 2018. The TAURON Capital Group has also implemented the action entitled: Energy of good words. As part of the project, TAURON's employees recorded fairy tales for children in a radio studio. The resulting CD was published in 3,000 copies and distributed to children's hospitals and hospices in the TAURON Capital Group's area of operation.

Since 2017, *the Diversity Policy in TAURON Group, Human Rights Respect Policy of TAURON Group, Work Health and Safety Policy of TAURON Group, Anticorruption Policy of TAURON Group, Customer Oriented Social Policy of TAURON Group and the Code of Conduct for Customers of TAURON Group companies* have been effective in TAURON. The development of those documents was aimed at fulfilment of the requirements imposed on companies under the amendment to the Accounting Act (Article 49b(2) and (3)) related to the preparation and publication of the declarations in the scope non-financial information.

Regulations of the sponsoring area in TAURON Group were created based on available reports and reviews of domestic and international practices as well as analyses and audits, including those executed in cooperation with entities specialised in individual topics on the Polish market.

At the end of 2018, the following documents refer to the sponsoring area in TAURON Capital Group:

- 1) Rules of conducting sponsoring activity in TAURON Group.
- 2) Sponsoring Strategy of TAURON Group for the years 2018-2025
- 3) The template of the sponsoring agreement, including the Agreement Template Card in the Regulations on the application of Standard Clauses.

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, semi-annual and annual cycles by specialised external entities and the oversight provided by organisational units of companies of the TAURON Capital 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 by 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.

As a result of the promotion effectiveness measurement, an independent research entity estimated the advertising equivalent in relation to activities completed in 2018. Comparing the summary value obtained in this way to the sum of all expenditure arising from sponsoring agreements the ROI ratio at a level of approximately 6. 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.

In 2018, the leading projects included: TAURON SEC, 75.Tour de Pologne and cooperation with TAURON Arena Krakow and the Polish Ski Association.

The confirmation of the effectiveness of conducted activities is the high positioning of TAURON brand in an independent research report, Sponsoring Monitor 2018, which is the only source of this type of information concerning the Polish market. According to this report, TAURON is ranked eighth in the TOP 10 list of sponsors and it is the most noticeable sponsor as compared to its direct competitors. Due to the relatively low level of sponsoring expenditure in TAURON Capital Group, the position in this ranking can be treated as very high.

The charity activity in TAURON 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 TAURON Foundation operates on the basis of funds acquired mainly from companies of TAURON Capital Group and charitable activities of employees within employee voluntary service. The aid is granted based on the preliminary budget of the foundation for a given year, developed by the Management Board and consulted with the Foundation Board, according to the procedures defined in the Regulations on aid granting to beneficiaries.

In 2018, 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 TAURON Foundation objectives.

Katowice, 2 April 2019

Chairwoman of the Supervisory Board - Beata Chłodzińska

Deputy Chairwoman of the Supervisory Board - Teresa Famulska

Secretary of the Supervisory Board - Jacek Szyke

Member of the Supervisory Board - Radosław Domagalski - Łabędzki

Member of the Supervisory Board - Barbara Łasak - Jarszak

Member of the Supervisory Board - Paweł Pampuszko

Member of the Supervisory Board - Jan Płudowski

Member of the Supervisory Board - Marcin Szlenk

Member of the Supervisory Board - Agnieszka Woźniak