



**Report on activities of the Supervisory Board
of TAURON Polska Energia S.A.
in the financial year 2017**

containing, among others:

- 1) the evaluation of the Company 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) the assessment of the method of fulfilment of information obligations by the Company, in relation to the application of corporate governance principles defined in the Rules of the Exchange and provisions related to current and periodical information submitted by issuers of securities,
- 3) the 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.

Warsaw, 12 March 2018

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1. Introduction

Acting pursuant to Article 382 § 1 of Commercial Companies Code and § 20(1)(4) of the Company Articles of Association, the Supervisory Board 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 2017* to the Ordinary General Meeting (hereinafter referred to as: the Report).

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

1. the Company 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 information obligations by the Company, in relation to the application of corporate governance principles defined in the Rules of the Exchange 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 2017 is presented.

2. Information on the term of office of the Supervisory Board, personal 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 authorising to exercise at least 25% (twenty five per cent) of the total number of votes in the Company, the State Treasury is entitled to appoint and dismiss members of the Supervisory Board in the amount equal to a half of the maximum number of the composition of the Supervisory Board defined in the Articles of Association (if the number is not integral it is rounded down to an integral number, for example 4.5 is rounded down to 4) increased by 1, provided that the State Treasury:
 - a) is obliged to vote at the General Meeting on determining of the number of members in the Supervisory Board representing the maximum number of members of the Supervisory Board defined in the Articles of Association, or in case of submission of such a motion to the Management Board by a shareholder or shareholders holding a number of votes entitling to exercise at least 5% (five per cent) of the total votes in the Company,

- b) is excluded from the voting right at the General Meeting on appointing and dismissing of other members of the Supervisory Board, including independent members of the Supervisory Board; however, this would not apply to the case when the Supervisory Board cannot act due to a composition minor 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 authorising 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 authorised 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 2017 and as at the date of drawing up this Report.

Table no. 1 Personal composition of the Supervisory Board as at 31 December 2017 and as at the date of drawing up this Report

No.	Name and surname	Function exercised
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.	Agnieszka Woźniak	Member of the Supervisory Board

As at 1 January 2017 the Supervisory Board consisted of the following persons: Beata Chłodzińska (Chairwoman of the Supervisory Board), Anna Mańk (Vice Chairwoman of the Supervisory Board), Jacek Szyke (Secretary of the Supervisory Board), Stanisław Bortkiewicz (Member of the Supervisory Board), Leszek Koziorowski (Member of the Supervisory Board), Jan Płudowski (Member of the Supervisory Board), Jacek Rawecki (Member of the Supervisory Board), Stefan Świątkowski (Member of the Supervisory Board) and Agnieszka Woźniak (Member of the Supervisory Board).

The table below presents changes in the composition of the Supervisory Board during the financial year 2017.

Table no. 2 Changes in the composition of the Supervisory Board during the financial year 2017

No.	Date	Changes in the composition of the Supervisory Board
1.	25 May 2017	Jacek Rawecki submitted the declaration on resignation from the function of the Supervisory Board Member as of 26 May 2017.

No.	Date	Changes in the composition of the Supervisory Board
2.	29 May 2017	The State Treasury, acting pursuant to its personal powers defined in § 23(1)(3) of the Company Articles of Association, appointed the following persons as members of the Supervisory Board of TAURON for the fifth joint term of office: Beata Chłodzińska, Teresa Famulska, Barbara Łasak - Jarszak, Jan Płudowski and Agnieszka Woźniak.
2.	29 May 2017	Pursuant to § 22(1) of the Company Articles of Association, the Ordinary General Meeting of the Company appointed the following persons as members of the Supervisory Board of TAURON Polska Energia S.A. for the fifth joint term of office: Radosław Domagalski - Łabędzki, Paweł Pampuszko and Jacek Szyke.

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

At least two members of the Supervisory Board should meet the criteria of independence (hereinafter referred to as: independent Supervisory Board members). The definition of an *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*.

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

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

The table below presents information on the fulfilment of independence criteria by Members of the Supervisory Board, in accordance with rule II.Z.4 of *Best Practice 2016* as at 31 December 2017 and as at the day of drawing up this report.

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

No.	Name and surname	Fulfilment of independence criteria referred to in rule II.Z.4 of <i>Best Practice 2016</i>	
		as at 31 December 2017	and as of the date of drawing up this report
1.	Beata Chłodzińska	Does not fulfil independence criteria.	Fulfils independence criteria.
2.	Teresa Famulska	Fulfils independence criteria.	Fulfils independence criteria.
3.	Jacek Szyke	Fulfils independence criteria.	Fulfils independence criteria.
4.	Radosław Domagalski-Łabędzki	Does not fulfil independence criteria.	Does not fulfil independence criteria.
5.	Barbara Łasak - Jarszak	Fulfils independence criteria.	Fulfils independence criteria.
6.	Paweł Pampuszko	Fulfils independence criteria.	Fulfils independence criteria.
7.	Jan Płudowski	Fulfils independence criteria.	Fulfils independence criteria.
8.	Agnieszka Woźniak	Does not fulfil independence criteria.	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 Articles of Association and the By-laws of the Supervisory Board, as well as corporate governance rules defined in *Best Practice 2016*.

In the financial year 2017 the Supervisory Board held, in total, 7 meetings and adopted 110 resolutions. In the majority of 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 Programme, 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 investment 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 2017

Main issues considered by the Supervisory Board during its meetings in 2017
<i>In the scope of its opinion-making / evaluation functions</i>
1. it issued a positive opinion concerning the <i>Plan of conducting sponsoring activity in TAURON Group in 2017</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 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. Capital Group for the financial year 2016</i> , in the scope of their compliance with the ledgers and documents as well as with the actual state of affairs,
3. 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, 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 operations of TAURON Polska Energia S.A. Capital Group for the financial year 2016</i> ,
4. 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 status,
5. it performed the evaluation of the Management Board motion concerning the method of loss coverage for the financial year 2016,
6. it adopted the <i>Report of the Supervisory Board of TAURON Polska Energia S.A. on the evaluation of the Financial statements of TAURON Polska Energia S.A., compliant with International Financial Reporting Standards for the financial year ended on 31 December 2016</i> , the <i>Report of the Management Board on the operations of TAURON Polska Energia S.A. for the financial year 2016</i> and the <i>motion of the Management Board concerning the method of loss coverage for the financial year 2016</i> ,
7. it issued a positive opinion concerning the <i>Annual Report on implementation of the Plan of conducting sponsoring activity in TAURON Group in 2016</i> ,

Main issues considered by the Supervisory Board during its meetings in 2017

8. it issued a positive opinion concerning the update of the *Rules of conducting sponsoring activity in TAURON Group*, aiming at their adjustment to the requirements included in the guidelines of the Ministry of Energy in the scope of sponsoring activity and the guidelines contained in *Best practice of sponsoring activity conducted by companies with the State Treasury shareholding*,

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 2016 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 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 updated *By-laws of the Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. and the By-laws of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.* taking into account the requirements relating to the activity of the audit committees defined in the Act of 11 May 2017 *on statutory auditors, audit firms and public oversight*,
 3. it adopted the amendments to the *Organisational 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 reorganisation measures and ensuring proper functioning of individual areas with the vacancy on the position of Vice-President of the Management Board for Commercial Affairs,
 4. it approved the updated *By-laws of the Management board of TAURON Polska Energia S.A.*, adjusting its wording to the amended *Organisational Regulations of TAURON Polska Energia S.A.*,
 5. it approved the *Material and financial plan of TAURON Group for 2017 and the Material and financial plan of TAURON Polska Energia S.A. for 2017*,
 6. 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 2017 and to perform the interim semi-annual review of the separate and consolidated financial statements of the Company for the period ended on 30 June 2017,
 7. in connection with the commencement of the new fifth joint term of office of the Supervisory Board, it elected the Chairman, the Vice-Chairman and the Secretary of the Supervisory Board,
 8. in connection with the commencement of the new fifth joint term of office of the Supervisory Board, it appointed Members of the Audit Committee, the Strategy Committee and the Nominations and Compensation Committee,
 9. it adopted a uniform text of the Company Articles of Association comprising the amendments introduced under resolutions No. 39-45 of the Ordinary General Meeting of 29 May 2017, entered in the register of entrepreneurs of the National Court Register on 12 July 2017,
 10. it approved concluding the agreements for legal services, marketing services, public relations services and social communication services as well as advisory services associated with management, whenever the level of the remuneration exceeded PLN 500 thousand net on an annual basis,
 11. 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 member of the management boards and supervisory boards, increase in the share capital,
 12. it adopted the *Framework work plan of the Supervisory Board of TAURON Polska Energia S.A. for 2018*.
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Main issues considered by the Supervisory Board during its meetings in 2017

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 monitored the expenditure incurred by TAURON Group on advertising, sponsoring, cultural, social and charity activities,
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 Programme,
5. it analysed the current information related to court disputes of the company - Polska Energia - Pierwsza Kompania Handlowa sp. z o.o.,
6. it analysed the status and planned activities related to the Strategic Research Agenda,
7. it monitored subjects covered under the agenda of General Meetings / Meetings of Shareholders of companies where TAURON Polska Energia S.A. holds shares/equity,
8. it monitored the process of implementation of the social dialogue in the Company and in TAURON Capital Group,
9. it analysed the terms and conditions of issuance of euro bonds and the financial needs from a multi-annual perspective,
10. it analysed the implementation of the programme of issuing intragroup bonds and the central financing model,

Main issues considered by the Supervisory Board during its meetings in 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 2016,
 2. it amended the former resolution concerning the development of remuneration of Management Board Members of TAURON Polska Energia S.A.,
 3. as of 16 March 2017, it appointed the following persons as Members of the Management Board of TAURON Polska Energia S.A. for the period of new joint fifth term of office: Filip Grzegorzczuk - as the President of the Management Board and Jarosław Broda, Kamil Kamiński and Marek Wadowski as Vice-Presidents of the Management Board,
 4. it concluded agreements for the provision of management services for TAURON Polska Energia S.A. with Members of the Management Board for a period of acting in the capacity of Members of the Management Board of the joint fifth term of office, with the provisions compliant with the resolution of the Extraordinary General Meeting No. 5 of 15 December 2016 concerning the development of remuneration of Company Management Board Members,
 5. it updated the *Remuneration policy for Members of supervisory and management bodies, including the description of its determination in TAURON Polska Energia S.A.*, adjusting its wording to the provisions of the resolution of the Extraordinary General Meeting of TAURON Polska Energia S.A. Of 15 December 2016 *concerning the rules on development of remuneration of Company Management Board Members*, including the amendments adopted by the Ordinary General Meeting on 29 May 2017,
 6. 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 performing work or provision of services in favour of other entities,
 7. 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 Management Board for accomplishment in 2017, including determining of the weight of those objectives and impartial criteria of their implementation and settlement,
 8. it performed the analysis of the implementation level of indicators determining awarding of the bonus to Members of the Company Management Board for 2016 and awarded the specified bonuses,
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Main issues considered by the Supervisory Board during its meetings in 2017

9. it concluded annexes to agreements for the provision of management services for TAURON Polska Energia S.A. with Members of the Management Board for a period of acting in the capacity of Members of the Management Board of the fifth joint term of office,

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

1. it approved incurring contingent liabilities in the form of annexes to bank guarantees assuming the extension of their validity period, constituting the security for banks' claims arising from credit facilities granted to Elektrociepłownia Stalowa Wola S.A. for financing of the investment project consisting of the construction of the new CCGT unit in Stalowa Wola,
2. it monitored expenditure on investment projects implemented within TAURON Capital Group, inter alia, through the analysis of the material and financial plan, including the accomplishment of investment expenditure in individual Areas of TAURON Capital Group operations.
3. it reviewed the implementation status of the schedule for investment projects of key importance for TAURON Group, in particular: the construction of the coal-fired unit with the capacity of 910 MW in Elektrownia Jaworzno III, the construction of the CCGT unit with the capacity of 450 MW in Elektrociepłownia Stalowa Wola, the construction of "Grzegorz" shaft including the construction of the infrastructure and accompanying workings, the construction of the 800 m level in Janina Mining Plant, the investment programme of Brzeszcze Mining Plant, the construction and implementation of innovative system for management of grid assets - ZMS, low emission elimination programme in the Silesia-Dąbrowa conurbation.

Based on the aforementioned activities, the Supervisory Board does not report any default in the scope of accuracy and effectiveness of spending funds associated with the implementation of investment by the Management Board of the Company in 2017, 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 2017, in the scope of execution of resolutions of the General Meeting of TAURON Polska Energia S.A., the Supervisory Board:

- 1) on 15 March 2017 concluded agreements for the provision of management services for TAURON Polska Energia S.A. with Members of the Management Board for a period of acting in the capacity of Members of the Management Board of the joint fifth term of office, with the provisions compliant with the resolution of the Extraordinary General Meeting No. 5 of 15 December 2016 concerning the development of remuneration of Company Management Board Members,
- 2) on 17 July 2017, adopted the uniform text of the Articles of Association of TAURON Polska Energia S.A., comprising the amendments introduced under resolutions of the Ordinary General Meeting no. 39 -45 of 29 May 2017, entered in the National Court Register by the District Court for Katowice - Wschód in Katowice, 8th Commercial Department on 12 July 2017,
- 3) on 28 August 2017 amended the earlier resolution of 19 December 2016 *concerning the development of remuneration of Management Board Members of TAURON Polska Energia S.A.*, adapting its provisions to resolution of the Ordinary General Meeting no. 36 of 29 May 2017 concerning the amendment to the resolution of the Extraordinary General Meeting of 15 December 2016 *concerning the development of remuneration of Management Board Members.*

6. Committees of the Supervisory Board

While implementing the recommendations and rules defined in the *Best Practice 2016*, in the previous financial year, the activity of the Supervisory Board was supported by the following committees: Audit Committee, Nominations and 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
<p>Audit Committee</p> <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 statutory 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 statutory 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(3) 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 on <i>specific requirements regarding statutory audit of public-interest entities...</i>, in line with policies referred to above in items 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 Accounting Act of 29 September 1994.
<p>Nominations and Compensation Committee</p> <ol style="list-style-type: none"> 1. Recommendations to the Supervisory Board concerning the recruitment procedure for the positions of Members of the Company Management Board. 2. Assessment of candidates for Members of the 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.

Tasks and competence of Committees of the Supervisory Board

5. Recommendations to the Supervisory Board concerning the need to suspend a Member of the Company Management Board due to material reasons.
6. Recommendations to the Supervisory Board concerning the need to delegate a member of the Supervisory Board to temporarily perform the duties of Members of the 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 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 statutory 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. Three Members of the Audit Committee meet the statutory independence criteria, including the Chairwoman of the Audit Committee who has knowledge and skills both in the scope of accounting and auditing of financial statements. Two Members of the Audit Committee have knowledge and skills in the scope of energy, i.e. the sector in which the Company operates.

At the first meeting members of Committees of the Supervisory Board elect among themselves a Chairperson to manage works of a given Committee and supervise preparation of the agenda, organisation of the distribution of documents and 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 Personal composition of the Supervisory Board Committees as at the day of drawing up this report

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

No.	Name and surname	Audit Committee	Nominations and Compensation Committee	Strategy Committee
6.	Paweł Pampuszko	-	-	Member
7.	Jan Płudowski	Member	-	Member
9.	Agnieszka Woźniak	-	Member	Member

In the financial year 2017: The Audit Committee held, in total, 10 meetings and adopted 23 resolutions; the Nominations and Compensation Committee held, in total, 5 meetings and adopted 26 resolutions; the Strategy Committee held, in total, 8 meetings and adopted 5 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 TAURON Group, the Strategy Committee held three meetings on the premises of companies of TAURON Group.

Table no. 7 Main issues considered by the Committees of the Supervisory Board during their meetings in 2017.

Main issues considered by the Committees of the Supervisory Board during their meetings in 2017.	
Audit Committee	
1.	presented the recommendation to the Supervisory Board concerning cancellation of the public procurement procedure for: "Auditing of separate and consolidated financial statements of TAURON for 2017-2019, auditing of financial statements of selected subsidiaries of TAURON for 2017-2019, review of interim semi-annual separate and consolidated financial statements of TAURON for periods ended on 30 June 2017, 30 June 2018, 30 June 2019" and launching a new procedure, including appointing a member of the Supervisory Board to the Public Procurement Commission,
2.	adopted the <i>Report on activities of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2016</i> and the <i>Report on activities of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. in the first half of the financial year 2017</i> , and submitted it to the Supervisory Board, and adopted the <i>Work Plan of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. For 2017</i> ,
3.	cooperated with the statutory auditor on issues related to: auditing the financial statements of the Company and the consolidated financial statements of the Capital Group for the financial year 2016, the review of the financial statements of the Company and the consolidated financial statements of the Capital Group for the first half of 2017, the process of auditing the financial statements of the Company and the consolidated financial statements of the Capital Group for the financial year 2017,
4.	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 status and presented the relevant recommendations to the Supervisory Board concerning the performed evaluation of: <ol style="list-style-type: none"> 1) <i>Consolidated Financial Statements of TAURON Polska Energia S.A. Capital Group for the financial year ended on 31 December 2016, 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 2016 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> 2) <i>Consolidated Financial Statements of TAURON Polska Energia S.A. for the financial year ended on 31 December 2016, 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 2016,</i> 3) <i>Extended consolidated reports of TAURON Polska Energia S.A. Capital Group for the 1st quarter of 2017, 1st half of 2017 and 3rd quarter of 2017.</i>
5.	positively evaluated the performance of financial revision activities, including the independence of the financial revision process, the independence and impartiality of the statutory auditor performing the audit of the separate financial statements of the Company and the consolidated financial statements of TAURON Group for the financial year 2016 and reviewing the financial statements for the 1st half of 2017,

Main issues considered by the Committees of the Supervisory Board during their meetings in 2017.

6. presented recommendations to the Supervisory Board concerning the assessment of the Company standing and the effectiveness of internal control, risk management, compliance and internal audit function systems existing in the Company,
7. presented the recommendation to the Supervisory Board concerning the selection of 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 2017 and to perform the interim semi-annual review of the separate and consolidated financial statements of TAURON Polska Energia S.A. for the period ended on 30 June 2017,
8. monitored on an on-going basis the results of conducted audit and control procedures and performed the analysis and assessment of the *Annual Audit Plan for TAURON Group for 2017*,
9. monitored on an on-going basis and evaluated key corporate and specific risks and the compliance system in TAURON Group, including with the actual status, and presented the relevant recommendations to the Supervisory Board,
10. analysed: the results of concluded public procurement procedures in TAURON Group, with special attention to procedures in the IT Area, pending court disputes, in particular the disputes carried out by the company Polska Energia - Pierwsza Kompania Handlowa sp. z o.o, the results of selected control proceedings conducted by external institutions,
11. analysed and assessed the membership of companies of TAURON Group in structures, institutions and trade organisations, focusing on benefits gained and costs incurred,
12. recommended the adoption of the updated *By-laws of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.* to the Supervisory Board, in order to adjust its provisions to the requirements of the Act of 11 May 2017 *on statutory auditors, audit firms and public oversight*,
13. developed and adopted:
 - 1) *Policy for selecting the audit firm to perform the audit and review of the financial statements and consolidated financial statements of TAURON Polska Energia S.A.*,
 - 2) *Procedure for selecting the audit firm to perform the audit and review of the financial statements and consolidated financial statements of TAURON Polska Energia S.A.*,
 - 3) *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. adopted the *Work plan of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. for the financial year 2018.*

Nominations and Compensation Committee

1. recommended the Supervisory Board to introduce changes in the rules concerning the development of remuneration of Management Board Members of TAURON Polska Energia S.A. , for the purpose of indexation of the fixed remuneration determined for Members of the Company Management Board, due to publishing of the average remuneration level in the enterprise sector by the President of the Central Statistical Office, excluding the disbursement of the profit sharing bonus in the fourth quarter of 2016 and reducing the percentage level of determined variable remuneration of Management Board Members,
2. recommended the Supervisory Board to shorten the fourth joint term of office of the Management Board , including the dismissal of all Management Board Members and appointment of the following persons to the Management board of TAURON Polska Energia S.A. for the fifth joint term of office: Filip Grzegorzczuk - for the position of the President of the Management Board, Jarosław Broda - for the position of the Vice-President of the Management Board for Asset Management and Development, Kamil Kamiński - for the position of the Vice-President of the Management Board for Customer and Corporate Affairs and Marek Wadowski - for the position of the Vice-President of the Management Board for Finance,
3. recommended the Supervisory Board to conclude agreements concerning the termination of existing employment contracts and non-competition agreements after termination of the employment relationship with Members of the Management Board who would be appointed to the Management Board of TAURON Polska Energia S.A. of the fifth joint term of office,

Main issues considered by the Committees of the Supervisory Board during their meetings in 2017.

4. recommended the Supervisory Board to conclude agreements for the provision of management services for TAURON Polska Energia S.A. over a period of acting in the aforementioned capacity with Members of the Management Board who would be appointed to the Management Board of TAURON Polska Energia S.A.,
5. recommended the Supervisory Board to adopt detailed management objectives for Members of the Company Management Board for accomplishment in 2017, including determining of the weight of those objectives and measurable criteria of their implementation and settlement,
6. 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 2016* and submitted it to the Supervisory Board,
7. recommended the Supervisory Board to change the weights of non-financial management objectives determined for Members of the Management Board, following the approval of the updated Organisational Regulations by the Supervisory Board of the Company,
8. performed the analysis and evaluation of indicators determining awarding of the annual bonus for 2016 to Members of the Management Board and presented the relevant recommendations to the Supervisory Board,
9. recommended the Supervisory Board to change the rules on development of remuneration of Management Board Members and update the detailed management objectives for Members of the Management Board to be accomplished in 2017 in connection with the amendment performed by the Ordinary General Meeting of the Company to the former resolution concerning the rules of development of remuneration for Members of the Management Board,
10. recommended the Supervisory Board to adopt the updated *Remuneration policy for Members of supervisory and management bodies, including the description of the rules of its determination in TAURON Polska Energia S.A.*, in order to adjust it to the provisions of the *Act of 9 June 2016 concerning the rules of development of remuneration of persons managing certain companies* and to the rules of development of remuneration for Members of the Management Board adopted by the Extraordinary General Meeting of TAURON Polska Energia S.A. specified in detail by the Company Supervisory Board.

Strategy Committee

1. adopted the *Report on activities of the Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. in the financial year 2016* and submitted it to the Supervisory Board,
2. elected the Chairperson of the Strategy Committee in connection with the commencement of the new fifth joint term of office of the Supervisory Board,
3. analysed and evaluated the activity and performance of the IT Area in TAURON Group, with special attention to the adopted model and organisation, corporate architecture management systems and systems supporting individual business areas, issues related to ensuring data and information security on information media, applicable procedures, cost structure and procedures related to awarding contracts and selection of contractors,
4. analysed standing of the Company as compared to other energy companies, focusing on economic and financial data, the level of sales, capital expenditure, level of debt, developments in share prices on the Stock Exchange, development outlook,
5. monitored the implementation status of key investment projects comprising the construction of a coal-fired unit for supercritical parameters with the capacity of 910 MW_e at Elektrownia Jaworzno and the construction of the 450 MW unit at Elektrociepłownia Stalowa Wola, getting acquainted with individual implementation stages of the said investment projects on the site, including the status of progress of the construction, the schedule of works and assumptions concerning the execution of subsequent stages,
6. analysed and evaluated the situation of Elektrownia Łagisza in Będzin, a Branch of TAURON Wytwarzanie S.A. in connection with the consequences of the fire,
7. analysed key issues related to financing and further implementation of the investment project comprising the construction of the 450 MW unit at Elektrociepłownia Stalowa Wola,
8. analysed the level of capital expenditure incurred in companies of TAURON Group in 2011-2016 from the generation, distribution, mining and heat area, including the investment needs of companies of TAURON Group in the years 2017-2026,
9. analysed and evaluated the activity and performance of the RES Area, focusing on: hydroelectric energy, wind energy, solar energy, biogas, economic and financial results and development opportunities in selected segments,

Main issues considered by the Committees of the Supervisory Board during their meetings in 2017.

10. analysed on an on-going basis the implementation status of the TAURON Group's 2016-2025 Strategy and the Investment Strategy of TAURON Group for 2017-2025,
11. analysed and evaluated the performance of the Distribution Area, with special attention to the reliability of consumer supply, maintenance and elimination of failures, service of customers connected to the grid, cooperation with large customers, possibility to reach SAIDI, SAIFI indicators and methods of their reduction, planned growth in expenditure (CAPEX, OPEX) in a three-year perspective,
12. analysed and evaluated the performance of the Sales Area, focusing on the strategy of cooperation towards Business Market area for the years 2015-2017, the level of electricity sales, cooperation with the largest clients and quantity of energy purchased, analysis of the public procurement segment as well as forms and directions of competitive advantage building on the Business Market,
13. analysed and evaluated the performance of the Customer Service Area, with special attention to the development strategy, undertaken projects aimed at building and maintaining sustainable competitive advantage enabling long-term capacity to generate required economic results, issues related to maintaining of the adequate market share, the appropriate structure of revenue and the quality of provided services and image among customers as well as assumed operational development directions for 2018 and planned promotions for households and sales plans for mass clients, including designed marketing campaigns,
14. analysed and evaluated needs related to the modernisation of generation units in TAURON Wytwarzanie in connection with the requirements defined in BAT conclusions as well as analysed issues related to the draft Act concerning introduction of the capacity market and impact of main elements of the Winter Package presented by the European Commission on 30 November 2016, which shall determine the directions of changes in the functioning of the EU energy market, leading to its deep restructuring,

7. Self-assessment of the Supervisory Board

The Supervisory Board of TAURON Polska Energia S.A. Performs 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 Management Board followed the rules contained in the *Best Practice 2016*.

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

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

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

In accordance with the foregoing, the Supervisory Board requests granting the discharge from fulfilment of duties by Members of the Supervisory Board of TAURON Polska Energia S.A. in the period from 1 January 2017 to 31 December 2017.

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 the Company standing

The financial standing of TAURON Polska Energia S.A. is stable, which was confirmed by the rating of the Fitch agency at the BBB level with stable outlook. This Agency maintained the rating outlook taking into account measures undertaken by the Company to improve its financial profile over the next five years, including a reduction of long-term investment programme and planned suspension of dividends until 2019. The first year when the payment of dividends will be possible is 2020. The stable outlook also reflects the reduced risk of infringing credit covenants and improved medium-term liquidity of the Company as compared to the fourth quarter of 2015 when the rating outlook was revised to negative.

The financial statement of TAURON Polska Energia S.A. drawn up for the financial year ended on 31 December 2017 indicated a positive operating result of PLN 263 million and a positive net financial result in the amount of PLN 854 million. One of the factors affecting generated financial results was the total reversal of provisions created by the Company in 2015 and updated in 2016, including the provision for agreements giving rise to liabilities with a joint venture and covering of operating costs of Elektrociepłownia Stalowa Wola S.A. The reversal of the aforementioned provision is associated with the fulfilment of conditions precedent arising from the contingent agreement signed on 27 October 2016 concerning setting of boundary conditions for restructuring of the project on the "Construction of the CCGT unit in Stalowa Wola". The conditions precedent were fulfilled through payment of all company liabilities towards financing institutions made on 31 March 2017 by Elektrociepłownia Stalowa Wola S.A. to institutions financing it so far, i.e. the European Investment Bank, the European Bank for Reconstruction and Development, Bank Polska Kasa Opieki S.A.

In 2017, the process of centralisation of functions and taking over the competence from companies of TAURON Capital Group was continued, aimed at improvement of effectiveness of the whole Capital Group. The new Business Model introduced in 2016 provided a stimulus for implementation of process management, representing the new approach to the organisation management method, which allows for continuous improvement of the overall organisation. The Management Board of TAURON Polska Energia started this path by defining the PRO (Partnership, Development and Courage) value. Partnership in striving to achieve excellence, joint Development and Courage in overcoming the "status quo" are the most important foundations of the new model. Process management helps in instilling those values in all employees of TAURON Group. It enables flexible operation and optimisation of internal processes and, at the same time, adapting to continuous changes occurring in the environment. The new approach to management has many advantages; the most important include simplification of processes operating so far, elimination of duplicated activities and elimination of redundant activities.

Effective process management means creating a possibility to influence activities in the Group through joint designing of processes and developing organisational culture oriented to cooperation and openness to changes.

TAURON Polska Energia S.A., as a parent entity in TAURON Group fulfils, in particular, the governing and the consolidating function. It also conducts activity in the scope of wholesale trading in electricity and other products of the energy market.

In connection with the foregoing, the major sources of the Company income include dividends from subsidiaries as well as revenue on sales of electricity, coal, gas, property rights pertaining to electricity certificates of origin, CO₂ emission allowances and commercial services.

In 2017, the Company recorded:

- 1) revenue on sales at a level of PLN 7,792 million, lower by 3% than in 2016, mainly due to:
 - a) gaining a lower revenue on electricity sales as a result of lower sales prices (as a consequence of a decline of wholesale prices on the Day-Ahead Market), at a higher electricity trading volume (in accordance with the upward trend of the domestic energy consumption according to the data of Polskie Sieci Elektroenergetyczne),
 - b) gaining a lower revenue on sales of gas due to lower accomplished volume of sales,
- 2) revenue on other operating activity at a level of PLN 1 million,
- 3) revenue on financial activity at a level of PLN 1,170 million, 42% lower than a year ago, mainly due to lower dividends from subsidiaries and interest on bonds and loans.

In 2017, the Company incurred:

- 1) cost of goods, materials and services sold at a level of PLN 7,355 million, lower by 5% as compared to 2016, which was mostly affected by lower costs of electricity purchase arising from the lower electricity prices,
- 2) costs of sales and overheads at a level of PLN 112 million, higher by 11% YoY - the growth was mainly related to costs of remuneration, exchange services and rental, which is associated with centralising of functions and taking over competence from subsidiaries,
- 3) costs of financial activity at a level of PLN 513 million, lower by 76% than last year's level due to recognising in 2017 the created and reversed revaluation allowances against the value of shares, equity and loans in subsidiaries in an amount lower than in 2016. The surplus of the revaluation allowance amount recognised over the revaluation of shares and equity and loans in 2017 reached the total of PLN 134 million, against PLN 1,610 million in 2016).

As at 31 December 2017 the carrying amount of the Company amounted to PLN 30,273 million and it was higher by 9% (PLN 2,601 million) in relation to the status as at 31 December 2016. The most significant change refers to:

- 1) in assets: a growth of shares and equity in connection with the capital injection in subsidiaries, a decline in the value of investment in subsidiaries' bonds and a decline in loans granted in connection with their repayment,
- 2) in liabilities: a growth of long-term and short term liabilities, mainly due to the issuance of euro bonds in the amount of EUR 500 million and recognising the loans within the cash pool service.

As at 31 December 2017, the structure of assets did not change significantly against the status as at 31 December 2016 - fixed assets constituted, respectively, 90% and 93% of the total assets. In the structure of liabilities, equity constituted 57% as compared to 60% at the end of 2016. Financial liabilities represented the most significant item of liabilities with the share of 40% of the total liabilities at the end of 2017, as compared to 37% at the end of 2016.

The status of cash gained as at 31 December 2017 was negative amounted to PLN (1,559.2) 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 2017, the price of the Company shares was significantly affected by the external environment and ranged from PLN 2.74 to PLN 4.32 (according to closing prices).

On the other hand, the main reasons of the general discount on valuation of domestic energy companies in 2017 included: regulatory uncertainty related to the future support system of renewable energy sources, write-offs related to the impairment in the value of assets in the electricity generation segment and risks associated with the involvement of energy companies on projects in the coal mining sector or related to building generation capacity based on hard coal.

It should be stressed that in 2017 the quotations of the biggest European energy groups also did not manage to lose the long-term downward trend.

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. The Group determined operational segments corresponding to its areas of activity: Mining, Generation, Distribution, Sales and Other activities.

The EBITDA result generated by TAURON Group in 2017 at a level of PLN 3,545 million was 6% higher than the result obtained in 2016. Segments with the highest shares in EBITDA of TAURON Group include: Distribution, Generation and Sales.

In 2017, the Mining Segment generated a negative EBITDA result at a level of PLN (83) million, comparable with the result achieved in 2016, which is the consequence of the following factors:

- 1) gaining a higher revenue as a result of sales of a higher coal volume (including stocks) at the increase in price,
- 2) a higher unit cost of coal production as a result of growth in costs of mining services, labour costs as a consequence of, among others, disbursement and creation of the provision for payment of a single bonus and consumption of increased quantity of coal to be processed, purchased from the market.

In 2017, the Generation Segment recorded EBITDA at a level of PLN 464 million, lower by 15% than the level achieved in 2016, which was mostly affected by:

- 1) a lower margin on electricity, due to a lower electricity sales price YoY,
- 2) a lower price and volume of property rights from RES due to over-supply of PMOZE on the market and decrease in production of biomass units,
- 3) a higher margin on heat due to the higher volume of heat and transmission services (higher external temperature in the heating period),
- 4) lower costs of CO₂ reserve, which is the result of: a higher quantity of free allowances, a higher volume of CO₂ emission (effect of higher production of electricity and heat) and lower prices of forward CO₂ contracting YoY,
- 5) higher costs of real estate tax on wind farms, costs of single bonuses for employees, higher costs of reserve for PDO, increased scope of current repairs and higher costs of electric damages.

In 2017, the Distribution Segment reached the EBITDA result at a level of PLN 2,283 million, lower by 5% than the result generated in 2016, which is a consequence of reversal of the actuarial provision in 2016 - impact on EBITDA - PLN 162 million. Excluding the aforementioned event, the EBITDA result of the Distribution Segment is higher by 2%, which was mostly influenced by the growth in the volume of distribution service sales, a higher average rate of distribution service sales to end customers, with simultaneous growth in costs of transmission services, as a result of a higher transitional fee and RES fee, as well as lower costs of grid losses as an effect of decrease in the volume of purchase in the Hedge contract.

In 2017, the Sales Segment reached the EBITDA result at a level of PLN 841 million, higher by 72% YoY, which was mainly affected by the reversal of the provision for agreements giving rise to liabilities with a joint venture, lower redemption costs of property rights, which is the result of a lower purchase price and a higher redemption obligation as well as gaining a lower margin on electricity sales as a consequence of accomplishing a lower sales price at a higher volume.

In 2017, the Other Activity Segment generated the EBITDA result at a level of PLN 118 million, 3% higher in relation to 2016.

The consolidated financial statement of TAURON Capital Group drawn up for the financial year ended on 31 December 2017 indicated:

- 1) the operating result at a level of PLN 1,806 million, in relation to PLN 802 million in 2016,
- 2) the net financial result at a level of PLN 1,383 million, in relation to PLN 370 million in 2016.

Both in 2017 and in 2016, the financial results (in own cost of sale at an operational level) comprised results of impairment tests of tangible fixed assets, in accordance with IAS 36 Impairment of assets, which indicated that a part of assets of the Generation Segment should be covered by an additional write-down and a part of write-down should be reversed. The necessity of revaluation of write-downs resulted from long-term maintaining of the market value of the Company net assets at a level below the balance sheet value, taking into account the developments of commodities on global markets in the

tests, changes in the situation on the domestic coal market, amendments to the RES Act, publication of the RES obligations for 2018 and 2019, adoption of the Act on capacity market and continuing unfavourable conditions in terms of profitability of conventional energy.

In the reporting period ended on 31 December 2017, TAURON Capital Group generated revenue on sales lower by 1.3% as compared to the values gained in 2016, due to lower revenue on sales of:

- 1) electricity - the resultant of a higher volume of energy retail sales and a lower volume of wholesale at lower energy sales prices,
- 2) property rights - a significant decline in PMOZE market prices.

The aforementioned declines were mainly undermined through the growth in the revenue on sales of:

- 1) distribution service - a growth in the volume of distribution service sales (by 4%) and the rate for distribution services provided to end consumers,
- 2) heat - a higher volume of sales of heat and transmission services and a higher rate for transmission services,
- 3) coal - a growth in the volume of sales at higher prices.

In 2017, costs of activity of TAURON Capital Group amounted to PLN 15.6 billion, which means that their level was lower by 7.3% than costs incurred in 2016. The above difference results from recognition and reversal of write-downs on tangible fixed assets at a level significantly lower than the write-down created in the year ended on 31 December 2016.

Should the aforementioned one-off events be disregarded in the results, the level of TAURON Capital Group costs in 2017 would be lower than costs incurred in the corresponding period of 2016 by 3.4%, which results from the following factors:

- 1) a decline in costs of electricity purchased for resale, mainly due to the lower volume of (wholesale) energy sold,
- 2) a growth in costs of the distribution service, mainly due to the growth in the volume of the distribution service,
- 3) a growth in costs of equipment maintenance, renovation services and other services,
- 4) a growth in costs of taxes, mainly real estate tax,
- 5) a growth in labour costs as a result of creating a provision for a single bonus in connection with the agreement signed with the social party,
- 6) a decline in costs of redeemed property rights as a result of decline in their price,
- 7) sales of coal from stocks as a consequence of increased sales (by 34%) due to the growth in demand.

As at 31 December 2017 the statement of financial situation of TAURON Capital Group indicates a balance sheet total lower by 0.7%, as compared to the status at the end of 2016.

Despite performing the impairment write-down, the value of fixed assets of TAURON Group increased by PLN 1,901 million (6.5%), 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 TAURON Wytwarzanie, TAURON Dystrybucja, Nowe Jaworzno Grupa TAURON and TAURON Ciepło) and intangible assets (mainly TAURON Dystrybucja),
- 2) purchase and reclassification of property rights to certificates of electricity origin and greenhouse gases emission allowances in connection with the requirement to secure the volume to fulfil the legal obligation of their redemption.

In the analysed period, as compared to the status as at the end of 2016, the value of current assets increased (by PLN 434 million, 10.1%), which was mainly determined by: a growth in the status of cash,

loans granted to joint ventures and receivables from customers. At the same time, a decline in the value of certificates of origin, inventory and other non-financial assets was recorded.

In 2017, 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 50.5%.

In relation to the status as at the end of 2016, the value of long-term liabilities of TAURON Capital Group has slightly increased (by PLN 769 million, 6.4%), mainly due to the issue of euro bonds with the value of EUR 500 million and redemption of a part of bonds issued in the previous years. The value of short-term liabilities of TAURON Capital Group increased (by PLN 177 million, 3.7%), which was determined by a slight growth of liabilities due to debt and towards suppliers, with a decline of investment liabilities and provisions for employee benefits.

In the statement of cash flows for 2017, TAURON Capital Group generated a positive flow on operating activity at a level of PLN 3,559 million (116.1% of the 2016 level). A decline in the status of inventory, payment of a lower income tax and advance payment for income tax in 2016 had the greatest impact on the change in operating flows. In addition, in 2017 TAURON Capital Group received the reimbursement of income tax surplus. Moreover, the Group incurred lower expenses for the purchase of property rights and recognised a negative balance due to the change in receivables and liabilities.

The value of flows from investment activity in 2017 was negative and it was higher by 6.7% than the investment expenditure accomplished in 2016, which was mostly affected by loan granting, whereas in 2016 TAURON Group returned received public aid, which was associated with the acquisition of ZG Brzeszcze.

The positive value of cash flows of financial nature results from the issue of euro bonds performed in 2017, with the total nominal value of EUR 500 million, the issue and redemption of bonds issued in previous years, with the nominal value of PLN 707 million and PLN 1,650 million, respectively and the repayment of credits and loans in the amount of PLN 155 million.

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

In 2017, TAURON Group incurred the capital expenditure of PLN 3,474 million, i.e. lower by 9% than the expenditure incurred in 2016, which amounted to PLN 3,817 million. This results mainly from the decline of expenditure in the Mining, Distribution and Generation Segment.

The most important investment projects implemented in 2017:

- 1) in the Mining Segment: the construction of the 800 m level at ZG Janina (PLN 41 million), the construction of Grzegorz shaft at ZG Sobieski (PLN 13 million), the investment programme of ZG Brzeszcze (PLN 38 million),
- 2) in the Generation Segment: construction of new 910 MW capacity at Jaworzno (PLN 1,278 million), replacement and modernisation expenditure and renovation components in TAURON Wytwarzanie (PLN 77 million), investment related to the development and maintenance of heating networks (PLN 16 million) and connecting new facilities (PLN 17 million),
- 3) in the Distribution Segment: modernisation and replacement of grid assets (PLN 865 million), construction of new connections (PLN 610 million).

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

Taking into account *Best Practice of WSE Listed Companies 2016* (hereinafter referred to as: “*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.

Evaluation of internal audit functioning

The internal audit system existing in TAURON Polska Energia S.A. is evaluated as effective. Nevertheless, due to the dynamic development of the internal audit system organisation is continuously improved adequately to the ongoing changes. The business unit managed by Executive Director for Internal Audit is located in the organisational structure of TAURON Polska Energia S.A. reporting directly to the President of the Management Board, which ensures independence, impartiality and maintaining of the due execution of the audit function. The scope of obligations and powers defined in internal regulations as well as the adopted methods of work and resources available to the Internal Audit enable effective accomplishment of the goals. In 2017, 36 audit tasks of both planned and ad hoc nature were conducted in TAURON Group. The results of those works comprised observations, conclusions and recommendations which contributed to the improvement of the internal control system in TAURON Polska Energia S.A. as well as in the entire TAURON Group. 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 scope of audit plan adopted for implementation in 2018 comprises significant issues and areas of the internal control system from the point of view of TAURON Polska Energia S.A. as well as the entire TAURON Group.

The objective of Internal Audit is planning and implementation of audit tasks, including the performance of commissioned ad-hoc inspections, and also activities of advisory and opinion-making (feedback) nature. 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 by the Management Board of TAURON Group. While implementing the internal audit function, the Company acts in compliance with the Code of Ethics and International Standards of Internal Audit Professional Practice.

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

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

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

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

Evaluation of compliance management

The Compliance Management System operating in TAURON Group (*CMS*) is a tool integrated in structures and processes aimed at creating of such a state of affairs in companies of TAURON Group, where the risk of non-compliance will be limited to the minimum.

The objective of the compliance management system in TAURON Group is to ensure the compliance of activities of TAURON Group companies with the legal regulations, the provisions of internal and intra-group regulations and the ethics. The compliance management system is aimed at mitigating the risk of sanctions, financial losses as well as loss of reputation, simultaneously contributing to building and consolidating the positive image of TAURON Group.

The tasks providing for compliance are performed by the Proxy for Compliance of TAURON Polska Energia S.A. with the support of the Compliance Team. The position of the compliance unit in the organisational structure is compliant with section III. Z.2. of *Best Practice 2016*. The Proxy for Compliance reports directly to the President of the Management Board, with simultaneous possibility to report directly to the Supervisory Board or the Audit Committee.

Compliance management in TAURON Group takes place through the following activities:

- 1) **preventive** - i.e. activities aimed at preventing the non-compliance,
- 2) **detective and remedying** - i.e. activities comprising the detection, examining and elimination of detected cases of non-compliance and mitigating their adverse consequences,
- 3) **analytical** - i.e. activities comprising the verification and analysis of detected cases of non-compliance in order to avoid events of similar nature in the future.

Activities performed by the Proxy for Compliance in 2017 were of major importance for the modernisation and extension of the compliance management system in TAURON Group. Activities in the scope of CMS implementation were preceded by an in-depth analysis of regulatory requirements binding investment firms, determining employees' needs, analysis of TAURON Polska Energia S.A. Activity, so as to provide for adjusting the compliance management system in TAURON Group to individual needs of the organisation.

The most important activities for the modernisation and extension of the compliance management system in TAURON Group carried out in 2017 comprise, among others the development and practical implementation of the **Responsible Business Code of TAURON Group**. It is the principal document reflecting the system of values adopted in the organisation which emphasises the requirement of adherence to the rules of procedure defined therein by employees and stakeholders of TAURON Group.

The Code was the starting point for drafting the **Compliance Policy of TAURON Group** - the document which defines in detail the rules of operation of the compliance management system in TAURON Group, i.e. the structure, procedures, tools, milestones and key areas of compliance management. The assumptions of the Policy were adopted by the Company Management Board and are currently consulted with business units of TAURON Polska Energia S.A. And representatives of TAURON Group companies. The adoption of the Policy is scheduled at the end of the 1st quarter of 2018

The activities carried out by the Proxy for Compliance for the introduction of the Responsible Business Code of TAURON Group and the Compliance Policy of TAURON Group should be assessed as a significant and fundamental step for ensuring due functioning of the CMS in TAURON Group.

The assessment of the functioning of the compliance management system in TAURON Group is also affected by other on-going activities performed by the compliance Area in order to protect TAURON Group against adverse consequences of *non-compliance*. It should be understood as preventive measures undertaken in the scope of ensuring the compliance of activity with new regulatory requirements as well as the protection of the brand, good name and reputation of TAURON Group which could be infringed as a result of publicity around irregularities on the media.

The **preventive** activities implemented by the Proxy for Compliance in 2017 included, in particular:

- 1) creating and updating internal and intra-group regulations applicable in TAURON Group, including inter alia:

- a) development and practical implementation of the Responsible Business Code of TAURON Group,
 - b) drafting the Compliance Policy of TAURON Group,
 - c) updating and extending the scope of application of the Procedure for Evaluation of Reliability of TAURON Polska Energia S.A. Customers to all companies of TAURON Group,
 - d) development of Anticorruption Policy in TAURON Group,
 - e) development and implementation of the Rules on organising projects in cooperation with external entities in TAURON Group,
- 2) cooperation with the relevant business units in the scope of creation of internal and intra-group regulations in TAURON Group, including, inter alia, initiating the process of adopting the following policies in TAURON Group: 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, Code of Conduct for Customers of TAURON Group companies, in order to ensure the compliance of TAURON Group activities with the new regulatory requirements arising from the amended *Accounting Act of 29 September 1994*,
- 3) issuing opinions and participation in the development of regulations created in TAURON Group linked with the compliance management area, including, inter alia:
- a) Regulations on procedure in the case of REMIT control,
 - b) Policy of business travel in companies of TAURON Group,
 - c) Rules on drawing up references in TAURON Group,
 - d) Mobbing and discrimination counteracting policy in TAURON Group.
- 4) participation in the activities of working teams established in TAURON Group, regarding key regulatory projects, including, inter alia:
- a) Permanent REMIT Working Group aimed at implementation of the requirements stemming from Regulation of the European Parliament and of the Council (EU) No. 1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency (REMIT),
 - b) Working Group for the implementation of the requirements of the Regulation of the European Parliament and of the Council (EU) No. 596/2014 of 16 April 2014 concerning market abuse (MAR) in TAURON Group, in the scope of obligations regarding CO₂ emission allowances,
 - c) Participation in the Working Group for the implementation of the requirements arising from Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MIFID II) in TAURON Group.
- 5) participation in legislative works related to acts of law of key importance for TAURON Group:
- a) in the scope of amendment to the *Act of 29 July 2005 on trading in financial instruments* in connection with the entry into force of MIFID II Directive, i.e. development of draft comments to the amendment, submitting the position within public consultations and participation in meetings at the Ministry of Finance,
 - b) concerning the list of due diligence premises on the part of purchaser in domestic transactions in the context of the right to deduct input tax, i.e. submitting the position in the scope of tax consultations conducted by the Ministry of Finance (developing and presenting proposed criteria, the verification of which should provide basis for recognising the observance of due diligence by a given entity in the process of potential customer's reliability assessment).
- 6) examining and monitoring of Customers' reliability, including external entities with whom companies of TAURON Group implement projects of PR and marketing nature,
- 7) issuing guidelines and announcements, e.g. warnings against misleading invoices,

- 8) consultancy and providing on-going aid in the scope of issues related to compliance through issuing opinions and recommendations, e.g. support to companies of TAURON Group in proceedings conducted by the ERO President,
- 9) conducting and participation in training in the scope of compliance-related issues, including, inter alia:
 - a) organisation and conducting workshops for the management staff of TAURON Group companies during which principal assumptions of Compliance Policy of TAURON Group were presented and discussed,
 - b) organisation and conducting workshops with participation of companies, regarding the adjustment of TAURON Group to the requirements stemming from MIFID II Directive,
 - c) development and implementation of the e-learning training aimed at introducing employees to the rules defined in the Responsible Business Code of TAURON Group,
 - d) raising competence by employees of the Compliance Team through participation in specialised training,
- 10) building corporate awareness and development of ethical attitudes among employees, including, inter alia:
 - a) conducting a cycle of meetings with employees with the aim of promoting the idea of the Responsible Business Code and creating the compliance culture in TAURON Group,
 - b) elaboration of promotional materials related to the Responsible Business Code of TAURON Group and their distribution in companies of TAURON Group.

The **detective** activities implemented by the Proxy for Compliance in 2017 included, in particular:

- 1) development and implementation of the new channel for reporting potential irregularities, i.e. The Abuse Reporting Form available for employees and external entities through the website www.tauron.pl,
- 2) verification of accuracy of activities performed by employees in terms of ensuring the compliance,
- 3) coordination and management of reports regarding potential cases of non-compliance (whistleblowing),

The **analytical** activities implemented by the Proxy for Compliance in 2017 included, in particular:

- 1) formulating the recommendations and guidelines in the scope of detected non-compliance cases,
- 2) supporting business units while implementing the recommendations and guidelines.

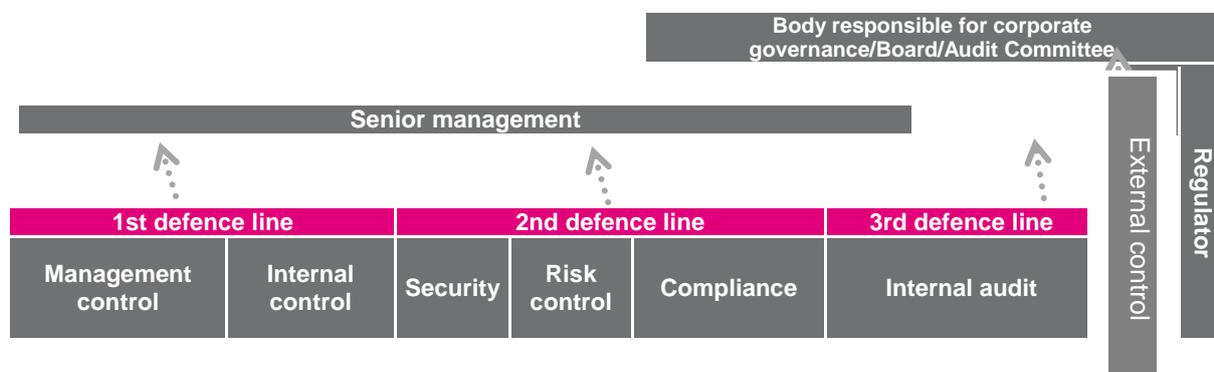
Taking into account the foregoing, it should be stated that the objective of the CMS applicable in TAURON Group, i.e. ensuring the compliance of TAURON Group's activities with legal regulations, internal regulations and ethical norms in order to mitigate events negatively affecting its functioning, is implemented through various activities which do not only represent the response to irregularities but should be mainly preventive. The catalogue of measures, tools and tasks implemented by the Proxy for Compliance is diversified and comprehensive, which ensures due performance of the protective, advisory and information and control function. The compliance management system applicable in TAURON Group should be assessed as optimum and adequate whereas the activities undertaken with the purpose of improvement of the procedures and mechanisms - as a strive for their continuous development. The effective compliance management system ensures TAURON Group's performance in compliance with broadly understood regulatory requirements as well as elimination of risk of unfavourable behaviours and activities.

Risk management in the model of "three defence lines"

In order to ensure security of the organisation functioning, the "three defence lines model" operates in TAURON Capital Group, comprising internal control, independent control within the second defence line and institutional control. In particular, the risk management function creates a system of internal control

in TAURON Capital Group constituting an element of the second defence line, next to the function of ensuring the compliance and security management.

Figure no. 1. Model of three defence lines



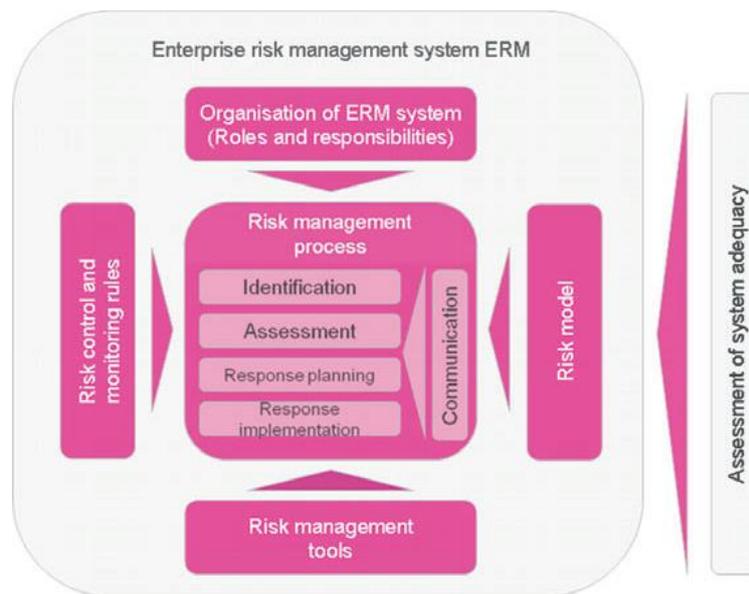
Functions of individual defence lines:

- The First Line** Business units obliged to perform ongoing control embedded in implementing tasks and the functional control.
- The Second**
 - 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,
 - the function of ensuring information security and technical safety.
- The Third** internal audit responsible for creating the internal control system and adequate functioning of the three defence lines model.

Risk management assessment

At a level of the Capital Group, a complex enterprise risk management system (ERM) has been implemented whose overriding objective is to support the implementation of TAURON Group's Strategy. The central element of system architecture is the process of enterprise risk management comprising continuous activities in the scope of risk identification, risk assessment, planning of risk response, implementation of the adopted risk response and communication between risk management process participants. The implementation of this process, in particular, ensures increasing the predictability of achieving the strategic goals, including sustainable creation of the financial result. 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.

Figure no 2. Architecture of the ERM System



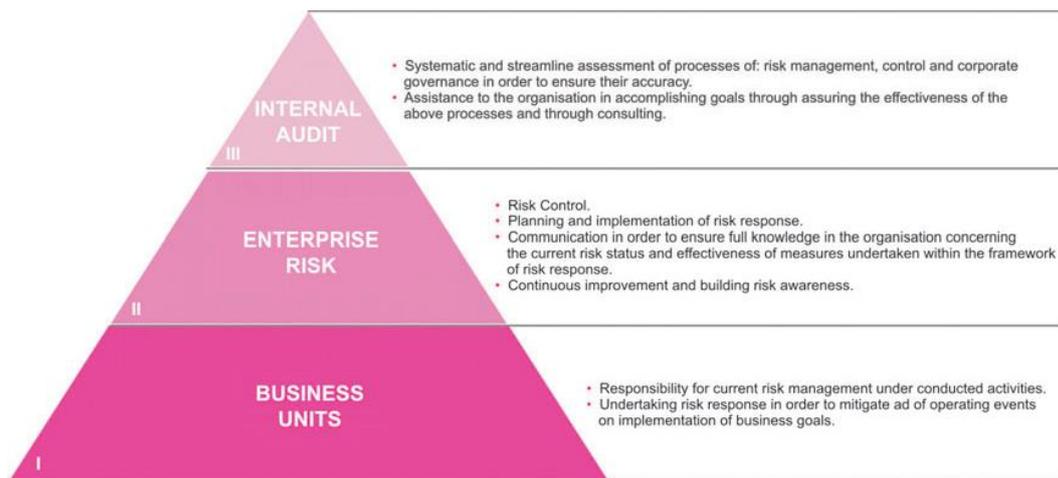
The ERM system operating in TAURON Group ensures comprehensive and consistent risk management rules linked with each other in terms of methodology and information. The operating risk management system architecture ensures centralising of the measurement, monitoring and risk control functions as well 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 Group's 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 the Group of risk area located in the structures of the parent entity. In accordance with the requirements of the *Best Practice of WSE Listed Companies*, the Executive Director for Risk responsible for coordination of the risk measurement and control function reports directly to the member of the Management Board and has a possibility of direct reporting to the Audit Committee.

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 defence line.



The risk management system operating in the Group is a systematic process and it is subject to continuous improvement in order to adjust it to the specific nature and organisational structure of TAURON Capital Group as well as 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 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 2017, the development of tools defined under the operating strategy was continued. In particular, the activities focused on the development of risk measurement, supplementing and updating the risk control indicators, with special emphasis on early warning indicators as well as risk control and monitoring.

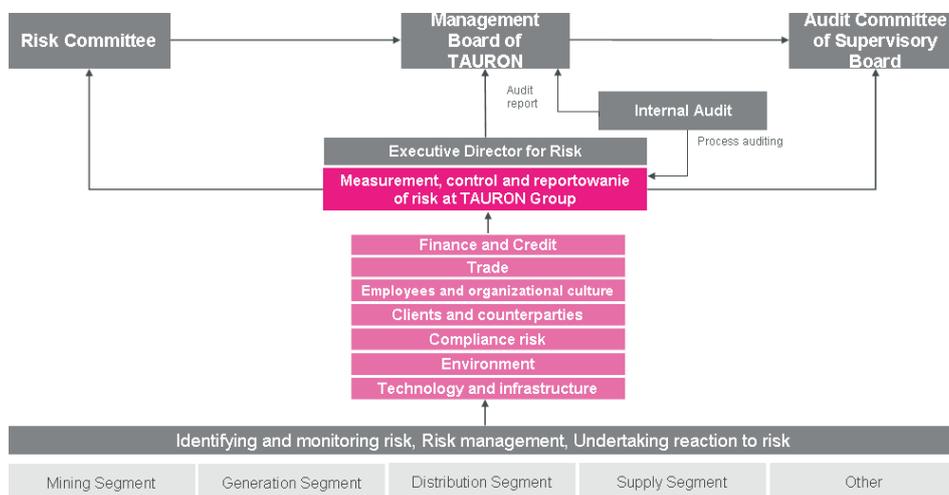
Figure no. 4. Risk Management Strategy



In the framework of the implementation of the risk control and monitoring functions, the Management Board of TAURON approves the risk Tolerance, 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 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. In the framework of 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 enterprise risk management system in TAURON Capital Group. The Risk Committee comprises persons with relevant knowledge on the Company and its environment as well as the required qualifications and powers. The role of the Risk Committee is to define risk management norms and standards in TAURON Capital Group and to supervise the effectiveness of the risk management process. Within the Risk Committee two separate teams were established for the commercial risk area and for the financial and credit risk area.

Figure no 5. Participants of the risk management process



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

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

In 2017, the Company was subject to corporate governance rules, described in the document *Best Practice of GPW Listed Companies 2016 (Best Practice 2016)*, which was adopted for application by the GPW 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 2017 the following rules do 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 2017, the Company developed and introduced for application the document called *Diversity Policy in TAURON Group*. So far, the Company lacked a single document describing the applied policy of diversity in relation to the authorities of the Company and its key managers, referred to in the rule designated as I.Z.1.15. of *Best Practice 2016*.

The obligations related to the application of corporate governance rules are defined in §29 of the Rules of the Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.) and in § 91(5)(4) of the Regulation of the Minister of Finance of 19 February 2009 concerning current and periodic information provided by issuers of securities and on conditions under which information required by legal regulations of a third country may be recognised as equivalent.

In accordance with §29 of the Exchange 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 provisions of § 29 of the Exchange Rules and entry into force of *Best Practice 2016*, on 1 February 2016 the Company published, via the EBI system, a report concerning its application. Since that time the Company did not notice violation of Best Practice 2016.

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

Pursuant to § 91(5) the report on the issuer's activity should contain, inter alia, the declaration on application of corporate governance which comprises, 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.

The Company published on its website the declarations on the application of corporate governance rules for year 2016 constituting a part of reports of the management board on operations of TAURON Polska Energia S.A. for a given year.

According to the assessment of the Supervisory Board of TAURON Polska Energia S.A., in 2017 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 activity associated with corporate social responsibility is conducted by TAURON Polska Energia S.A. and companies of TAURON Group based on and in compliance with the Sustainability Strategy. In connection with adopting of the *TAURON Group's 2016-2025 Strategy* in September 2016 and introducing the new business model of the company, in 2017 the *Sustainable Development Strategy of TAURON Group* was also updated. The new time perspective covers the period of 2017-2025.

The document is consistent with the published *TAURON Group's 2016-2025 Strategy* and the objectives defined therein, provides support to the Group's decisions, taking into account issues of sustainable development in each area of activity. The Strategy takes into consideration the opinion of TAURON

Group's environment, business model change as well as current and future challenges to be faced by the energy sector in the dynamically changing reality. It is also compliant with *Best practice in the scope of corporate social responsibility in companies with the State Treasury share* under preparation by the Chancellery of the Prime Minister.

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*. 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.

Projects in the area of corporate social responsibility carried out in 2017 by TAURON Polska Energia, companies of TAURON Group and TAURON Foundation respond to the directions of the Strategy, in particular, the secondary directions: Social and business partnership and Work safety, ethical culture and engaging workforce.

In November 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* were adopted in the Company for application. 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.

In 2016, in connection with the publication of *Best Practice in the scope of pursuing sponsoring activity by companies with the State Treasury shareholding* by the Ministry of Treasury, a review and adjustment of existing regulations to the new requirements was launched. This process was completed in 2017, taking into account also the recommendations of the Ministry of Energy in this scope. In the previous financial year, updated rules of sponsoring area performance in TAURON Group and the *Sponsoring strategy of TAURON Group for 2018-2025* was adopted, comprising also the required methodology of sponsoring project examination. Legal clauses indicated in Best practice, never used before, were included in the practice of negotiating sponsoring agreements.

In 2017, preparations to updating of the formerly accepted rules were also commenced in connection with the amendments introduced in the Company Articles of Association.

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 2017, the following documents refer to the sponsoring area in TAURON 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 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 Polska Energia S.A.

As a result of the promotion effectiveness measurement, an independent research entity estimated the advertising equivalent in relation to activities completed in 2017. 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 7.2. 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 119 million.

In 2017, leading projects included Vive TAURON Kielce, 74.Tour de Pologne, cooperation with the Polish Ski Association and TAURON Arena Kraków.

The confirmation of the effectiveness of conducted activities is the high positioning of TAURON brand in an independent research report, Sponsoring Monitor 2017, 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. In the ranking resulting from opinion surveys 208 brands were classified. Despite relatively lower sponsoring expenditure as compared to certain direct competitors, TAURON recorded a better result, taking a position higher by three than the next group, being included among top most recognised sponsors. Due to the relatively low level of sponsoring expenditure in TAURON Group, the position in this ranking can be treated as very high. Taking into account the indicative value of the sponsoring market in Poland according to the data of the Sponsoring Insight and the data of the aforementioned ranking, it can be extrapolated that the effect gained gives the Group the 11 per cent market share which, compared to other entities of the power sector, is the result positioning TAURON as a leader of effectiveness and efficiency of resources invested in this activity.

The charity activity in TAURON Polska Energia S.A. is implemented through TAURON Foundation whose statutory goal is to act to the benefit of public welfare, mainly in the scope of education, upbringing and teaching, and additionally, in the scope of health protection, development of economy, culture and arts, social welfare and social care, sport and recreation, environmental protection, protection of cultural assets and national heritage as well as promotion and organisation of volunteer activities. The Foundation operates on the basis of funds acquired mainly from companies of TAURON Group and 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 2017, 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.

Warsaw, 12 March 2018

Signatures of the Supervisory Board members presented at the meeting:

Chairperson of the Supervisory Board - Beata Chłodzińska

Vice Chairperson of the Supervisory Board - Teresa Famulska

Secretary of the Supervisory Board - Jacek Szyke

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 - Agnieszka Woźniak