Dear Sirs, Shareholders and Stakeholders,

On behalf of myself and the other members of the Management Board of ZE PAK SA, I am presenting to you a separate annual report of ZE PAK SA and a consolidated report of the Capital Group ZE PAK SA for 2017.

Revenues from sales in the past year exceeded PLN 2.4 billion. The ZE PAK SA Group produced nearly 8.4 TWh of electricity, while sales amounted to nearly 11.8 TWh. The Group generated PLN 511.9 million of EBITDA, which brings PLN 183.5 million of net profit. At the same time, it should be taken into account that the net result in 2017 was significantly affected by one-off events, the sum of which decreased the level of net profit by approximately PLN 79 million. Detailed results achieved in 2017 can be found in the financial statements and their analysis in the management board's report. It is also worth noting that last year the Company paid out a dividend in the total amount of over PLN 65.5 million, and over the last 12 months it was possible to reduce the net debt by PLN 295 million.

We are all aware of the challenges that current reality puts before companies from the electricity generation sector. The market on which we operate is changing very much. The regulatory environment plays an increasingly important role in our activity. In this context, it is enough to mention the act on the power market or changes in the rules of operation of the EU ETS system, which were announced last year. These are changes that are very important to our business and will certainly shape the framework of our activity in the future.

At the beginning of 2018, after over 50 years of operation, Elektrownia Adamów was shut down. In a natural way, this resulted in the scale of operations of ZE PAK SA Group. Last year we devoted a lot of time and effort to properly prepare for this process. Currently, in this new situation, we are working on using our assets and resources, including coal resources, to the most optimal extent. We are optimistic about the current announcements referring to the auctions that are to be held this year, concerning renewable energy sources and the first auctions for entities wanting to participate in the power market. We will certainly consider participating in these auctions, our priority is and will always be the maximum use of the potential to build shareholder value.

In the past year, despite many efforts and openness to cooperation with decision-making bodies, unfortunately we were unable to close the environmental decision for the new open-pit in Ościsłowo. We believe that our professional approach and cooperation with decision-making bodies will allow for a positive resolution in the shortest possible time.

Certainly, in the short form of the letter, I am not able to provide all relevant information about the ZE PAK SA Group, the details of functioning in the past year, perspectives and the environment. Therefore, I cordially encourage you to read our annual report. This year, for the first time, we are also presenting you a statement on non-financial information, which is part of the management board's report. We have made every effort to make it a comprehensive complement to the information provided so far.

I would like to thank the employees of the whole Capital Group for their hard work, the Union Organizations for their constructive approach to everyday challenges and the Shareholders for the trust they place in us.

President of ZE PAK SA Management Board

Adam Kłapszta

INDEPENDENT AUDITOR'S REPORT ON THE AUDIT OF THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders Meeting and Supervisory Board of Capital Group Zespół Elektrowni Pątnów – Adamów – Konin S.A.

The audit report on the annual consolidated financial statements

We have audited the accompanying consolidated annual financial statements for the year ended 31 December 2017 of Zespół Elektrowni Pątnów – Adamów – Konin S.A. Group ('the Group'), for which the holding company is Zespół Elektrowni Pątnów – Adamów – Konin S.A. ('the Company') located in Konin at Kazimierska 45 Street, containing the consolidated statement of financial position as at 31 December 2017, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated cash flow statement for the period from 1 January 2017 to 31 December 2017 and the summary of significant accounting policies and other explanatory notes ('the accompanying consolidated financial statements').

Responsibilities of the Company's Management and members of the Supervisory Board for the consolidated financial statements

The Company's Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Accounting Standards, International Financial Reporting Standards and related interpretations announced in the form of European Commission decrees and other applicable laws, as well as the Company's Statute. The Company's Management is also responsible for such internal control as determined is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In accordance with the Accounting Act of 29 September 1994 (the 'Accounting Act'), the Company's Management and the members of the Company's Supervisory Board are required to ensure that the accompanying consolidated financial statements meet the requirements of the Accounting Act.

Auditor's responsibility

Our objective was to express an opinion on whether the accompanying consolidated financial statements give a true and fair view[1] of the financial position and results of the operations of the Group in accordance with International Accounting Standards, International Financial Reporting Standards and related interpretations announced in the form of European Commission regulations and adopted accounting policies.

[1] Translation of the following expression in Polish is 'rzetelny i jasny obraz'.

We conducted our audit of the accompanying consolidated financial statements in accordance with:

- Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Oversight ('Act on Statutory Auditors'),
- National Auditing Standards in the wording of the International Auditing Standards adopted by the resolution no. 2783/52/2015 of the National Council of Statutory Auditors of 10 February 2015 with subsequent amendments,
- Regulation (EU) No. 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC ("Regulation 537/2014").

Those regulations require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the accompanying consolidated financial statements are free from material misstatement.

The purpose of the audit is to obtain reasonable assurance as to whether the consolidated financial statements as a whole were prepared based on properly maintained accounting records and are free from material misstatement due to fraud or error, and to issue an independent auditor's report containing our opinion. Reasonable assurance is a high level of assurance, but it is not guarantee that an audit conducted in accordance with the above mentioned standards will always detect material misstatements. Misstatements may arise as a result of fraud or error and are considered material if it can reasonably be expected that individually or in aggregate, they could influence economic decisions of the users taken on the basis of these consolidated financial statements. The risk of not detecting a material misstatement due to fraud is higher than the risk of not recognizing a material misstatement due to an error, as fraud may involve collusion, falsification, deliberate omissions, misleading or circumventing internal control and may affect every area of law and regulation, not just this directly affecting the consolidated financial statements.

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

The scope of the audit does not include assurance on the future profitability of the audited Group nor effectiveness of conducting business matters of the Group now and in the future by the Company's Management Board.

In accordance with International Auditing Standard 320 section 5 the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the consolidated financial statements and in forming the opinion in the auditor's report. Hence all auditor's assertions and statements contained in the auditor's report, including those on other information or regulatory requirements, are made with the contemplation of the qualitative and quantitative materiality levels established in accordance with auditing standards and auditor's professional judgement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. The opinion is consistent with the additional report to the audit committee issued on the date of this report.

Independence

While conducting our audit, the key certified auditor and the audit firm remained independent of the entities comprising the Group in accordance with the regulations of Act on Statutory Auditors, Regulation 537/2014 and principles of professional ethics adopted by resolutions of the National Council of Statutory Auditors.

Based on our best knowledge and belief, we declare that we have not provided non-audit services, that are prohibited based on article 136 of the Act on Statutory Auditors and article 5, point 1 of Regulation 537/2014, to the Company.

Appointment of the audit firm

We were appointed to audit the accompanying consolidated financial statements based on the Company's Supervisory Board resolution dated 19 May 2017. We have been auditing the consolidated financial statements of the Company consecutively since the beginning of the financial year ended 31 December 2002; this is for 16 years.

Most significant assessed risks

In the course of our audit we have identified the below described most significant assessed risks of material misstatement (key audit matters), including due to fraud and we designed appropriate audit procedures in response to those risks. Where we considered to be relevant in order to understand the nature of the identified risk and audit procedures performed we have also included key observations arising with respect to those risks.

These matters were addressed in the context of our audit of the accompanying consolidated financial statements as a whole, and in forming our opinion thereon. Therefore we do not provide a separate opinion on these matters.

Description of the nature of the risk of material misstatement (key audit matters)	*Audit procedures in response to the identified risk*
Impairment of property, plant and equipment *Reason of determining Key Audit Matter* Net value of Group's property, plant and equipment as at 31 December 2017 amounted to 3 281 million zlotys, where the amount of recognized impairment losses of Group's cash generating unit in prior years amounted to 1 880 million zlotys. As at 31 December 2017 the Company's Management Board identified rationale for impairment of assets, especially the carrying amount of net assets of the Group was significantly higher than the market capitalization of the Group. Therefore, the Company's Management Board carried out testing for impairment with respect to the related cash generating units. Tests for impairment were prepared based on discounted cash flow that included following factors: expected long-term energy prices, process of EUA allowances and green certificates, including key assumptions regarding operational specifications as implementation of Capacity Reliability Mechanism. Because of scale and area of significant Management Board's estimations we decided to determine the impairment of the property, plant and equipment as Key Audit Matter. *Reference to consolidated financial statement disclosure* The Group's disclosure concerning carried out tests for impairment of property, plant and equipment were embedded in Notes 5 and 19.1 of consolidated financial statement.	*Audit's strategy* As part of audit procedures we verified the Group's control environment designed in order to identify rationale for impairment. We obtained complete understanding of the process and evaluated method of establishing cash generating units. Our procedures, performed in cooperation with EY internal valuation experts, included analysis of established model and its key assumptions with emphasis on: • verification of the Management Board's future cash flow projections including comparison of actual results to previous forecasts and available market data as well as forecasts prepared for other purposes; • comparison of key macroeconomic factors applied in model (discount rates, forecasted growth rates) to market data and other external sources; • verification of mathematical accuracy of discounted cash flow; • assessment of adequacy and completeness of disclosures regarding tests for impairment in consolidated financial statement, including sensitivity analysis prepared by the Management Board.

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Revenue recognition related to PPA

Reason of determining Key Audit Matter

With the basis on the act of 29 June 2007, the Group’s subsidiary Elektrownia Pątnów II sp. z o.o. (“Elektrownia Pątnów II sp. z o.o.”) is engaged in the program of covering the stranded costs. Elektrownia Pątnów II sp. z o.o. receives compensations for recovering stranded costs emerged as a result of termination of long-term agreements for sales of power and electric energy (KDT) in form of quarterly prepayments adjusted by year end corrections. The final correction is to be made at the end of the primary long-term agreement. Total revenue of the Group for the year ended 31 December 2017 amounted to 2 433 million zlotys, out of which revenues related to the termination of long-term power purchase agreements of the subsidiary Elektrownia Pątnów II sp. z o.o. amounted to 181 million zlotys.

Determining the value of such revenue to be recognized is based on the complex financial model prepared by the Management Board of Eletrownia Pątnów sp. z o.o.. The model is based on estimated results from operational activity of Elektrownia Pątnów II sp. z o.o. for the time of participation in program of covering stranded costs i.e. till 2026. Because of scale and area of significant Management Board’s estimations we decided to determine the revenue recognition related to PPA as Key Audit Matter.

Reference to consolidated financial statement disclosure

The Group’s disclosure concerning revenue recognition related to PPA were embedded in Notes 5, 9, 10.28.4, 13 and 34.1 of consolidated financial statement.

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Audit’s strategy

As part of audit procedures we analyzed and evaluated adopted accounting policy in terms of disclosing revenue related to PPA and implemented methods of its recognition. Furthermore we documented our understanding of this process and identified internal control environment regarding presentation of compensations in the Company’s accounting books. The analysis included verification of year end compensations, final correction and compensations in previous years. Our procedures also included i.e.:

- analysis of realization of values estimated in previous periods;
- assessment of key assumptions adopted for the purposes of financial model utilized to calculate final correction, including comparison of actual results with previous estimations and analysis of available market information;
- verification of mathematical accuracy of model mentioned above;
- examination of year end adjustment for 2017 based on Elektrownia Pątnów sp. z o.o. financial data;
- assessment of adequacy and completeness of disclosures regarding revenue related to PPA in consolidated financial statement.

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Provisions for land reclamation and other related to mining activities	*Audit's strategy*
Reason of determining Key Audit Matter As part of activities related to lignite mining in surface mines owned by subsidiaries: PAK Kopalnia Węgla Brunatnego "Konin" S.A. and PAK Kopalnia Wegla Brunatnego "Adamów" S.A., the Group is obliged to reinstate initial condition or restore mining sites caused by mining movements. The amount of provisions for reclamation and other mining activities stated in consolidated financial statement as at 31 December 2017 amounted to 362 million zlotys. Provisions are calculated for reclamation costs of area that is currently being engaged in mining activities as well as for reclamation of final excavations in relation to level of lignite excavation as at balance sheet date. Matter of estimations of provisions for land reclamation and other mining activities was recognized as Key Audit Matter because of value of provisions mentioned above that is significant for consolidated financial statement. What is more performed estimations require professional judgement and other substantial assumptions regarding reclamation activities, timetable of realization, amount of estimated costs including public-law costs and discount and inflation rates. During the process the Company employed external specialists, especially in the field of estimating reclamation costs and reclamation of excavations and post mining lands. *Reference to consolidated financial statement disclosure* The Group's disclosure concerning provisions for land reclamation and other related to mining activities were embedded in Notes 5, 9, 10.26, 31.3.3 of consolidated financial statement.	As part of audit procedures we analyzed and evaluated adopted accounting policy in terms of disclosing provisions for land reclamation and other related to mining activities. Furthermore, we verified implemented by the Management Board of PAK Kopalnia Węgla Brnatnego "Konin" S.A. and the Management Board of PAK Kopalnia Węgla Brunatnego "Adamów" methods and techniques regarding recognition and valuation of mentioned provisions. Our audit procedures included i.e.: • understanding and analysis of process of estimating provisions and related to this process internal control environment; • verification of mathematical accuracy of estimations prepared in order to calculate the amount of the provisions; • analysis of assumptions applied by the Management Board of PAK Kopalnia Węgla Brunatnego "Konin" S.A. and the Management Board of PAK Kopalnia Węgla Brunatnego "Adamów" S.A. We verified the applied timetable and amount of estimated costs including external specialists reports. We evaluated competencies of appointed external specialists; • assessment of key factors applied for estimating discounted value of future costs including discount and inflation rates. We compared the amounts to available market data • assessment of adequacy and completeness of disclosures regarding provisions for land reclamation and other related to mining activities in consolidated financial statement.

Opinion

In our opinion, accompanying consolidated financial statements:

- give a true and fair view of the financial position of the Group as at 31 December 2017 and its financial performance for the year from 1 January 2017 to 31 December 2017 in accordance with International Accounting Standards, International Financial Reporting Standards and related interpretations announced in the form of regulations of the European Commission and other applicable laws and the adopted accounting policies,
- are in respect of the form and content in accordance with legal regulations governing the Company and the Company's Statute.

Report on other legal and regulatory requirements

Opinion on the Directors' Report

Our opinion on the consolidated financial statements does not include the Directors' Report.

The Company's Management is responsible for preparation of the Directors' Report in accordance with the Accounting Act and other applicable laws. In addition, the Company's Management and members of the Company's Supervisory Board are required to ensure that the Directors' Report meets the requirements of the Accounting Act.

Our responsibility in accordance with the Act on Statutory Auditors was to issue an opinion on whether the Director's Report was prepared in accordance with relevant laws and that it is consistent with the information contained in the accompanying consolidated financial statements.

Our responsibility was also to make a statement, on whether based on our knowledge about the Company and its environment obtained during the audit of the accompanying consolidated financial statements we have identified in the Director's Report any material misstatements and to indicate the nature of each of material misstatement.

In our opinion the Directors' Report was prepared in accordance with the relevant regulations and reconciles with the information derived from the accompanying consolidated financial statements. Moreover, based on our knowledge of the Company and its environment obtained during the audit of the financial statements, we have not identified material misstatements in the Directors' Report.

Opinion on the corporate governance application representation

The Company's Management and members of the Company's Supervisory Board are responsible for preparation of the representation on application of corporate governance in accordance with the applicable laws.

In connection with the conducted audit of the accompanying consolidated financial statements, our responsibility in accordance with the Act on Statutory Auditors was to issue an opinion on whether the issuer, obliged to present a representation on application of corporate governance, constituting a separate part of the Director's Report, included in the representation information required by applicable laws and whether the related information is in accordance with applicable regulations and with the information included in the accompanying consolidated financial statements.

In our opinion, in the representation on application of corporate governance, the Company has included information stipulated in paragraph 91, section 5, point 4, letter a, b, g, j, k and l of the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information provided by issuers of securities and conditions of deeming information required by the regulations of a non-member country equal (‘Regulation’). Information stipulated in paragraph 91, section 5, point 4 letter c-f, h and i of the Regulation included in the representation on application of corporate governance is in accordance with applicable laws and information included in the accompanying consolidated financial statements.

Information on preparation of the statement on non-financial information

In accordance with the requirements of the Act on Statutory Auditors, we inform that the Company has published information on the preparation of a separate report on non-financial information, referred to in art. 55 par. 2b of the Accounting Act and that the Company has prepared such a separate report.

We have not performed any attestation services in respect to the statement on non-financial information and do not express any assurance in its respect.

Warsaw, 19 April 2018

Key Certified Auditor

Piotr Chęciek
certified auditor
no in the register: 13253

on behalf of
Ernst & Young Audyt Polska
spółka z ograniczoną odpowiedzialnością sp. k.
Rondo ONZ 1, 00-124 Warsaw
no on the audit firms list: 130

19 April 2018

STATEMENTS OF THE MANAGEMENT BOARD

ZE PAK SA Management Board composed of the following members:

Adam Kłapszta – President of the Management Board

Aneta Lato-Żuchowska – Vice President of the Management Board

Elżbieta Niebisz – Vice President of the Management Board

Zygmunt Artwik – Vice President of the Management Board

States that:

- to the best of its knowledge, the Consolidated Financial Statements of ZE PAK SA Capital Group for the year ended 31 December 2017 and comparative data have been prepared in accordance with the applicable accounting principles and that they reflect in a true, reliable and clear manner the property and financial position and financial results of ZE PAK SA Capital Group. We also declare that the Management Board Report on the operations of ZE PAK SA Capital Group for the financial year 2017 contains a true picture of the development and achievements and situation of ZE PAK SA Capital Group, including a description of the basic risks and threats.

- the entity authorized to audit financial statements, auditing the Consolidated Financial Statements of ZE PAK SA Capital Group for the financial year ended on 31 December 2017, was selected in accordance with the law. It also informs that this entity and statutory auditors who audited the financial statements met the conditions for expressing an impartial and independent opinion on the audited annual consolidated financial statements, in accordance with applicable regulations and professional standards.

ZESPÓŁ ELEKTROWNI PĄTNÓW–ADAMÓW–KONIN SA
CAPITAL GROUP

CONSOLIDATED FINANCIAL STATEMENT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017
WITH AUDIT REPORT

This is a translation of the document issued originally in Polish language.
The Polish original should be referred to in matters of interpretation.

19 APRIL 2018

(in thousand PLN)

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For 12 months period ended 31 December 2017

	Note	*12 months period ended 31 December 2017*	*12 months period ended 31 December 2016*
Continuing operations			
Sales revenue	*13.1*	**2 443 075**	**2 704 711**
Cost of goods sold	*13.6*	(2 035 396)	(2 241 353)
Gross profit / (loss)		**407 679**	**463 358**
Other operating revenues	*13.2*	11 324	26 461
Selling and distribution expenses	*13.6*	(4 258)	(4 360)
Administrative expenses	*13.6*	(119 467)	(108 634)
Other operating expenses	*13.3*	(5 186)	(5 392)
Gross profit / (loss) from operations		**290 092**	**371 433**
Finance income	*13.4*	16 193	9 117
Finance costs	*13.5*	(47 652)	(72 672)
Profit / (loss) before tax		**258 633**	**307 878**
Income tax expense (taxation)	*15.1*	(75 089)	(57 592)
Net profit / (loss) for the period from continuing operations		**183 544**	**250 286**
Discontinued operations			
Profit/ (loss) for the period from discontinued operations		-	-
Net profit / (loss) for the period		**183 544**	**250 286**
Net profit/ (loss) attributable to equity holders of the parent		183 243	247 674
Net profit/ (loss) attributable to non-controlling interests		301	2 612

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

Profit / loss per share (in zloty):	Note	12 months period ended 31 December 2017	12 months period ended 31 December 2016
Basic, for profit for the period attributable to equity holders of the parent	17	3.61	4.87
Basic, for profit for the period from continuing operations attributable to equity holders of the parent	17	3.61	4.87
Diluted, for profit for the period attributable to equity holders of the parent	17	3.61	4.87
Diluted, for profit for the period from continuing operations attributable to equity holders of the parent	17	3.61	4.87

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

(in thousand PLN)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For 12 months period ended 31 December 2017

	Note	*12 months period ended 31 December 2017*	*12 months period ended 31 December 2016*
Net profit / (loss) for the period		**183 544**	**250 286**
Other comprehensive income			
Items to be reclassified to the profit / (loss) in subsequent reporting periods:			
Cash flow hedges	*14*	5 439	5 996
Income tax on other comprehensive income	*15.1, 14*	(1 033)	(1 139)
Other comprehensive income to be reclassified to the profit / (loss) in subsequent reporting periods		4 406	4 857
Items not to be reclassified to the profit / (loss) in subsequent reporting periods:			
Profits / (losses) on provisions for post-employment	*14*	(2 155)	4 613
Income tax on other comprehensive income	*15.1, 14*	409	(876)
Other comprehensive income not to be reclassified to the profit / (loss) in subsequent reporting periods		(1 746)	3 737
Net other comprehensive income		**2 660**	**8 594**
Comprehensive income for the period		**186 204**	**258 880**
Comprehensive income attributable to equity holders of the parent		185 903	256 268
Comprehensive income attributable to non-controlling holders		301	2 612

Adam Klapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

(in thousand PLN)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

	Note	*31 December 2017*	*31 December 2016*
ASSETS			
Fixed assets			
Property, plant and equipment	*19*	3 280 835	3 391 246
Investment property		2 365	2 337
Intangible assets	*21*	6 679	119 282
Assets of removing overburden and other mining assets (long-term)	*22*	72 536	80 524
Other long-term financial assets	*23.1*	10 311	11 945
Other long-term non-financial assets	*23.2*	2 122	5 726
Deferred tax assets	*15.3*	72 928	90 998
Total fixed assets		**3 447 776**	**3 702 058**
Current assets			
Short-term intangible assets	*21*	261 654	273 036
Inventories	*25*	97 758	105 296
Trade and other receivables	*26*	253 261	246 025
Income tax receivables		17 731	10 227
Short-term financial derivatives (assets)	*33.4*	-	296
Other short-term financial assets	*23.1*	35 788	77 317
Other short-term non-financial assets	*23.2*	11 425	28 776
Amounts due from customers under long-term construction contracts	*13.8*	7 080	8 168
Cash and cash equivalents	*27*	322 201	350 101
Total current assets		**1 006 898**	**1 099 242**
Assets classified as held for sale		1 038	-
TOTAL ASSETS		**4 455 712**	**4 801 300**

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

	Note	*31 December 2017*	*31 December 2016*
LIABILITIES AND EQUITY			
Equity			
Share capital	*28*	101 647	101 647
Reserve capital	*29*	1 094 493	1 028 647
Revaluation reserve from valuation of hedging instruments		(2 678)	(7 084)
Other reserve capital	*29.1*	3 472	3 472
Retained earnings / Accumulated losses		884 095	769 302
Net profit / (loss)		183 243	247 674
Equity attributable to equity holders of the parent		**2 264 272**	**2 143 658**
Equity attributable to non-controlling interests		-	-
Total equity		**2 264 272**	**2 143 658**
Long-term liabilities			
Interest-bearing loans and borrowings	*30*	302 465	587 851
Long-term employee benefits	*24.1*	48 166	48 587
Trade liabilities and other long-term financial liabilities	*33.2*	5 146	5 069
Long-term financial derivatives (liabilities)	*33.4*	870	4 294
Long-term subsidies	*33.5*	44 509	43 302
Other long-term provisions and accruals	*31*	357 902	312 253
Deferred tax liability	*15.3*	432 900	388 359
Total long-term liabilities		**1 191 958**	**1 389 715**
Short-term liabilities			
Trade liabilities and other short-term financial liabilities	*33.1*	146 416	302 662
Current portion of interest-bearing loans and borrowings	*30*	349 573	421 958
Short-term financial derivatives (liabilities)	*33.4*	4 139	5 759
Other non-financial liabilities	*33.3*	107 387	116 431
Current income tax liability		1 092	166
Short-term employee benefits	*24.1*	5 457	6 503
Short-term subsidies	*33.6*	1 507	6 670
Amounts due to customers under long-term construction contracts	*13.8*	5 626	3 990
Other short-term provisions and accruals	*31*	378 285	403 788
Total short-term liabilities		**999 482**	**1 267 927**
Total liabilities		**2 191 440**	**2 657 642**
TOTAL LIABILITIES AND EQUITY		**4 455 712**	**4 801 300**

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

(in thousand PLN)

CONSOLIDATED STATEMENT OF CASH FLOWS

For 12 months period ended 31 December 2017

	Note	*12 months period ended 31 December 2017*	*12 months period ended 31 December 2016*
Cash flow from operating activities			
Profit /(loss) before tax		258 633	307 878
Adjustments for:			
Depreciation and amortization	*27*	195 692	207 829
Interests and shares in profits		32 129	44 717
(Profit) / loss on foreign exchange differences		(13 801)	10 752
(Profit) / loss on investing activities		2 516	15 219
(Increase) / decrease in receivables	*27*	11 701	3 123
(Increase) / decrease in inventories	*27*	7 537	52 219
Increase / (decrease) in payables except for loans and borrowings	*27*	(99 080)	(5 117)
Change in provisions, prepayments, accruals and employee benefits	*27*	328 799	239 186
Income tax paid		(19 679)	(24 074)
Allowances for emission of CO_2		(249 437)	(315 533)
Impairment write-down on fixed assets and mining assets		22 165	-
Other		1 623	(148)
Net cash flow from operating activities		**478 798**	**536 051**
Cash flow from investing activities			
Proceeds from sale of property, plant and equipment and intangible assets		3 478	3 723
Purchase of property, plant and equipment and intangible assets		(98 272)	(195 352)
Proceeds and expenses relating to other financial assets	*27*	1 451	7 773
Deposit termination for securing debt	*27*	35 630	-
Dividends paid		208	60
Interest paid		5	6
Other		(124)	82
Net cash flow from investing activities		**(57 624)**	**(183 708)**
Cash flow from financing activities			
Payment of finance lease liabilities		(7 012)	(15 038)
Proceeds from loans and borrowings and debt securities		-	12 295
Repayment of loans and borrowings and debt securities		(340 837)	(334 211)
Dividends paid		(65 562)	-
Interest paid		(33 373)	(48 632)
Other		(466)	(1 428)
Net cash flow from financing activities		**(447 250)**	**(387 014)**
Net increase / (decrease) in cash and cash equivalents		**(26 076)**	**(34 671)**
Cash and cash equivalents at the beginning of the period	*27*	**348 646**	**383 318**
Cash and cash equivalents at the end of the period		**322 570**	**348 647**

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

(in thousand PLN)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For 12 months period ended 31 December 2017

	Note	*Issued capital*	*Reserve capital*	*Revaluation reserve of financial instruments*	*Other reserve capital*	*Retained earnings / accumulated losses*	*Total*	*Non-controlling interest*	*Total equity*
as of 1 January 2017		**101 647**	**1 028 647**	**(7 084)**	**3 472**	**1 016 976**	**2 143 658**	**-**	**2 143 658**
Net profit for the period		-	-	-	-	183 243	183 243	301	183 544
Total other comprehensive income		-	-	4 406	-	(1 746)	2 660	-	2 660
Total income for the period		**-**	**-**	**4 406**	**-**	**181 497**	**185 903**	**301**	**186 204**
Distribution of profits from previous years		-	65 846	-	-	(65 846)	-	-	-
Dividend for previous years		-	-	-	-	(65 562)	(65 562)	-	(65 562)
Distribution of profits from previous years for CSBF		-	-	-	-	(28)	(28)	-	(28)
The effect of the 'put' option settlement on the shares of non-controlling interests	*29.3*	-	-	-	-	301	301	(301)	-
as at 30 December 2017		**101 647**	**1 094 493**	**(2 678)**	**3 472**	**1 067 338**	**2 264 272**	**-**	**2 264 272**

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

(in thousand PLN)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For 12 months period ended 31 December 2016

	Nota	*Issued capital*	*Reserve capital*	*Revaluation reserve of financial instruments*	*Other reserve capital*	*Retained earnings / Accumulated losses*	*Total*	*Non-controlling interest*	*Total Equity*	*Issued capital*
As at 1January 2016		**101 647**	**2 542 060**	**(11 941)**	**5 877**	**(752 820)**	**-**	**1 884 823**	**-**	**1 884 823**
		-	-	-	-	247 674	-	247 674	2 612	250 286
Net profit for the period		-	-	4 857	-	3 737	-	8 594	-	8 594
Total other comprehensive income		**-**	**-**	**4 857**	**-**	**251 411**	**-**	**256 268**	**2 612**	**258 880**
Total income for the period		-	(1 513 413)	-	(2 405)	1 515 818	-	-	-	-
Distribution of profits from previous years	*29.3*	-	-	-	-	2 612	-	2 612	(2 612)	-
Share of profits from previous years for ZFŚS		-	-	-	-	(45)	-	(45)	-	(45)
The effect of the settlement of a put option on the shares of non-controlling interests		**101 647**	**1 028 647**	**(7 084)**	**3 472**	**1 016 976**	**-**	**2 143 658**	**-**	**2 143 658**

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

ZASADY (POLITYKI) RACHUNKOWOŚCI ORAZ DODATKOWE NOTY OBJAŚNIAJĄCE

1. General information

The Capital Group of Zespół Elektrowni Pątnów – Adamów – Konin SA ("the Group") consists of Zespół Elektrowni Pątnów – Adamów – Konin SA ("the parent company", "the Company", "ZE PAK SA"), with its head office in Konin at 45 Kazimierska str., and its subsidiaries (see Note 2). The Group's consolidated financial statement covers the year ended 31 December 2017 and includes comparative data for the year ended 31 December 2016. The parent company is entered into the Register of Entrepreneurs of the National Court Register kept by the District Court Poznań – Nowe Miasto and Wilda in Poznań, IX Commercial Division of the National Court Register, under the KRS number 0000021374.

The parent company was assigned the statistical number (REGON) 310186795.

The duration of the parent and member companies of the Capital Group is unlimited.

The main activities of the Group are:

1) generation and sale of electricity,
2) generation and sale of heat (steam and hot water),
3) lignite extraction.

(in thousand PLN)

2. Composition of the Group

The Group consists of Zespół Elektrowni Pątnów – Adamów – Konin SA and the following subsidiaries:

Entity	*Registered office*	*Scope of operations*	*Group's share in the capital in %*	
			31.12.2017	*31.12.2016*
Przedsiębiorstwo Remontowe „PAK SERWIS" sp. z o.o.	62-510 Konin ul. Przemysłowa 158	Construction and repair services	100.00%	100.00%
„Elektrownia Pątnów II" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Electric Energy production and distribution from the 464 MW power unit	100.00%*	100.00%*
„PAK – HOLDCO" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Holding activity	100.00%	100.00%
„PAK Infrastruktura" sp. z o.o.	62-510 Konin ul. Kazimierska 45	General construction of engineering objects, not classified elsewhere	100.00%	100.00%
„PAK GÓRNICTWO" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Exploration and recognition of lignite	100.00%	100.00%
Energoinwest Serwis sp. z o.o. in liquidation	62-510 Konin ul. Spółdzielców 3	Repair-construction service	100.00%*	100.00%*
PAK Kopalnia Węgla Brunatnego Konin SA	62-540 Kleczew ul. 600-lecia 9	Lignite extraction	97.58%*	96.23%*
PAK Kopalnia Węgla Brunatnego Adamów SA	62-700 Turek Warenka 23	Lignite extraction	99.26%	98.41%
„Aquakon" sp. z o.o. in liquidation	62-610 Sompolno Police	Mechanical services, repairs, reclamation of land, production and trade of mineral water	96.2%*	92.57%*
Eko-Surowce sp. z o.o. in liquidation	62-540 Kleczew ul. 600-lecia 9	Vulcanization services, sales of lignite	100.00%*	96.23%*
PAK – Volt SA	00-834 Warszawa ul. Pańska 77/79	Trade of electricity	100.00%	100.00%
EL PAK Serwis sp. z o.o. in liquidation	62-510 Konin ul. Przemysłowa 158	Repair and maintenance of electric equipment, repair and maintenance of machines	100.00%*	100.00%*
PAK Adamów sp. z o.o	62-510 Konin Ul. Kazimierska 45	Buying and selling real estate	100.00%	-

* *Entities in which ZE PAK SA has an indirect share in the capital*

As of 31 December 2017, the share in the general number of votes held by the Group in subsidiaries is equal to the Group's share in capitals of these subsidiaries.

As a result of the process of redeeming shares from eligible employees and after the transfer of shares repurchased from the State Treasury, the share of ZE PAK SA Capital Group's companies in the shareholding of PAK KWB Konin SA increased to 97.58% and in PAK Coal Mine Brunatnego Adamów SA to 99.26%.

On 9 May 2017 PAK Górnictwo sp. Z o.o. has made agreements with PAK KWB Konin SA, PAK Serwis sp. z o.o. and EL PAK sp. z o.o., as a result of which PAK Górnictwo sp. z o.o. acquired shares in the following companies: EL PAK Serwis sp. z o.o., Aquakon sp. z o.o., Eko-Surowce sp. z o.o., Energoinwest Serwis sp. z o.o. On August 1, 2017, the Extraordinary General Meeting of Shareholders of four companies acquired by PAK Górnictwo sp. Z o.o. took resolution on terminating the companies and starting their liquidation as of 1 August 2017. The initiated liquidation process is a consequence of the restructuring of the auxiliary activity towards the main segments of the Capital Group. The activities carried out by the abovementioned companies will be carried out by PAK Górnictwo sp. Z o.o. that takes over the rights and obligations of the liquidated companies.

On 30 June 2017, EL PAK sp. z o.o. (acquired company) and PAK Serwis sp. z o.o. (acquirer) have merged into one Company, pursuant to Art. 492 § 1 point 1 of the CCC by transferring all the assets of EL PAK sp. z o.o. to PAK Service sp. z o.o. Legal status EL PAK sp. z o.o. ceased from 1 July 2017. This change in the Group's structure is also a consequence of the consolidation of auxiliary activities to the Group's main segments. As of December 31, 2016 ZE PAK SA held 100% of shares in EL PAK sp. Z o.o. On 16 October 2017 a new subsidiary has been set up – PAK Adamów Sp. z o.o., in which ZE PAK SA holds all the shares. The appointment of the new subsidiary company is related to preparation of the process of terminating the activity of Elektrownia Adamów.

3. Composition of the Management Board of the parent company

As the day of the report publication, ZE PAK SA Management Board is composed of the following members:

- Adam Kłapszta President of the Board,
- Aneta Lato-Żuchowska Vice President of the Board,
- Zygmunt Artwik Vice President of the Board,
- Elżbieta Niebisz Vice President of the Board,

On 3 March 2017, by the resolution of the Supervisory Board of the Company, Mr. Adam Kłapszta, who previously held the position of the Vice-President of the Management Board of the Company acting as the President of the Management Board, was appointed as the President of the Management Board of the Company. The resolution on entrusting the function of the President of the Management Board of the Company entered into force upon its adoption.

During a meeting of the Supervisory Board held on 3 March 2017, Ms. Katarzyna Sobierajska and Mr. Tomasz Zadroga stepped down from the positions of the Vice-Presidents of the Management Board of the Company as of 3 March 2017.

On 3 March 2017, the Supervisory Board of the Company appointed Ms. Elżbieta Niebisz to the position of the Vice-President of the Management Board. The resolution on the appointment became effective upon its adoption.

4. Approval of the financial statement

This consolidated financial statement was approved for issuing by the Management Board on 19 April 2018.

5. Essential values based on professional judgement and estimates

5.1. Professional judgement

The preparation of the consolidated financial statement of the Group requires, from the Management Board of the parent company, the judgements, estimates and assumptions, which affect the reported income, costs, assets, liabilities and the related notes and disclosures related to contingent liabilities. Uncertainty about these assumptions and estimates may result in the significant impairment of balance sheet values of assets and liabilities in the future.

In the process of application of the rules (policies) of accounting, the Management Board made the following judgements that have the greatest impact on the presented balance sheet values of assets and liabilities.

Capitalisation of foreign exchange rates

Due to executed investments, the Group’s companies use external financing sources.

The borrowing costs, which can be directly allocated to the implementing investments, are capitalized in the value of the capital work in progress until the commissioning of the capital work to use.

The companies capitalize the foreign exchange rates related to the received credits and loans in the foreign currency to the extent to which they represent an adjustment to the interest costs. The Group uses the cumulative approach in the scope of capitalisation of external borrowing costs. The cumulative approach considers an investment as a whole. That is why the amount of foreign exchange rates possible to be capitalised as an adjustment of external financing costs in the reporting period may be subject to changes together with changes in exchange rates in the period of investment.

Classification of lease contract

The Group classifies the lease as operating or financial one based on the assessment of the extent to which the risk and benefits of ownership of the leased asset come to the lessor and to the lessee. This assessment is based on the economic content of each transaction.

Identification of embedded derivatives

At each balance sheet date, the Group's management assesses whether under the contracts, there are economic characteristics and risk specific to the embedded derivative in a foreign currency, which are not closely related to the economic characteristics and risk of the host agreement.

5.2. Uncertainty of estimates

Basic assumptions concerning the future and other key sources of uncertainty occurring at the balance sheet date, to which vital risk of the significant adjustment of balance sheet value of assets and liabilities in the next financial year are related, are discussed below. The Group adopted assumptions and estimates concerning the future on the basis of the knowledge possessed during development of the financial statement. Occurring assumptions and estimates may be subject to change due to future events resulting from market fluctuations or fluctuation not controlled by the Group. Such fluctuations are reflected in estimates or assumptions at the moment of occurrence.

Loss in fixed assets

As a result of analyses conducted as of 31 December 2016, the Group identified the existence of circumstances, which would indicate possible loss in value of the asset components, in the form of the balance sheet net value of the Group's assets higher than the value of its market capitalisation. In relation to the above fact, the Group conducted value impairment tests of components of fixed assets. On the basis of the conducted tests, it was stated that there is a need to identify the Impairment write-downs against tangible fixed assets. Information about the conducted test is presented in note 19.1.

Evaluation of provisions for employee benefits

Provisions for employee benefits were estimated using actuarial methods. The assumptions adopted for that purpose were presented in the note 24.1.

Estimate was developed on the basis of following main assumptions:

- discount rate 3.5%
- estimated inflation rate 2.5%
- estimated salary increase rates depending on the company, in the range from 0% to 3%

Changes of the financial indexes, which are a basis of the estimation, would change the balance of the provisions by the amounts presented in the table below (in thousands zloty).

	(+) increase by 1 percentage point	*(-) decrease by 1 percentage point*
discount rate	(2 488)	2 947
salary increase rates	2 886	(2 127)

Component of deferred tax assets

The Group recognises the component of deferred tax assets on the basis of assumption that tax profit enabling to its use will be achieved. The deteriorations of the achieved tax results in the future, could lead to a situation, in which this assumption would become unjustified.

Fair value of financial instruments

The fair value of financial instruments, for which there is no active market, is determined using relevant measurement techniques. When selecting relevant methods and assumptions, the Group is guided by professional judgement. The way of determination of the fair value of particular financial instruments was presented in note 10.10.

Capitalisation of overburden stripping costs in the production phase

In cases justified by IFRIC 20, the Group capitalizes overburden stripping costs during the operation phase of an open pit mine. The basis for cost capitalisation is meeting the following conditions: the Group is likely to achieve future economic benefits associated with overburden stripping, the Group is able to identify the part of a coal seam, to which access was facilitated and the costs associated with overburden stripping regarding that part of the seam can be credibly appraised. The Group verifies the estimates regarding the above criteria on a regular basis, in order to ensure correct cost capitalisation.

Settlement period for assets related to overburden stripping and other mining assets

On a periodic basis, the Group verifies the settlement periods of assets related with overburden stripping and other mining assets, on the basis of current forecasts regarding the open pit exploitation.

Payment in shares

In order to settle employee shares, it was accepted that the start date of vesting for the shares was the date of the Company's commercialisation, and the date of granting entitlements to the shares was the date of the final hanging of the lists with the number of shares granted to PAK Kopalnia Węgla Brunatnego Konin SA and PAK Kopalnia Węgla Brunatnego Adamów SA's employees. Fair value of the programme on the day of the acquisition of control was determined on the basis of the fair value of PAK Kopalnia Węgla Brunatnego Konin SA and PAK Kopalnia Węgla Brunatnego Adamów SA companies. The process of acquisition of shares by entitled employees begun in February 2013 and lasted until 20 October 2014. The price of shares redemption was specified in PAK KWB Konin and PAK KWB Adamów's shares sale agreements dated 28 May 2012 and was established at the level of the price of purchase of shares of earlier purchased shares of mines index-linked by the consumption products and services price indicator.

Compensation for the termination of long-term contracts for sale of power and electricity

Note 34 presents the descriptions of essential contingent liabilities and essential law suits, including these concerning compensations for the termination of long-term contracts for the sale of power and electricity.

Revenue recognition

The Group uses the percentage of work completion method at settlement of long-term contracts. Use of this method requires from the Group estimation of proportions of completed works to all services to be performed.

On every balance sheet date, the Group updates the budgeted estimates of total revenues and costs of realised projects. The projected contract-related loss is recognised as costs of the period, when it was recognised in accordance with IAS 11.

Depreciation rates

The amount of depreciation rates is determined on the basis of the projected period of economic usability of tangible fixed asset components and intangible assets. The Group verifies accepted periods of economic usability on the basis of current estimates annually.

Uncertainty associated with tax settlement

Regulations regarding the goods and services tax, the corporate income tax and the burden associated with social insurance are subject to frequent changes. These frequent changes result in the lack of relevant benchmarks, incoherent interpretations and few established precedents, which could be applied. The binding legislation also contains ambiguities, which create differences in the opinions, in terms of legal interpretation of tax legislation, both, between state authorities, as well as state authorities and the enterprises.

Tax settlements and other areas of activity (for example customs or foreign currency issues) can subjected to inspection by the authorities, which are entitled to impose large penalties and fines, and all additional tax liabilities, resulting from the inspection, must be paid together with high interest. These circumstances cause the tax risk in Poland to be higher than in countries with a more mature tax system.

As a consequence, the amounts shown and disclosed in financial statements can be changed in the future, as a result of the ultimate decision by a tax audit authority.

Amendments to the Tax Code were introduced on 15 July 2016 in order to reflect the provisions of the General Anti-Abuse Regulation (GAAR). The GAAR is supposed to prevent the creation and abuse of artificial legal structures, formed in order to avoid paying taxes in Poland. The GAAR defines tax evasion as an activity conducted mainly with the aim to obtain a tax benefit, contradictory in current circumstances to the subject matter and goal of the tax law regulations. According to GAAR, such an activity does not result in obtaining a tax benefit, if the manner of activity was artificial. All events of (i) unjustified division of operations, (ii) involvement of intermediaries, despite a lack of economic or business justification, (iii) elements mutually cancelling or compensating each other and (iv) other activities of a similar effect to the previously mentioned, can be treated as a prerequisite for the existence of artificial activities subject to GAAR provisions. The new regulations will require a much wider judgement when assessing the tax implications of individual transactions.

The GAAR clause shall be applied in relation to transactions made after it came into effect and to transaction, which were conducted prior to the GAAR entering into force but for which the benefits were or still are achievable after the date of entry into force. The implementation of the above regulations will enable Polish tax audit authorities to question the legal agreements and arrangements executed by the taxpayers, such as group restructuring and reorganisation.

The Group recognizes and measures assets or liabilities for current and deferred income tax by applying the requirements of IAS 12 *Income tax*, on the basis of the profit (tax loss), taxation base, unsettled tax losses, unused tax relief and tax rates, taking into account the uncertainties associated with tax settlements.

In the case of uncertainty whether a tax authority would and to what extent accept tax settlement of a transaction, the Group recognises these settlements taking into account the uncertainty assessment.

Impairment write-downs on receivables

On the balance sheet date, the Group evaluates whether there is objective evidence of the loss in value of the financial assets component or a group of financial assets. If the asset component value possible to recover is lower than its balance sheet value, a given entity establishes an impairment write-down to the level of current value of planned cash flows.

Provision for the liquidation of tangible fixed assets components

The group creates provisions for the liquidation of tangible assets in the event of such an obligation or undertaking such a liability by the Group's management. The provision is created in the amount resulting from the received offers concerning liquidation of components of tangible fixed assets. The Group updates the value of the provision on every balance sheet date. The value of the provision due to liquidation of components of tangible fixed assets is discounted on every balance sheet date. Provisions for the disassembly of the Adamów Power Plant assets are not created due to the lack of a legal obligation. The integrated permit received by Adamów Power Plant for conducting operations does not contain a clause on the obligation to liquidate assets, and therefore no provision has been created. The provision is described in note 31.3.2.

Provision for liquidation of ash storage yards

The Group creates the provision for liquidation of ash dumps due to a legal obligation resulting from the integrated approval entries. The basis of estimation are developments, technical and economic analyses developed by the Group, as well as received external offerings for planned directions of reclamation. At the end of each reporting period, the Group updates the value of the provision. The provision is described in note 31.3.2.

Reclamation and other provisions related to mining activity

The Group creates both, the provision for reclamation costs related to current extraction of coal on a given open pit, and the provision for costs of the final excavation. The provision is created on the basis of the estimates of future reclamation costs, as well as assumed start and finish dates of reclamation, on the basis of reports by independent experts estimating reclamation costs on the order of the Management Board, as well as internal estimates of the Group, and is discounted on every balance sheet date. The provisions are described in note 31.3.3.

Valuation of Energy certificates

The Group recognises the energy certificates of origin (green certificates) due to the energy production from renewable energy, gas, and peak load co-generation sources according to the fair value at the end of the month, in which they were produced. On the balance sheet date, the Group appraises certificates of origin to the net value possible to achieve – for green certificates on 31 December 2017 to the price of 45.29 PLN /MWh. A write-down against the certificate value is created in case the sale price possible to achieve, diminished by the disposition costs, is lower than the historical production cost.

Provision for liabilities for the emission of greenhouse gases and provisions for the redemption of certified emission reductions (EUA)

The Group recognises the provision for the redemption of greenhouse gases allowances and certified emission reductions. In association with completing the settlement period for the allocation of emission allowances NAP II, a new 2013-2020 settlement period related to emission allowances is effective as of 1 January 2013. The assumption of that period is to grant the Group free EUAs, resulting from the generation of thermal energy, however, the power sector was additionally covered by the possibility of derogation, resulting from Art. 10c of the ETS Directive, involving the granting of extra free allowances, under the condition of transferring declared investment expenses on the investments reported in the National Investment Plan.

Emissions in ZE PAK SA Group in 2016 amounted to 11 456 099 tons of CO_2.

As at January 1, 2017, the Group had physical assets in its EUA accounts in the amount of 13 820 841 tons. In January 2017, 1 345 000 EUA units purchased in futures contracts concluded at the turn of 2015 and 2016 accounted for the Group's accounts in the Union Registry. In addition, in February 2017, the Group received free EUA for heat for 2017 (Article 10a of the ETS Directive) in the amount of 83,317 EUA. Then in April 2017, the Group redeemed CO2 emissions for 2016 in the amount of 11 456 099 tons of CO2. The balance of EUA units in the Group after redemptions amounted to 3 793 059 EUA units.

In the following months, the Group continued to make further purchases of CO2 emission allowances. The total purchase of EUAs in the Group that influenced the Group Account in the Union Registry in 2017 amounted to 7 328 000 EUA, and the status of EUA units in the Group after all the operations described above as at 31 December 2017 amounted to 9 776 059 EUA.

As at December 31, 2017, the Group created a provision for allowances in respect of the actual volume of issue for the period from January 1, 2017 to December 31, 2017.

Details regarding the provision for liabilities for the redemption of greenhouse gas emission allowances and certified emission reduction units are presented in note 31.3.1.

Reclamation reserve

The Group did not create any restructuring reserves related to the end of the Adamów Power Plant operation, because in the opinion of the Management Board as at 31 December 2017, there were no conditions under IAS 37. If such requirements were met IAS 37 will be created.

6. Basis for development of the interim condensed consolidated financial statement

This consolidated financial statement was developed according to the historical cost principle, except for the derivatives and other financial instruments.

The balance sheet value of the recognised hedged assets and liabilities is adjusted with fair value changes, which may be attributed to the risk against which such assets and liabilities are hedged.

This consolidated financial statement is presented in Polish zloty (zloty) and all values, unless shown otherwise, are expressed in thousands of zloty.

This consolidated financial statement was developed under the assumption of continuing the activity over a period of at least 12 months after the balance sheet date. On the day of approving this financial statement, it cannot be stated that there are circumstances indicating a threat to the continuation of the activities by the Group’s companies, whereas, there are operations regarding the allocation of specified types of activity between the Group’s companies. The indicated actions will not impact the limitations of the scope of the business activity conducted by the ZE PAK SA Capital Group.

6.1. Statement of compliance

This consolidated financial statement was developed in conformity with the International Financial Reporting Standards ("IFRS"), approved by the EU ("EU IFRS"). At the date of approval of this report for publishing, taking into account the EU's ongoing process of implementation of IFRS; IFRS applicable to these financial statements do not differ from EU IFRS.

EU IFRS covers standards and interpretations adopted by the International Accounting Standards Board ("IASB").

The Group's companies keep their accounting books in accordance with the policy (rules) specified in the Act of 29 September 1994 on accounting ("the Act"), as amended, and the regulations issued therein ("Polish accounting standards"). The consolidated financial statement includes adjustments, which are not included in the accounting books of the Group's units, introduced in order to make their financial statements comply with IFRS.

6.2. Functional currency and financial statements currency

The functional currency of the parent company and other companies included in this consolidated financial statement and the presentation currency of this consolidated financial statement is the Polish zloty (zloty).

7. Amendments to the used accounting policies and to comparative data

The accounting (policy) rules applied for the development of this consolidated financial statement are coherent with the ones used for the development of the Company's consolidated financial statement for the year concluded on 31 December 2015, except the one shown below. The following amendments to the IFRS were applied in this consolidated financial statement according to their date of entry into force, however, they did not have a significant impact on the presented and disclosed financial information, did not apply to the transactions concluded by the Group:

- Amendments to IAS 12 *Recognition of deferred income tax assets in respect of unrealized losses*

  The changes clarify issues related to the creation of negative temporary differences in the case of debt instruments valued at fair value, an estimate of the likely future taxable income and an assessment of whether the income generated will allow realizing negative temporary differences. The changes are retrospective.

- Amendments to IAS 7 *Initiative on disclosure of information*

  The changes require the entity to disclose information that enables users of financial statements to evaluate changes in liabilities arising from financing activities. No comparative information is required for previous periods.

- Amendments to IFRS 12 *Disclosures about shares in other entities being part of changes resulting from the review of IFRSs 2014-2016*

  The changes clarify that the requirements in the standard also apply to the entity's shares in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), affiliates or structured units not consolidated, which have been classified (or included in the group for sale, which has been classified) as held for sale or as discontinued operations in accordance with IFRS 5 *Fixed assets held for sale and discontinued operations.*

The Group did not decide on the earlier application of any other standard, interpretation, or amendment, which were issued but are not yet effective in light of the European Union regulations.

8. New standards and interpretations which were issued but are not effective yet

- IFRS 9 Financial Instruments (issued on 24 July 2014) – applicable to annual periods beginning on 1 January 2018 or later,
- IFRS 14 Regulatory Deferral Accounts (issued on 30 January 2014) – as per the decision of the European Committee, the approval process for the standard in the preliminary version will not be initiated prior to the standard being issued in the final version – until the day of approval of this financial statement not approved by the EU – applicable to the annual periods beginning on 1 January 2016 or later,

- IFRS 15 Revenue from Contracts with Customers (issued on 28 May 2014), covering the amendments to IFRS 15 Effective date of IFRS 15 (issued on 11 September 2015) – applicable to the annual periods beginning on 1 January 2018 or later,
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued on 11 September 2014) – works leading to the approval of these changes were delayed indefinitely by the EU - the effective date was delayed indefinitely by IASB,
- IFRS 16 Leasing (published on January 13, 2016) - applicable to annual periods beginning on January 1, 2019 or later,
- Amendments to IFRS 4 Application of IFRS 9 Financial Instruments, including IFRS 4 Insurance Contracts (published on September 12, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- Explanations to IFRS 15 Revenue from contracts with customers (published on April 12, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- Amendments to IFRS 2 Classification and valuation of payment transactions based on shares (published on June 20, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- Amendments to IAS 28 Investments in Associates and Joint Ventures as a part of Changes resulting from the review of IFRS 2014-2016 (published on December 8, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- Amendments to IFRS 1 Application of International Financial Reporting Standards for the first time as part of the Changes resulting from the review of IFRS 2014-2016 (published on December 8, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- KIMSF 22 Transactions in foreign currency and advances (published on December 8, 2016) - applicable to annual periods beginning on January 1, 2018 or later,
- Amendments to IAS 40: Transfer of investment property (published on December 8, 2016) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2018 or later,
- IFRS 17 Insurance Contracts (published on May 18, 2017) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2021 or later,
- IFRIC 23 Uncertainty related to the recognition of income tax (published on June 7, 2017) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2019 or later,
- Amendments to IFRS 9 Early repayments with negative compensation (published on October 12, 2017) - applicable to annual periods beginning on January 1, 2019 or later,
- Amendments to IAS 28 Long-term shares in associates and joint ventures (published on 12 October 2017) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2019 or later,
- Changes resulting from the review of IFRS 2015-2017 (published on December 12, 2017) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2019 or later,
- Amendments to IAS 19 Change, limitation or settlement of the program (published on February 7, 2018) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2019 or later.
- Amendments to References to the Conceptual Assumptions contained in International Financial Reporting Standards (published on March 29, 2018) - until the date of approval of these financial statements not approved by the EU - applicable to annual periods beginning on January 1, 2020 or later.

The dates of entry into force are dates resulting from the content of standards announced by the International Financial Reporting Council. The dates of application of standards in the European Union may differ from the dates of application resulting from the content of standards and are announced at the time of approval for application by the European Union.

8.1. Implementation of MSSF 9

In July 2014, the International Accounting Standards Board published the International Financial Reporting Standard 9 Financial Instruments ("IFRS 9"). IFRS 9 covers three aspects related to financial instruments: classification and measurement, impairment and hedge accounting. IFRS 9 applies to annual periods beginning on January 1, 2018 and later, with the possibility of earlier application.

The Group plans to apply IFRS 9 from the effective date of the standard, without transforming the comparative data.

In 2017, the Group carried out a detailed assessment of the impact of the introduction of IFRS 9 on the accounting principles (policy) applied by the Group with respect to the Group's operations or its financial results. This assessment is based on currently available information and may be subject to changes resulting from the acquisition of rational and documentable additional information during the period when the Group applies IFRS 9 for the first time.

The Group does not expect a material impact of the introduction of IFRS 9 on the statement of financial position and equity, except for the effects of the application of IFRS 9 on impairment. The Group expects an increase in impairment losses, with a negative impact on equity, as described below. In addition, as a result of the application of IFRS 9, the classification of some financial instruments will change.

- **Classification and valuation**

In connection with the application of IFRS 9 in the area of classification and valuation, the Group does not expect a material impact on the statement of financial position and equity, the expected changes relate to the presentation. It is expected that all financial assets so-far measured at fair value will continue to be measured at fair value. Trade receivables are maintained to obtain cash flows arising from the contract. The Group has no trade receivables subject to factoring. The Group uses a practical exemption and for trade receivables under 12 months does not identify significant elements of financing.

- **Impairment**

In accordance with IFRS 9, the entity measures the write-down for expected credit losses in the amount equal to the 12-month expected credit loss or expected credit losses in the life of the financial instrument. In the case of trade receivables, the Group will apply a simplified approach and measure the write-off for expected credit losses in the amount equal to the expected credit losses throughout their life.

For the purpose of estimating the expected credit losses, IFRS 9 indicates the validity of using both historical data in the field of repayment as well as reliable data available at the balance sheet date that may increase the accuracy of estimating the expected credit losses in future periods.

The Company identified the following classes of financial assets for which, in accordance with IFRS 9, it estimated the impact of expected loan losses on the financial statements:

- Trade receivables for deliveries and services,
- Other receivables, including those due to LTC settlement
- Sureties and bank deposits,
- Cash.

With respect to trade receivables, it is assumed that the repayment data can be used to estimate credit risk in the future, and therefore the credit losses were estimated using historical data on the maturities of trade receivables and their fulfilment. In order to estimate the expected loss for other financial assets, the insolvency risk was determined based on other data, in particular rating assessments made by rating agencies or given to counterparties as part of the internal credit risk assessment process, adjusted for the probability of default assessment.

The Group estimates that due to the nature of trade receivables, the impairment loss would increase by approximately PLN 637 thousand as at December 31, 2017, along with the associated increase in deferred tax liability by PLN 121 thousand.

- **Hedge accounting**

Because IFRS 9 does not change the general principles of the Group's hedge accounting due to the lack of a decision on the possibility of implementing the changes provided for in this standard, the application of IFRS 9 in the area of hedge accounting will not have a material impact on the Group's financial statements.

8.2. Implementation of MSSF 15

International Financial Reporting Standard 15 Revenue from contracts with clients ("IFRS 15"), which was issued in May 2014, and then amended in April 2016, establishes the so-called The Five Steps Model for Recognizing Revenue from Contracts with Customers:

1) Identification of contracts with the client;
2) Identification of obligations to perform the benefit contained in the contract;
3) Determining the transaction price;
4) Assigning the transaction price to the performance obligations included in the contract;
5) Recognition of revenue when the entity complies with its obligations.

In accordance with IFRS 15, revenues are recognized in the amount of remuneration which, according to the entity's expectation, is due in exchange for the transfer of promised goods or services to the client.

The new standard will replace all existing requirements regarding revenue recognition in accordance with IFRS. The standard applies to annual reporting periods beginning on January 1, 2018 and later. Earlier use is allowed.

The Group has the right to choose a full or modified retrospective approach, and the transitional provisions provide for some practical solutions. The Group plans to apply IFRS 15 from the effective date of the standard, without transforming the comparative data.

The Group's companies conduct activities in the area of generation and sale of electricity, production and sale of heat, extraction of lignite and maintenance and repair-construction services. Lignite sale and purchase transactions and selected other transactions were excluded from the analysis as eliminated in the consolidation process.

Based on the work carried out so far by the Group related to the implementation of IFRS 15, the identified areas of impact of IFRS 15 will not have a material impact on the results presented in the financial statements, except for:

- changes in the presentation of revenues from a part of construction contracts implemented in a consortium of contractors, which until now were presented in the full amount of the subject of the agreement and from 1 January 2018 will be recognized in the part of the implementation attributable to the Group's companies. According to the current state of analysis, revenues from sales and operating costs in 2017 would be lower by approx. PLN 13 million.
- recognition of revenues from trade balancing services for selected clients, which from 1 January 2018 will be separated from the value of goods. This change will only affect the transfer between revenue items in the amount of about PLN 1 million.

Disclosures in the financial statements

IFRS 15 introduces new requirements regarding the presentation and disclosure. The Group believes that the impact of some of these disclosures may be significant. In particular, the Group expects additional disclosures regarding significant judgments and changes in these judgments regarding the areas of long-term construction contracts and trade in electricity.

In addition, in accordance with the requirements of IFRS 15, the Group will present recognized revenues from contracts with customers, divided into categories, which reflect the manner in which economic factors affect the nature, amount, payment date and uncertainty of revenues and cash flows. The Group will also disclose information that will enable users of financial statements to understand the relationship between the disclosure of revenue divided into categories and the revenue information that the Group discloses for each reporting segment.

8.3. Implementation of MSSF 16

In January 2016, the International Accounting Standards Board issued the International Financial Reporting Standard 16 Lease ("IFRS 16"), which replaced IAS 17 Leasing, IFRIC 4 Determining whether the contract includes leasing, SKI 15 Operating leases - special promotional offers and SKI 27 Substance assessment transactions using the form of leasing. IFRS 16 sets out the accounting principles for leasing in terms of valuation, presentation and disclosure.

IFRS 16 introduces a single model of the lessee's accounting and requires the lessee to recognize assets and liabilities resulting from each lease with a period exceeding 12 months, unless the underlying asset is of low value. On the date of the commencement, the lessee recognizes an asset component due to the right of use of the underlying asset and a lease liability that reflects his obligation to make lease payments.

The lessee separately recognizes depreciation of the asset component under the right of use and interest on the lease liability.

The lessee updates the valuation of the lease liability after the occurrence of certain events (e.g. changes in the leasing period, changes in future lease payments resulting from a change in the index or the rate used to determine such charges). As a rule, the lessee recognizes the revaluation of the lease liability as an adjustment to the asset's value due to the right of use.

The Group is a lessee in the case of machine and car leasing contracts, rents office space and uses land, including perpetual usufruct.

Lessor accounting in accordance with IFRS 16 remains substantially unchanged from current accounting in accordance with IAS 17. A lessor will continue to recognize all lease agreements using the same classification principles as in IAS 17, distinguishing between operating leases and finance leases.

IFRS 16 requires broader disclosures from both the lessee and the lessor than in the case of IAS 17.

The lessee has the right to choose a full or modified retrospective approach, and the transitional provisions provide for some practical solutions.

IFRS 16 is effective for annual periods beginning on January 1, 2019 and later. Earlier application is permitted for entities that use IFRS 15 from or before the first application of IFRS 16. The group has not decided to apply IFRS 16 earlier.

As at the date of approval of these consolidated financial statements for publication, the Management Board is in the process of assessing the impact of the introduction of IFRS 16 on the accounting principles (policy) applied by the Group with respect to the Group's operations or its financial results.

9. Change of estimates

During the period covered by the financial statement, the following changes of estimates, affecting the values shown in the financial statements, occurred:

- estimates in the assumptions for the valuation of actuarial provisions,
- estimates in the scope of assumptions regarding the valuation of derivative instruments,
- estimates in the assumptions regarding the calculation of the revenue for compensation of LTC,
- estimates in the assumptions regarding the periods of economic usability of the capital work,
- estimates related to realisation of the deferred tax assets,
- estimates in the scope of assumptions regarding the valuation of provisions for ash storage reclamation,
- estimates in the assumptions for the valuation of the provision for the liquidation of components of tangible fixed assets,
- estimates regarding the valuation of long-term contracts,
- estimates in the scope of assumptions regarding the valuation of the reclamation provisions associated with mining activity
- estimates in the scope of fixed asset impairment.

The impact of changes in estimates on the value of the recoverable amount of property, plant and equipment was presented in Note 19.1.

The impact of estimate changes on the value of actuarial provisions was presented in note 5.2.

In case of the valuation of derivatives (IRS, options), the change in estimates is due to the market changes of risk factors on the interbank market, i.e. the exchange rate and market interest rates. The description of the used protections was included in note 40.3.1.

In the calculation of the revenue due to compensation, the change of estimates relates primarily to changes in the sale prices and purchase of energy on the Commodity Power Exchange and balancing market, the volume of energy production and purchase of energy in order to meet sale plans as well as the interest rate of the 5-year government bonds and the NBP deposit rate, affecting the discount rate. The value of the yearly impairment due to compensations for 2017 is (+) zloty 58.30 million. The principles of recognition of revenue for compensations to cover stranded costs are described in note 10.28.4.

The period of economic usability of the fixed assets is subject to verification at the end of each reporting period based on the expected functionality period, verified against the Management Board’s plans related to the modernisation, sale, and liquidation of the main components of assets. The effect of the changes is recognised in the year in which the verification was performed.

With reference to the deferred tax asset, for each balance sheet day an analysis is carried out and, if necessary, a revaluation write-down is created, which is described in more detail in note 15.3.

The description of the titles of the main recognised provisions and changes of provision items in the current and previous fiscal year was described in note 31.

Note 13.8 shows the values of revenues for construction contracts, taking into account the balance sheet measurement and the expected losses due to these contracts.

10. Significant accounting rules

10.1. Consolidation rules

This consolidated financial statement includes the financial statement of Zespół Elektrowni Pątnów – Adamów – Konin SA as well as financial statements of its subsidiaries, developed each time for the year concluded on 31 December 2017. The financial statements of the entities controlled by it (subsidiaries), after the taking into account the adjustments to ensure compliance with IFRS, are prepared for the same reporting period as the parent company’s statement, using consistent accounting rules, based on uniform accounting policies applied for transactions and economic events of a similar nature. In order to eliminate any differences in the applied accounting methods, adjustments are implemented.

All significant balances and transactions between the Group's entities, including unrealised profits arising from transactions within the Group, were entirely eliminated. Unrealised losses are eliminated, unless they prove the impairment.

Subsidiaries are subject to consolidation from the date on which they are controlled by the Group and cease to be consolidated from the date on which such control ends. The control of the parent company over an entity takes place when:

- it has power over a given entity,
- it is exposed to variable returns or has rights to variable returns due to its commitment in a given entity,
- it has the possibility to use the power to shape the level of the generated returns.

The Company verifies the fact of having control over other entities, if the situation, which indicates a change of one or more of the above-mentioned control conditions, occurred.

If the company has less than a majority of the voting rights of the entity, but the held voting rights are sufficient to unilaterally manage the relevant activities of the entity, it means that it holds power over the entity. When assessing whether the voting rights in a given entity are sufficient to ensure power, the Company analyses all significant circumstances, including:

- the size of the held voting rights block in comparison to the scale of shares and the degree of dispersion of the voting rights held by other shareholders;
- potential voting rights held by the Company, other shareholders, or other parties;
- rights under other contractual arrangements; and
- additional circumstances that may demonstrate that the Company has or does not have the possibility to manage relevant activities in the decision-making moments, including voting schemes observed during previous meetings of the shareholders.

Changes in the parent company's ownership that do not result in the loss of control of the subsidiary are recognised as equity transactions. In such cases, in order to reflect changes in relative shares in the subsidiary, the Group adjusts the balance value of the controlling and non-controlling shares. Any differences between the amount of the adjustment of non-controlling shares and the fair value of the paid or received amount are recognised in the equity and attributed to owners of the parent company.

10.2. Investments in associates and joint ventures

The associates are entities, which are influenced directly by the parent company or through its subsidiaries, and which are neither its subsidiaries nor joint ventures.

Joint ventures constitute contractual arrangements, under which two or more parties undertake a business activity that is subject to joint control.

The financial year of associates, joint ventures, and the parent company is the same. Associates and joint ventures apply accounting rules included in the Act. Before calculating the share of associates and joint ventures in net assets, relevant adjustments are made, in order to make the financial data of these entities comply with IFRSs applied by the Group.

The Group's investments in associates and joint ventures are included in the consolidated financial statement using the equity method. According to the equity method, the investment in the associate or joint venture is initially recognised in accordance with the cost, and then adjusted to reflect the Group's share in the financial result and other complete revenue of the associate or joint venture. If the Group's share in losses of the associate or joint venture exceeds the value of its shares in this entity, the Group discontinues recognising its share in further losses. Additional losses are recognised only to the extent relevant to the legal or customary obligations adopted by the Group or payments made on behalf of the associate or joint venture.

An investment within the associate or joint venture is recognised using the equity method from the date on which the entity acquired the status of a joint venture or associate. On the day of making an investment in the associate or joint venture, the amount by which the value of the investment costs exceeds the Group's share in the net fair value of the identifiable assets and liabilities of this entity is recognised as the value of the company and is included in the balance sheet value of the investment. The amount, by which the Group's share in the net fair value of the identifiable assets and liabilities exceeds the cost of the investment, is directly recognised in the financial result in the period in which the investment was made.

When assessing the need for recognition of the value impairment of the Group's investment in the associate or joint venture, the requirements of IAS 39 are applied. If necessary, the entire balance sheet amount of the investment is tested for the value impairment in accordance with IAS 36 "Value Impairment of Assets" as a single component of assets, comparing its recoverable value with the balance sheet value. The recognised value impairment is part of the value balance sheet of the investment. A reversal of the value impairment is recognised in accordance with IAS 36 to the extent that is relevant to the further increase in the recoverable value of the investment.

The Group ceases to apply the equity method on the day when the investment is no longer the associate or joint venture and when it is classified as the one for sale. The difference between the balance sheet value of the associate or joint venture at the date of cessation of the use of the equity method and the fair value of the retained shares and profits from the partial disposal of shares in the entity is taken into account when calculating the profit or loss on the sale of the associate or joint venture.

The Group continues to apply the equity method, if the investment in an associate becomes an investment in a joint venture, or the other way around: if the investment in a joint venture becomes an investment in an associate. In case of such changes of the ownership shares, the revaluation is not performed.

If the Group reduces the share in the associate or joint venture, but it still settles the share using the equity method, it partially transfers to the financial result the profit or loss, which were previously recognised in other comprehensive income, corresponding to the decrease in the share, if the profit or loss is subject to reclassification to the financial result at the time of sale of the related assets or liabilities.

10.3. Calculation of items denominated in foreign currency

Transactions denominated in currencies other than zloty are calculated into Polish zloty using the exchange rate applicable on the date of conclusion of the transaction.

At the balance sheet date, assets and liabilities denominated in currencies other than zloty are calculated into Polish zloty using the average exchange rate determined for a given currency by the Polish National Bank at the end of the reporting period. The foreign exchange differences, which arise from the calculation, are respectively recognised in the financial revenue item (costs), or in cases of the rules (policy) of accounting, capitalised in the value of assets. Assets and non-monetary liabilities recognised at historical cost in a foreign currency are disclosed at the historical exchange rate of the transaction date. Assets and non-monetary liabilities recognised as per the fair value expressed in a foreign currency are converted to the fair value at the rate of the evaluation date. Profits or losses arising from the recalculation of assets and non-monetary liabilities recognised within the fair value are recognised in accordance with the recognition of profit or loss, which arises from changes in the fair value (i.e., in other comprehensive income or profit or loss, respectively, depending on where the change in the fair value is recognised).

(in thousand PLN)

The following exchange rates were adopted for the purposes of the balance sheet valuation:

	31 December2017	*31 December 2016*
EUR	4.1709	4.4240
GBP	4.7001	5.1445
USD	3.4813	4.1793

10.4. Tangible fixed assets

Tangible fixed assets are stated according to the acquisition price / production cost reduced by the redemption and impairment write-downs for the loss in value. The initial value of fixed assets includes the acquisition price increased by all costs directly related to the acquisition and adaptation of the asset components to a condition for its intended use. The cost also includes the cost of replacing the individual components of machinery and devices when incurred, if the recognition criteria are met. Any costs incurred after the date when a fixed asset is put into operation, such as the maintenance and repair costs, encumber the profit or loss when incurred.

Fixed assets, at the time of their acquisition, are divided into components with a significant value, to which a separate period of the economic usability can be attributed. The costs of general overhauls are also classified as components.

The redemption is calculated on a straight-line basis for an estimated useful life of a given component of assets, amounting to:

Type	**Period**
Buildings and structures	2 - 61 years
Machinery and technical devices	2 - 61 years
Means of transport	2 - 39 years
Other fixed assets	2 - 26 years

The final value, useful life and a depreciation method for the asset components are annually verified and, if necessary, adjusted with effect from the beginning of the just ended financial year. Any changes resulting from the conducted review are recognised as a change in estimates.

A given item of the tangible fixed assets may be removed from the balance sheet after its sale, or if any economic benefits, arising from the further use of such a component of assets, are expected. Any profits or losses resulting from removal of a given component of assets from the balance sheet (calculated as the difference between potential net income from the net sale and the balance sheet value of a given item) are recognised in the profit and loss of the period, in which such removal was made.

Commenced investments relate to fixed assets under construction or assembly and are reported in accordance with the acquisition or production costs reduced by potential impairment write-downs for the loss in value. The fixed assets under construction are not subject to redemption until the completion of their construction and putting the fixed asset into operation. Financing costs subject to capitalisation are also a value element of fixed assets under construction. The question of their capitalisation is described in more detail in note 10.12.

10.4.1. Fixed assets intended for sale

Fixed assets and their groups are deemed as held for sale when their balance sheet value is recovered rather by means of a sale transaction than through their further use. This condition can be met only when the sale transaction is highly probable and the assets' component is available for immediate sale in its present condition. The classification of the assets' component as intended for sale assumes the intention of the company's management board to conduct the sale transaction within one year from the date of classification. The fixed assets classified as held for sale are measured at the lower of two values:

the balance sheet value or fair value reduced by costs related to the sale.

If the Group wants to make a sale transaction, which would result in losing control over its subsidiary, all assets and liabilities of this entity are classified as held for sale, regardless of whether the Group keeps non-controlling interests after this transaction.

If the Group is committed to implement the sales plans for the sale of investments in the joint venture or associate, or part of such an investment, an investment or part of it intended for sale are classified as meant for sale after the fulfilment of the above-mentioned criteria, and the Group discontinues the use of the equity method of accounting for part of the investment classified as meant for sale. The other part of the investment in an associate or joint venture, which is not classified as intended for sale, is still settled using the equity method. The Group discontinues using the equity method at the time of sale, if the sale transaction causes a loss of significant influence on the associate or joint venture.

After the sale transaction, the Group settles retained shares in accordance with IAS 39, unless these shares enable a further classification of this entity as an associate or joint venture; in such case, the Group still continues to apply the equity method.

10.5. Investment properties

The initial recognition of the investment properties takes place according to the acquisition price or production cost, taking into account the transaction costs. The balance sheet value of the investment properties includes the cost of replacing the individual components of the investment property at the time of its incurrence, if the recognition criteria are met, and it does not include costs of the current maintenance of these properties. After the initial recognition, the value of investment properties is reduced by redemption and impairment write-downs for the loss in value.

Investment properties are removed from the balance sheet upon their sale or permanent withdrawal of the given investment property from use, when no future benefits of its sale are expected. Any profits or losses arising from removal of the investment property from the balance sheet are recognised in the income statement of the period in which the aforementioned removal took place.

The transfer of assets to investment properties is made when there is a change in their use confirmed by the owner ceasing to use the assets' component or the conclusion of an operating leasing agreement.

The Group as investment properties presents post-mining lands for which the reclamation process was completed. Such lands, in accordance with the plans of companies executing extraction activities, will be sold in the future.

10.6. Assets concerning stripping and other mining assets

Assets concerning overburden stripping and other mining assets include activated costs incurred in the pre-production phase of the mine, in particular:

- expenses related to the creation of sharing excavation,
- the asset associated with the creation of the provision for reclamation, in the part in which it relates to the removed overburden within the frameworks of works connected with the excavation of the initial excavation,
- the asset associated with the creation of provisions for large, one-off costs related to the areas on which open-pit mining proceeds.

In any case, the Group settles activated costs on a straight-line basis in the period of the economic usability of the duration of particular open pits (the exploitation period adopted for particular open pits). The adopted depreciation periods and depreciation methods are periodically reviewed, at least at the end of each financial year. The assets related to the removal of overburden and other mining assets with the economic usability of less than 12 months are classified within short-term assets.

The write-down against settlement of mining assets is recognised as operating costs within the depreciation costs.

10.7. Expenses related to exploration and evaluation of mineral resources

Within the mining assets item, the Group also shows expenses related to the exploration and evaluation of mineral resources.

The Group activates the expenses related to the exploration and evaluation of mineral resources until the end of the exploration works. The next step is to verify if the identified resources demonstrate the technical feasibility and economic viability of extracting. In the absence of viability of extracting, all the incurred expenses are written off in other operating costs.

Within the costs associated with the exploration and evaluation of mineral resources, the following element can be distinguished, among other things:

- topographical, geological, geochemical, and geophysical analyses,
- drilling,
- open-pit mining works,
- sampling,
- acquisition of extraction rights.

10.8. Intangible assets

Intangible assets acquired in a separate transaction or created (if they meet the recognition criteria for development costs) are measured at initial recognition, at their acquisition price or production cost, respectively. The acquisition price of intangible assets acquired in a business combination transaction is equal to their fair value at the date of the combination. Following the initial recognition, intangible assets are stated at their acquisition price or production cost reduced by the redemption and value impairment write-downs. The expenses incurred on the intangible assets produced internally, except for the activated assets incurred on the development works, are not activated and are recognised in the costs for the period, in which they were incurred.

The Group determines whether the period of use of the intangible assets is definite or indefinite. Intangible assets with a definite useful life are depreciated over the period of use and are subjected to the value impairment tests whenever there are premises indicating their value loss. The depreciation period and method of intangible assets with a definite useful life are verified at least at the end of each fiscal year. Changes in the expected useful life or the expected method of consuming the economic benefits from a given component of assets are recognised through a change of the period or depreciation method, and treated as changes in estimates. Depreciation write-downs for components of intangible assets with a definite useful life are recognised in the profit or loss in the expense of the category, which corresponds to the function of a given component of intangible assets.

Intangible assets with an indefinite useful life and those that are not in use are subject to the annual value impairment test, with respect to particular assets or at the level of the cash generating unit.

Usufruct periods are verified annually and, if necessary, adjusted with effect from the beginning of the just ended financial year. Any changes resulting from the conducted review are recognised as a change in estimates.

Research and development costs

Research costs are recognised in the profit or loss at the time they are incurred. The expenses incurred on the development works executed within the framework of a given venture are transferred to a subsequent period, when it can be assumed that it will be recovered in the future. After the initial recognition of expenses for the development works, a historical cost model is applied, which requires the asset components to be recognised according to the acquisition prices/production costs reduced by the accumulated depreciation and accumulated impairment write-downs against the loss in value. The capitalised expenses are depreciated by the expected period of obtaining revenue from the sale of a given venture.

A summary of the policies applied in relation to the Group's intangible assets is as follows:

	Concessions, patents and licenses	*Computer software*	*Other*
Periods of use	5 years	2 years	5 years
Applied depreciation method	Straight-line method	Straight-line method	Straight-line method
Internally produced or acquired	Acquired	Acquired	Acquired
The value impairment test	The annual assessment of whether there are any prerequisites indicating the occurrence of the loss in value.	The annual assessment of whether there are any prerequisites indicating the occurrence of the loss in value.	The annual assessment of whether there are any prerequisites indicating the occurrence of the loss in value.

Profits or losses resulting from removal of intangible assets from the balance sheet are valued according to the difference between the income from the net sales and the balance sheet value of a given asset component and are recognised in the profit or loss, when they are removed from the balance sheet.

The company also shows the CO_2 emission allowances received or acquired for own needs, as intangible assets.

A detailed description of the accounting policy in respect of CO_2 emission allowances was included in note 10.27.

10.9. Leasing

The Group as a lessee

Financial lease agreements, which substantially transfer all risks and benefits related to holding a leased asset onto the Group, are recognised in the financial situation statement on the lease commencement date according to the lower of the two following values: the fair value of the fixed asset constituting a subject of the lease or the current value of minimal lease payments. Lease payments are allocated between the financial costs and reduction of the balance of the lease liabilities in a way that allows the obtaining of a constant interest rate on the remaining unpaid liability. Financial costs are recognised in profit or loss, unless the capitalisation requirements are met.

The principles of depreciation of fixed assets used under financial leasing should be coherent with the principles used for depreciation of the Group's own assets subject to depreciation. In the event of a lack of sufficient certainty that the lessor will obtain a tenure prior to the end of the lease period, fixed assets used under financial lease agreements are depreciated over the shorter of the two periods: the estimated useful life of a fixed asset or the lease term. The lease agreements, under which the lessor substantially retains all the risks and benefits of ownership of the leased asset, are classified as operating lease agreements. Lease payments under the operating lease agreement and subsequent lease instalments are recognised as operating costs in profit or loss on a straight-line basis over the lease term.

Conditional lease payments are recognised as a cost in the period in which they become due.

10.10. Fair value measurement

The Group measures financial instruments such as instruments available for sale, derivative instruments at the fair value, at each balance sheet date. In addition, the fair value of financial instruments measured in accordance with the depreciated cost was included in note 41.

The fair value is defined as the price that would be received from the sale of an asset or paid in order to transfer a liability in the transaction conducted on normal sale conditions of a component of assets between market participants at the valuation date in the current market conditions. The valuation of fair value is based on the assumption that the sale transaction of a component of assets or the transfer of a liability occurs either:

- on the main market for a given component of assets or liability,
- in the event of absence of a principal market, in the market, this is most advantageous for the asset or liability.

Both, the main and the most advantageous markets must be available to the Group.

The fair value of a component of assets or liability is measured at the assumption that market participants, when determining the price of a component of assets or liability, act in their best economic interest.

The fair value of a component of non-financial assets takes into account the market participant's ability to generate economic benefits by making the greatest and the best use of the component of assets or its sale to another market participant that would provide the greatest and the best use of this component of assets.

The Group uses measurement techniques that are relevant to the circumstances and for which sufficient data to determine the fair value, with maximum use of relevant observable input data and minimal use of unobservable input data, are available.

All assets and liabilities that are measured at the fair value, or their fair value is disclosed in the financial statement, are classified in the fair value hierarchy as described below on the basis of the lowest level of input that is significant to the valuation of fair value treated as a whole:

- Level 1 – Quoted (unadjusted) market prices on the active market for identical assets and liabilities,
- Level 2 – Valuation techniques, for which the lowest level of input data, which is significant for the fair value measurement as a whole, is directly or indirectly observable,
- Level 3 – Valuation techniques, for which the lowest level of input data, which is significant for the valuation of the fair value as a whole, is unobservable.

At each balance sheet date, in the event of assets and liabilities existing per each balance sheet date in the financial statement, the Group evaluates whether there were transfers between levels of the hierarchy through a re-assessment of the classification into different levels, following the materiality of input data from the lowest level, which is essential for the valuation to the fair value treated as a whole.

Summary of essential procedures for the fair value measurement

The Management Board of the Group determines the rules and procedures for both, the systematic valuation of non-listed financial assets at the fair value, as well as one-time valuations, e.g. in case of assets intended for sale within a discontinued activity.

In order to determine the fair value, independent experts are engaged to perform the valuation of significant assets such as assets available for sale and financial liabilities, measured at the fair value. Internal valuation models are also used.

In order to perform the above valuations, independent experts, unrelated to the Group and with qualifications appropriate to conduct such valuations, as well as having current experience in such valuations in locations, where there are assets of the Group are appointed.

For the purposes of disclosure of the fair value measurement, the Group established classes of assets and liabilities based on the type, characteristics, and risks of the various components of assets and liabilities and the level in the fair value hierarchy, as described above.

10.11. Loss in value of non-financial fixed assets

At the balance sheet date, the Group evaluates whether there are any prerequisites indicating that loss in value of the component of non-financial fixed assets may have occurred. In the event when there are such prerequisites, or in case of the necessity to conduct an annual impairment test, the Group estimates the recoverable value of a given component of assets or a cash generating unit, which the component of assets belongs to.

The recoverable value of a component of assets or a cash generating unit corresponds to the fair value reduced of effecting the sale of the given component of assets or respectively the cash generating unit, or its value in use, depending on which one is higher. The recoverable value is determined for an individual asset, unless a given asset component does not independently generate cash inflows that are largely independent of those generated by other assets or groups of assets. If the balance sheet value of a component of assets is higher than its recoverable value, the loss in value occurs, and the write-down to the determined recoverable value is made.

In assessing the value in use, the projected cash flows are discounted to their current value using a discount rate prior to entailing the effects of taxation reflecting the current estimated value of money in time as well as the risk typical for a given component of assets. Impairment write-downs for the loss in value of assets used in the continued activity are recognised in the category of costs, which are consistent with the function of the asset component, in case of which the loss in value was identified.

At each balance sheet date, the Group assesses whether there are any prerequisites indicating that the value impairment write-down, which was recognised in previous periods, in relation to a given asset component, is unnecessary or whether it should be reduced. If such prerequisites exist, the Group estimates the recoverable value of the component of assets. The previously recognised impairment write-down for the loss in value is reversed only if, from the time of recognition of the impairment write-down, a change of the estimated values applied to determine the recoverable value of a given component of assets occurred. In this case, the balance sheet value of the component of assets is increased to its recoverable value. The increased amount cannot exceed the balance sheet value of the component of assets that would have been determined (after taking into account redemption) if, in the previous years, the impairment write-down for the loss in value, in relation to this component of assets, was not recognised. A reversal of the impairment write-down for the loss in value of the component of assets is immediately recognised as income. After the reversal of the impairment write-down, in the following periods, the depreciation write-down related to a given component is adjusted in a way, which within the remaining period of use of this component of assets allows systematically writing down the verified balance sheet value of the component of assets reduced by the final value.

10.12. Borrowing costs

Borrowing costs are capitalised as part of the fixed assets production cost. Borrowing costs consist of interests calculated using the effective interest rate method, financial encumbrances due to financial lease agreements and foreign exchange differences resulting from the external financing up to the amount corresponding to the adjustment of the interest cost. In terms of foreign exchange differences, the cumulative approach is applied.

10.13. Financial assets

Financial assets are classified into the following categories:

- financial assets maintained to the maturity date,
- financial assets measured at the fair value by the financial result,
- loans and receivables,
- available-for-sale financial assets

Financial assets maintained until the maturity date

Financial assets maintained to the maturity date are the financial assets quoted in the active market, and which are not derivative instruments with definite or possible to define payments as well as with the fixed maturity date, which the Group intends and has the possibility to hold to that time, other than:

- determined at the initial recognition as measured at the fair value by the financial result,
- determined as available-for-sale,
- meeting the definition of loans and receivables.

Financial assets maintained to the maturity date are measured at the depreciated cost using the effective interest rate method. Financial assets held to the maturity date are classified as long-term assets if their maturity exceeds 12 months from the balance sheet date.

Financial assets measured at the fair value by the financial result

The component of financial assets measured at the fair value by the financial result is a component that meets one of the following conditions:

a) it is classified as held for trading. The components of financial assets are classified as held for trading, if they are:
   - principally acquired for the purpose of selling in a short period of time,
   - part of the portfolio of identified financial instruments that are managed together and for which there is a probability to generate profit in a short period of time,
   - derivatives, except for the derivatives that are part of hedge accounting and financial guarantee contracts,

b) in accordance with IAS 39, classified into this category upon the initial recognition.

The financial assets measured at the fair value by the financial result are measured at the fair value taking into account their market value at the balance sheet date without the sale transaction costs. Changes in the value of these financial instruments are recognised in the income statement as financial revenues or costs. If the contract contains one or more embedded derivatives, the whole contract can be classified as financial assets measured at the fair value by the financial result. It does not apply to cases where the embedded derivative does not significantly influence the cash flows of the contract or it is clear without conducting or after a superficial analysis that if a similar hybrid instrument was firstly considered then separating the embedded derivative would be prohibited. Financial assets at the initial recognition can be classified to the category measured at the fair value by the financial result if the following criteria are met: (i) such classification eliminates or significantly reduces inconsistency in terms of recognition or valuation (accounting mismatch); or (ii) assets are a part of a group of financial assets, which are managed and measured on the basis of the fair value, in accordance with a documented risk management strategy; or (iii) financial assets contain embedded derivatives that should be recognised separately.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in the active market. They are included in current assets, if their maturity date does not exceed 12 months from the balance sheet date. The granted loans and receivables with the maturity date exceeding 12 months from the balance sheet date are classified as fixed assets.

Assets available for sale

The available-for-sale financial assets are the financial assets which are not derivatives, and which were classified as available for sale or those that do not belong to any of the three previously mentioned categories. Financial assets available for sale are recognised in accordance with the fair value increased with the transaction costs that can be directly attributed to the acquisition or issue of the component of financial assets. In the event of a lack of exchange quotations on the active market and if it is not possible to reliably determine their fair value using alternative methods, the available-for-sale financial assets are measured at the acquisition price adjusted by the impairment writ-down for the loss in value. The positive and negative differences between the fair value of the available-for-sale assets (if there is a market price established on the active market or if their fair value can be determined by some other reliable method), and their acquisition price, after deduction of the deferred tax, are included in other comprehensive income. The decrease in value of the available-for-sale assets caused by the loss in value is recognised as a financial cost.

The acquisition and sale of the financial assets are recognised at the transaction date. At the time of the initial recognition, a component of financial assets is measured at the fair value, increased, in case of the component of assets not classified as the measured at the fair value by the financial result, with the transaction costs, which can be directly attributed to the acquisition.

The component of financial assets is removed from the balance sheet when the Group loses control over the contractual rights that comprise a given financial instrument; it usually occurs when the instrument is sold or when all the cash flows attributed to a given instrument are transferred to an independent third party

In a situation, in which the Group:

- has a legally enforceable right to compensate the recognised amounts, and
- intends to settle on a net basis, or at the same time to realise the component of assets and settle the liability

a financial asset component and financial liability are compensated and presented in the financial statement in the net amount.

The framework agreement described in IAS 32.50 does not constitute grounds for compensation, if both above described criteria are not met.

10.14. Loss in value of financial assets

At the balance sheet date, the Group evaluates whether there are objective prerequisites of the loss in value of the component of financial assets or the group of financial assets.

10.14.1.Assets recognised in accordance with the depreciated costs

If there are objective prerequisites that a loss in value of the granted loans and receivables, measured in accordance with the depreciated cost, occurred, then the cost of the impairment write-down for the loss in value equals to the difference between the balance sheet value of the component of financial assets (excluding future credit losses that have not been incurred yet), discounted using the initial (i.e. determined at the initial recognition) effective interest rate method. The balance sheet value of the asset component is decreased using a write-down account. The amount of the loss is recognised in profit or loss.

The Group firstly evaluates whether there are objective prerequisites for the loss in value of the individual financial assets which are individually significant, as well as prerequisites of the loss in value of the financial assets that individually are not significant. If the conducted analysis shows that there are no objective prerequisites for the loss in value, regardless of whether it is significant or not, the Group includes this component to the group of financial assets with similar credit risk characteristics and jointly assesses in terms of the loss in value. The assets that are individually assessed for the loss in value, and for which the impairment write-down for the loss in value was recognised, or it was considered that the current write-down will not change, are not taken into account in the total assessment of the group of assets in terms of the loss in value.

If the impairment write-down for the loss in value decreased in the next period, and the decrease can be objectively associated with an event occurred after the impairment write-down recognition, then the previously recognised impairment write-down is reversed. The subsequent reversal of the impairment write-down for the loss in value is recognised in profit or loss to the extent, in which as of the date of reversal, the balance sheet value of the component of assets does not exceed its depreciated cost.

10.14.2.Financial assets stated at cost

If there are the objective prerequisites that the loss in value of the unquoted equity instrument, which is not stated in accordance with the fair value, because its fair value cannot be reliably determined, of the equity instrument, which is linked to and has to be settled by delivery of such an unquoted equity instrument, the amount of the impairment write-down for the loss in value is determined as the difference between the balance sheet value of the component of financial assets and the current value of the estimated future cash flows, which are discounted using the current market rate of return for similar financial assets.

10.14.3.Available-for-sale financial assets

If there are objective prerequisites that there was a value of a financial asset component available for sale was impaired, then the amount constituting the difference between the asset component acquisition price (decreased by any repayments of the capital and depreciation) and its fair value, decreased by any impairment write-downs against the component value loss, previously recognised in profit or loss, is derecognised from the equity and transferred to profit or loss. The reversal of the impairment write-down for the loss in value of the equity instruments classified as available for sale cannot be recognised in profit or loss. If the fair value of the debt instrument available for sale increases during the next period, and this increase can be objectively associated with an event occurred after recognition of the impairment write-down for the loss in value in profit or loss, then the amount of the reversible impairment write-down is recognised in profit or loss.

10.15. Other non-financial assets

The Group recognises prepayments as other non-financial assets, if the following conditions are met:

- they result from past events – expenses incurred for the operational purpose of entities,
- their extent can be reliably determined,
- they will result in the impact of economic benefits to the entities in the future,
- they apply to future reporting periods.

Write-offs of active prepayments of costs can occur appropriately to the passage of time and the amount of benefits. The time and method of settlement is justified by the nature of the settled costs, respecting the precautionary principle.

At the end of the reporting period, the Group verifies the active prepayments of costs in order to check whether the degree of certainty associated with the achievement of economic benefits by the entity, after the expiry of the current financial period, is sufficient to show a given item as a component of assets.

During the reporting period, the subjects of prepayments are, among others:

- costs of property insurance,
- costs of current charges for perpetual usufruct of lands,
- deductions for social insurance fund,
- subscriptions,
- other costs related to next reporting periods.

Other non-financial assets include, in particular, the public and legal settlement receivables (except for CIT settlements, which are presented in a separate item of the financial statement), as well as advance payments for future purchases of tangible fixed assets, intangible assets and inventories. The advance payments are presented according to the nature of the assets, to which they relate – respectively, as fixed or current assets. As non-monetary assets, the advance payments are not subject to discount.

10.16. Embedded derivatives

Embedded derivatives are separated from the contracts and treated as derivatives, if the following conditions are met:

- the economic characteristics and risks of the embedded instrument are not closely related to the economic characteristics and risks of the contract, to which a given instrument is embedded;
- a separate instrument with the same performance conditions as the embedded instrument would conform to the definition of the derivative;
- a hybrid (complex) instrument is not stated at the fair value, and the changes of its fair value are not recognised in profit or loss.

The embedded derivatives are stated in a similar way as separate derivatives, which are not treated as hedging instruments.

The scope, in which, according to IAS 39, the economic characteristics and risks specific to the embedded derivative in a foreign currency are closely related to the economic characteristics and risks appropriate for the host agreement (the basic contract) also covers the situations, when the currency of the host agreement is a typical currency for the purchase or sale contracts of non-financial items on the market of a given transaction.

The Group assesses whether a given embedded derivative is separated at the time of its initial recognition.

10.17. Financial derivative instruments and securities

The derivatives used by the Group in order to secure against the risk related to the changes of interest rates and exchange rates are mainly the forward foreign exchange contracts and contracts for the interest rates change (interest rate swaps). Such derivatives are measured at the fair value. Derivatives are stated as assets when their fair value is positive, and as liabilities – when their value is negative.

Profits or losses for the fair value changes of derivatives, which do not comply with the hedge accounting principles are directly stated in the net financial result of the financial year.

The fair value of forward foreign exchange contracts is determined by the reference to the current forward rates for contracts with a similar maturity date. The fair value of contracts for the interest rate swaps is determined by the reference to the market value of similar instruments.

Within the hedge accounting, securities are classified as:

- the fair value hedge securing against the risk of changes in the fair value of a recognised component of assets of liabilities, or
- cash flow hedges securing against the changes in cash flows, which can be attributed to a specific kind of risk related to a recognised component of assets, liability or forecasted transaction, or
- hedging shares in the net assets within a foreign entity.

Securing the currency risk of the substantiated future liability is settled as the cash flow hedge.

At the inception of the hedge, the Group formally determines and documents the hedging relationship as well as the risk management objective and strategy for establishing the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the characteristics of the hedged risk as well as a method of assessing the hedge instrument effectiveness in the compensation for the risk of changes of the fair value of the hedged item or cash flows related to the hedged risk.

It is expected that the hedge will be highly effective in the compensation for changes of the fair value or cash flows resulting from the hedged risk. The hedge effectiveness is constantly assessed to determine whether it is highly effective within all the reporting periods for which it was established.

In addition, the Group secures the cash flow associated with purchasing CO_2 emission allowances in the form of short-term forward contracts.

Due to the fact that contracts for the purchase of non-financial assets are concluded in order to secure own needs, they are excluded from the scope of IAS 39.

10.17.1.Fair value security

The fair value hedge is a hedge against changes in the fair value of a recognised component of assets or liability, or an unrecognised substantiated future liability, or a separated part of such a component of assets, liability or substantiated future liability, which can be attributed to a specific type of risk, and which could influence profit or loss. In case of hedging the fair value, the balance sheet value of the hedged item is adjusted with profits and/or losses for changes of the fair value, resulting from the hedged risk, the hedging instrument is measured to the fair value, and profits or losses for the hedging instrument and the hedged item are recognised in the profit or loss.

If an unrecognised substantiated future liability is designated as a hedged item, the subsequent cumulative changes of the fair value of the substantiated future liability resulting from the hedged risk are recognised as an asset component or a liability, and arising profits or losses are included in the profit or loss. Changes of the fair value of the hedging instrument are also recognised in the profit or loss.

The Group discontinues to use the hedge accounting principles, if a hedging instrument expires, is sold, terminated, or executed, and if the hedge fails to fulfil the criteria of hedge accounting, or if the Group revokes the hedging relationship. Any adjustment of the balance sheet value of the hedged financial instrument, to which the depreciated cost method is applied, is subject to depreciation, and the write-offs are recognised in the profit or loss. The depreciation can begin as soon as the adjustment is made, however, not later than at the time of ceasing the adjustment of the item hedged with changes of the fair value resulting from the hedged risk.

10.17.2.Cash flow security

The cash flow hedge is a hedge against the exposure to variability in cash flows, which can be attributed to a specific type of risk related to a recognised component of assets, liability, or highly probable planned transaction, and which could influence profit or loss. The part of profits or losses related to the hedge instrument, which constitutes an effective security is recognised in other comprehensive income, and an ineffective part is recognised in profit or loss.

If a hedged planned transaction subsequently results in the recognition of a component of financial assets or a financial liability, the associated profits, or losses, which were included in other comprehensive income and accumulated in equity, are transferred to the income statement within the same period, or in the periods, during which the acquired component of assets or liability affect the profit or loss.

If hedging the planned transaction subsequently results in the recognition of a component of non-financial assets or non-financial liability, or the planned transaction related to a component of non-financial assets or non-financial liability becomes a substantiated future liability, to which the fair value hedge will be applied, then, the profits or losses that were recognised in other comprehensive income are excluded from the equity and included in the acquisition price or other balance sheet value of the component of assets of liability.

The profits or losses resulting from changes of the fair value of derivatives, which do not meet the conditions for the application of hedge accounting principles are directly recognised in the net financial result for the current period.

The Group discontinues using the hedge accounting principles when the hedging instrument expires or was sold, its use terminated or it was executed, or the hedge no longer meets the conditions, which allow the application of hedge accounting principles to it. In such a case, the total profit or loss on a hedging instrument, which were recognised in other comprehensive income and accumulated in the equity are still stated in the equity until the forecast transaction takes place.

If the Group no longer expects that the forecast transaction will occur, then the total net profit or loss, accumulated in the equity, are charged to the net financial result for the current period.

10.18. Inventories

Inventories are measured at the lower of the two values: the acquisition price/production cost and the net sale price possible to achieve.

The costs incurred on bringing each component of inventories to its current location and condition – both with regard to the current and previous year – are recognised as follows:

- production fuel - weighted average method
- spare parts and other materials - weighted average method

The net sale price, which is possible to achieve, is an estimated sale price in the ordinary course of business, decreased with costs of completion as well as the estimated costs necessary to complete the sale.

Certificates of Energy origin

Energy origin certificates received free of charge due to the production from renewable, gas, and co-generation sources are shown according to the fair value at the end of the month, in which they were produced. The outgoings of energy origin certificates are measured according to the FIFO method.

10.19. Trade receivables and other receivables

The delivery and service receivables are recognised and stated according to initially invoiced amounts, including the write-down against doubtful receivables. The write-down against receivables is estimated when the recovery of the full number of receivables is no longer probable.

When the impact of the time value of money is significant, the value of the provision size is determined by discounting the predicted future cash flows to the current value, using the discount rate reflecting the current market estimates of the time value of money as well as the possible risk related to a given liability. If a method involving discounting was applied, then the increase in liabilities due to the passing time is recognised as financial revenues.

Other receivables include, in particular, receivables for settlements with employees.

Advance payments for future purchases of tangible fixed assets, intangible assets and inventories are recognised in the item for other non-financial assets. The advance payments are shown according to the nature of the assets, to which they relate – as fixed or current assets, respectively. As non-monetary assets, the advance payments are not subject to discount.

Budgetary receivables are presented as other non-financial assets, except for the receivables due to corporate income tax, which constitute a separate item in the financial statement.

10.20. Cash and cash equivalents

Cash and short-term deposits in the balance sheet include cash in bank and in hand as well as short-term deposits with the original maturity date that does not exceed three months.

The balance of cash and cash equivalents in the consolidated statement of cash flows consists of the above-mentioned cash and cash equivalents.

10.21. Interest-bearing bank loans, borrowings and debt securities

At the time of the initial recognition, all bank credits, loans, and debt securities are recognised at the fair value, decreased by the costs associated with obtaining a credit or loan.

After the initial recognition, the interest credits, loans and debt securities are measured in accordance with the depreciated cost.

While determining the depreciated cost, the costs associated with obtaining a credit or loan as well as discounts or premiums achieved in connection with the liability are taken into account.

Revenues and costs are recognised in the profit or loss, when the liabilities are removed from the balance, and also as a result of the settlement with the effective interest rate method.

10.22. Trade liabilities and other financial liabilities

Short-term liabilities for deliveries and services are stated in the payable amount.

Financial liabilities, which are measured at the fair value by the financial result, include financial liabilities intended for trading as well as financial liabilities initially classified to the categories measured to the fair value by the financial result. Financial liabilities are classified as intended for trading if they were acquired for the purpose of selling in the near future. Derivatives, including separated embedded instruments, are also classified as designed for trading unless they are considered effective hedging instruments. Financial liabilities at the initial recognition can be classified in the categories measured at the fair value by the financial result if the following criteria are met: (i) this classification eliminates or significantly reduces inconsistency of treatment when both the valuation and principles of recognising losses or profits are subject to other regulations; or (ii) liabilities are part of the group of financial liabilities, which are managed and measured on the basis of the fair value, in accordance with a documented risk management strategy; or (iii) financial liabilities contain embedded derivatives that should be recognised separately.

The financial liabilities measured at the fair value by the financial result are measured at the fair value taking into account their market value at the balance sheet date without the sale transaction costs. Changes in the fair value of these instruments are recognised in profit or loss as costs or financial revenues.

Other financial liabilities, which are not financial instruments measured at the fair value by the financial result, are measured in accordance with the depreciated cost using the effective interest rate method.

The Group excludes a financial liability from its balance when the liability expires – i.e. when the contractual obligation is fulfilled, redeemed or terminated. Replacing the existing debt instrument with the instrument of essentially different conditions made between the same entities is recognised by the Group as termination of the original financial liability and recognition of a new financial liability. Similarly, significant modifications of the contractual provisions concerning an existing financial liability are recognised by the Group as termination of the original one and recognition of a new financial liability. The difference of reference balance sheet values arising due to the replacement is shown in the profit or loss.

10.23. Other non-financial liabilities

Other non-financial liabilities include, in particular, liabilities for the value added tax, other public-legal liabilities (except for liabilities due to the corporate income tax, which is recognised in a separate item of the financial statement), as well as liabilities for the received advance payments, which will be settled by the supply of goods, services or fixed assets. Other non-financial liabilities are recognised in the amount that requires payment.

10.24. Sharing profits for employee purposes and special funds

In accordance with the Polish economic practice, the stockholders/shareholders of entities can distribute the profits for employee purposes in the form of making a contribution to a social fund or other special funds. In the financial statement, in accordance with IFRS, this part of the profit distribution is recognised as operating costs of the period, in which the profit distribution was approved by a Shareholders Meeting, due to the fact that the Groups Companies are burdened with neither legal nor customary obligation to this type of the profit distribution.

10.25. Share-based payments

Share-based payments is a transfer of equity instruments of the entity or their equivalents made by the entity or its shareholders to the third parties (including employees), who provided goods and services to a given company, unless the transfer is made for the purpose that is other than paying for goods and services provided for the entity.

The Group includes goods and services received or acquired within the framework of the share-based payment transactions in the equity instruments as well as the corresponding increase in the equity when it obtains these goods and services. If the goods or services obtained or acquired within the framework of the share-based payment transactions are not classified to be recognised as assets, the entity includes them as the cost.

The Group evaluates the obtained goods or services and the corresponding increase in the equity at the fair value of the obtained goods or services, unless it is impossible to reliably estimate their fair value. If the group is unable to reliably estimate the fair value of the obtained goods or services, it indirectly determines their value and the corresponding increase in equity by the reference to the fair value of the granted equity instruments.

The own share-based payments resulting from the entitlement of the PAK Kopalnia Węgla Brunatnego Konin SA and PAK Kopalnia Węgla Brunatnego Adamów SA employees to the free acquisition of the companies' shares on the basis of the Act of 30 August 1996 on the commercialisation and privatisation are recognised in accordance with the above rules. The Group recognises the costs of employee benefits for to this reason from the date of taking control over PAK Kopalnia Węgla Brunatnego Konin SA and PAK Kopalnia Węgla Brunatnego Adamów SA On the other side, the Group recognises the share-based payment programmes in the item of the retained profits, at the same time, allocating a part to the non-controlling shareholders' equity.

10.26. Provisions

Provisions are created when the Group is burdened with the existing liability (the legal or customary expected one) resulting from past events, and when it is probable that the fulfilment of this liability will result in the necessity of the economic benefits outflow, and the amount of this liability can be reliably estimated. If the Group expects the costs covered by the provision to be reimbursed, for example under an insurance contract, then the reimbursement is recognised as a separate component of assets, but only when it is virtually certain that the reimbursement of this will actually occur. The costs related to a given provision are stated in the income statement after the reduction by any reimbursement.

When the impact of the time value of money is significant, the value of the provision size is determined by discounting the forecast future cash flows to the current value, using the discount rate reflecting the current market estimates of the time value of money as well as the possible risk related to a given liability. If a method of discounting was applied, then the increase in liabilities due to the passage of time is recognised as financial costs.

In particular, the Group creates the following provisions:

- **provisions for post-employment benefits as well as jubilee awards**

In accordance with the remuneration systems, the Group's employees are entitled to the following benefits:

- retirement or disability benefits, payable at the time of retirement,
- death benefits for families of deceased employees,
- coal benefits for employees of PAK KWB Konin SA and PAK KWB Adamów SA

The amount of benefits depends on the number of years of employment and the average salary of the employee. The Group creates provisions for these future liabilities for the purpose of allocating the costs to the periods that they concern. The current value of these liabilities at each balance sheet date is calculated by an independent actuary. The accumulated liabilities are equal to the discounted payments, which will be made in the future, taking into account the rotation of employment and they relate to the balance sheet date. Demographic information and information about the rotation of employment are based on historical data. Profits and losses of actuarial calculations are recognised in profit or loss and other comprehensive income.

- **Provision for the liquidation of fixed assets components**

The provision for liquidation of fixed assets is created in the event of the legal obligation occurrence or making the commitment by the management board of the Group. The provision is created on the basis of estimates of the future liquidation costs based on available offers related to the fixed assets liquidating services, taking into account the rules set out in IFRIC 1. The discount effect is recognised in the income statement.

- **Provision for the liquidation of ash storage yards**

The Group creates a provision for liquidation of ash dumps due to a legal obligation resulting from the integrated approval entries. This provision is created on the basis of ash storage yard future reclamation cost estimates, resulting from the studies and technical-economic analyses, developed by the management of the Group, as well as the received external offers for planned directions of reclamation.

- **Provision for the submission of redemption of Energy origin certificates**

The provision for the obligation to present the redemption of certificates of origin of energy produced from renewable energy sources or in peak load co-generation is recognised as follows:

- in a part covered by the certificates of origin held at the balance sheet date – in the value of the held certificates,
- in a part uncovered by the certificates of origin at the balance sheet date – at the lower value of the market value of the certificates required to fulfil the obligation at the balance sheet date, and a possible penalty.

- **Provisions for the liabilities due to the emission of greenhouse gasses and provisions for the redemption of certified emission reduction (EUA)**

The provision for liabilities due to the emission of greenhouse gases included in the system of emission allowances is created only when the actual production shows a shortage of emission allowances in respect of the allowances granted for the whole reporting period.

The provision is created by net liabilities method, in the amount of:

- in a part covered by the allowances held at the balance sheet date – in the value of the held allowances, i.e. purchased at the balance sheet value, received in the zero value.
- in the part uncovered by the allowances on the balance sheet date – at the lower of the market values of the allowances required to satisfy the obligation and a possible penalty.

- **Reclamation and other provisions associated with mining activity**

- the provision for liquidation of facilities and mining areas

On the basis of the Geological and Mining Law act, the companies conducting extraction activities are obliged to reclaim the areas of extraction works. Due to this, the Group creates a provision both, for the costs of area reclamation related to current coal extraction on a given open pit and for the costs of the final excavation reclamation in the state of advancement of coal extraction in particular open pits on every reporting date.

The provision for the final excavation reclamation is created in correspondence with the assets' component (in the part in which it relates to the initial excavation, on the basis of the volume of the final excavation), and in correspondence with the income statement (in the remaining part, taking into account the state of advancement of coal extraction in particular open pits on a given reporting date). In correspondence with the assets' component, the Group also creates a provision for the external dump reclamation. The provision for reclamation costs associated with current coal mining is created in correspondence with the income statement.

The provision is created on the basis of estimation of future reclamation costs based on reports of independent experts estimating reclamation costs on the order of the company's management boards executing extraction activities. Estimates concerning projected reclamation costs are analysed periodically; on every reporting date, the size of provision is verified in accordance with current assumptions within discount rate, inflation, and the size of extraction. Write-down for the provision related to extraction of a given year charges operating costs (other costs by type), and the difference resulting from the provision discount from previous years influences financial costs. The use of the provision is settled in correspondence with financial costs at the end of every reporting period. The use of the provision in the part concerning taxes and charges is settled as a reduction of costs incurred during the reporting period of tax costs and charges, while the use of the provision in the part related to other liquidation and reclamation costs is settled as a reduction of other costs by type.

- The provision for the costs related to the preparation of exploitation areas

The Group, within run activities, is obliged to restore to the original condition, or to rebuild damages caused by the mine operations. Due to this, the Group creates the provision for projected costs, to pay which it is obliged on the basis of concluded agreements. Estimates concerning projected costs related to the mine operations are updated on every reporting date. The creation of the provision is recognised, on the other side, within the framework of mining assets.

10.27. CO_2 emission allowances

The CO_2 emission allowances obtained free of charge are recognised in the financial statement as allowances intended for own needs at a zero value in the intangible assets item. The emission allowances and their equivalents purchased by the Group for own needs are recognised as intangible assets. These allowances are measured at the acquisition price. The provision for liabilities due to the emission of greenhouse gases included in the system of emission allowances is created only when the actual production emission shows a shortage of emission allowances in respect of the allowances granted for the entire reporting period. This provision is created according to the FIFO principle.

The cost of the created provision is presented in the income statement, in the cost of sales.

10.28. Revenues

Revenues are recognised to the extent that it is probable that the Group will achieve economic benefits associated with the transaction, and the amount of revenues can be reliably measured. Revenues are recognised at the fair value of the received or receivable payment, after deduction of the value added tax (VAT), as well as excise tax and discounts. Revenues are also recognised according to the below criteria.

10.28.1. Sale of goods and products

Revenues are recognised if the significant risk and benefits of the equity related to goods and products were transferred to the buyer and the amount of revenues can be reliably measured.

Sales revenues also include the sales revenues of green and red certificates. At the time of production, the certificates of origin held for sale are included in the sales revenues, and therefore, in order to avoid inflating revenues at the time of selling, the costs of selling certificates are recognised as an adjustment of the sales revenues.

10.28.2.Provision of Services

Revenues from services are recognised on the basis of the extent of their completion.

The percentage progress status for the services completion is determined as a relation between the incurred costs and estimated costs, which are necessary to complete the order.

If it is impossible to reliably estimate the contract results, then the revenues generated due to this contract are recognised only to the amount of incurred costs which the Group expects to recover.

10.28.3.Contracts for construction services

The construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use.

If it is possible to reliably estimate the outcome of the contract for a construction service, the revenues and costs related to the contract for a construction service are recognised as the revenues and costs according to the extent of the contract execution at the end of the reporting period.

The contract performance progress is obtained by determining the share of contract costs, incurred due to the works executed until the valuation date, in the estimated total contract costs.

When the outcome of a contract cannot be estimated reliably:

a) negative revenues should be recognised only to the extent of incurred contract costs, which have a probability of being recovered; and

b) the contract costs are recognised as a cost for the period, in which they were incurred.

When it is probable that the total contract costs will exceed the total contract revenue, the expected loss shall be immediately recognised as an expense.

The gross payable amount from the employers for the works under the contract is recognised in the financial situation statement as assets and the gross amount payable to the employers for the works under the contract - as liabilities.

10.28.4.Revenues from compensation for stranded costs

The Group receives compensation for the coverage of the stranded costs pursuant to the Act of 29 June 2007 on the principles of coverage of costs incurred by producers due to early termination of long-term agreements for the sale of power and electricity. Revenue from compensation is recognised successively with the earned compensation rights at the end of each fiscal year, until the end of their validity period.

Per each revenue recognition moment, the Group determines a factor for estimated stranded costs to the total amount of received, returned, and expected discounted annual advance payments (including the previously received advance payments). The revenue amount for a given fiscal year is the product of the indicator and previously received amounts of advance payments adjusted with annual impairments, decreased by the revenues for compensation recognised in the previous years.

The difference between the total amount of the recognised revenue and the total amount of the received advance payments to the total amount of the stranded costs are recognised by the Group as:

- receivables, in the event of a negative difference between the total amount of received advance payments and the revenue recognised in relation to compensation,
- liabilities, in the event of a positive difference between the total amount of received advance payments and the revenue recognised in relation to compensation.

10.28.5. Government subsidies

In the event of a justified certainty that a grant will be acquired and all the associated requirements will be satisfied, then the government grants are recognised as per their fair value.

If the grant relates to a given cost item, then it is recognised as revenue in a manner commensurate with the costs, the grants is intended to compensate. If the grant relates to an asset component, then its fair value is recognised on the revenue account for future periods and then, gradually, through equal yearly write-downs, recognised in the profit or loss over the estimated period of use of the associated asset component.

If the Group receives non-monetary grants, both the component of the assets and the grant are recognised at nominal value and gradually, by equal annual write-offs, are included in profit or loss during the estimated useful life of the received component of assets.

10.29. Costs

Costs of goods sold

The cost of goods sold includes:

- the production cost incurred during the reporting period, adjusted for the change in the level of products (finished products, semi-finished products and production in progress), as well as adjusted for the cost of manufacturing products for own needs,
- the value of sold goods and materials according to the acquisition cost,
- the creation of the impairment write-downs against the value of tangible fixed assets, intangible assets and inventories,

The production costs, which can be directly allocated to the revenues achieved by the entities, influence the financial result of the entities for the reporting period, in which the revenues occurred.

The production costs, which can be only indirectly allocated to the revenues and other benefits achieved by the entities, influence the financial result of the entities in the part, in which they relate to a given reporting period, providing their adequacy to the revenues and other economic benefits, including the valuation of fixed assets and inventories.

10.30. Other operating revenues and costs

Other operating income and costs include items mainly related to:

- the disposal of tangible fixed assets, intangible assets,
- the creation and reversal of provisions, except for the provisions related to the financial operations or included in operating expenses,
- free transfer or receiving, including the way of donation of assets, as well as cash.
- the compensation, penalties, and fines, as well as other costs not related to the usual business activity.

10.31. Revenues and financial costs

Revenues and financial costs especially include the revenues and costs related to:

- the sale of financial assets,
- the revaluation of financial instruments, except for the financial assets available for sale, the revaluation effects of which are included in the revaluation capital,
- the revenues due to the share in profits of other entities,
- the interest (including the valuation effect with a depreciated cost),
- the changes in the value of the provision resulting from the fact of approaching the date of incurring the cost (the unwinding of the discount effect),
- the foreign exchange differences which are a result of the operations performed during the reporting period and the balance sheet valuation of assets and liabilities at the end of the reporting period, except for the foreign

exchange differences recognised in the initial value of the fixed asset, to the extent in which they are considered as an adjustment of the interest costs and foreign exchange differences,

- other items connected with the financial activity of the company.

Revenues and costs for the foreign exchange rates are presented after compensation.

The revenues and costs due to the interest are successively presented as they grow, including the effective interest rate method in relation to the net balance sheet value of a given financial instrument, based on the concept of materiality.

Dividends are recognised at the time of establishment of the shareholders' rights to these dividends.

10.32. Taxes

10.32.1. Current tax

The liabilities and receivables for the current tax for the current period and previous periods are measured in the amount of the expected payment to the tax authorities (subject to return from tax authorities), using the tax rates and regulations, which were legally or actually applicable as at the balance sheet date.

10.32.2. Deferred tax

For the purpose of financial reporting, the deferred tax is provided, using the balance liability method in relation to all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their balance sheet value presented in the financial statement.

The provision for the deferred tax is recognised in reference to all positive temporary differences:

- except for the situation when the provision for the deferred tax arises from the initial recognition of the company's value or of the assets' component or liability on a transaction other than a combination of the entities, and at the time of its conclusion have no influence on the gross financial result, as well as on the taxable income or tax loss, and
- in case of positive temporary differences resulting from the investment in subsidiaries or associates and shares in joint ventures – except for the situations where dates of the reversal of temporary differences are subject to the investor's control and it is probable that in the predictable future, temporary differences shall not be reversed.

The assets for the deferred tax are recognised in relation to all negative temporary differences, as well as unused tax credits and unused tax losses transferred to future years, to the extent that it is probable that the taxable income, which allows using the above-mentioned differences, assets, and losses, will be achieved:

- except for a situation when the assets for the deferred tax associated with negative transition differences as a result from the initial recognition of the assets or liability component for a transaction other than a combination of the entities, and at the time of its conclusion, have no influence on the gross financial result, nor on the taxable income or tax loss, and
- in case of negative temporary differences resulted from the investment in subsidiaries or associates and shares in joint ventures, the assets' component for the deferred tax is recognised in the balance sheet only to the extent that it is probable that in the predictable future, the above mentioned temporary differences will be reversed and the taxable income, which enables the negative temporary differences to be deducted, will be achieved.

The balance sheet value of the asset component for the deferred tax is reviewed on every balance sheet date and reduced to the extent that it is no longer probable that the taxable income sufficient for a partial or complete realisation of the assets' component for the deferred tax will be achieved.

An unrecognised deferred tax asset is re-assessed as at each balance sheet date, and is recognised at the amount reflecting the likelihood of achieving the future taxable income allows the recovery of this asset component.

The deferred tax assets and provisions for the deferred tax are evaluated with the use of the tax rates that are expected to be applicable in the period, in which the assets component is realised or the provision is reversed, the basis for which will be tax rates (and tax regulations) applicable at the balance sheet date, or those which will certainly be effective as at the balance sheet date in the future.

The income tax on items recognised outside of the profit or loss is recognised outside of the profit or loss: other total income related to the items recognised in other comprehensive income or directly in the equity, relating to the items recognised directly in the equity.

The companies of the Group compensate the deferred income tax assets with the provisions for the deferred income tax provisions only and solely if it has an executable legal right to compensate receivables with current tax liabilities, and the deferred income tax is related to the same taxpayer and the same tax authority.

10.32.3. Value added tax and excise tax

Revenues, costs, assets and liabilities are recognised after deducting the value added tax, with the exception of:

- the situation when the value added tax paid at the time of the assets or service purchase is impossible to be recovered from the tax authorities; it is then recognised as part of the acquisition price of the assets' component or as a cost item part, and
- receivables and liabilities, which are stated with the amount of the value added tax.

The net amount of the value added tax, which is recoverable or payable to the tax authorities, is included in the financial statement as part of receivables or liabilities.

The net amount of the value added tax and excise tax, which are recoverable or payable to tax authorities are included in the financial statement as parts of receivables or liabilities.

10.33. Net profit per one share

The net profit per share for each period is calculated by dividing the net profit for a given period by the weighted average number of shares in a given reporting period.

10.34. Acquisition under joint control

The situation, in which a particular transaction or economic phenomenon, requiring inclusion in the statement drawn up in accordance with IFRS, is not regulated by the provisions of the various standards, was settled by IAS 8 point 10–12. These provisions impose on the entity, which draws up the statement in accordance with IFRS, the obligation to create its own list of accounting rules, indicating the characteristics of the following accounting principles: a faithful presentation of the financial position, results of operations and cash flows, reflection of the substance of the transaction, neutrality, caution and completeness in all aspects.

According to the analyses conducted by the Company, the commonly used method for the settlement of such transactions is pooling of interests, and such a method was applied by the Company. At the bottom of this method, there is an assumption that merging entities, both before and after the transaction, were controlled by the same shareholder, and therefore the consolidated financial statement reflects the continuity of joint control and does not reflect any changes in the value of net assets to fair values (or recognition of new assets), or the valuation of the company's value, since none of the merging entities is not actually acquired. The settlement takes place on the day of the merger and the previous data is not adjusted.

10.35. Obligation to purchase non-controlling interests

The Company's obligation to redeem the employee shares is recognised at the date of taking control, and refers to situations in which employees have the option of selling shares. According to the selected policy, non-controlling interests receive the allocation of the result and other total incomes in the subsequent reporting periods. At the end of every reporting period, the adjustment of non-controlling interest takes place, as if they were acquired while simultaneously recognising the liability due to the option to redeem shares. The difference between the value of the non-controlling shares derecognised at the reporting date and the recognised financial liability is included in the position of retained profits.

11. Acquisition of ventures

In the period between 1 January 2017 and 31 December 2017, there were no new acquisitions of ventures.

12. Operating segments

For the purpose of management, the Group was divided into parts on the basis of manufactured products and provided services.

Therefore, there are following operating segments:

- The Generation Segment covering production of electricity both from conventional sources (including cogeneration) and by combustion and co-combustion of biomass. Basic fuels used by the Generation Segment are lignite and biomass. The Generation Segment covers following entities:
    - Zespół Elektrowni "Pątnów – Adamów – Konin" SA
    - "Elektrownia Pątnów II" Sp. z o.o.
    - "PAK – HOLDCO" Sp. z o.o.
    - "PAK Infrastruktura" Sp. z o.o.
- The Mining Segment covering the extraction of lignite. In the Mining Segment, within the Capital Group ZE PAK SA:
    - „PAK Kopalnia Węgla Brunatnego Konin" SA
    - „PAK Kopalnia Węgla Brunatnego Adamów" SA
- The Renovation Segment performing services in the scope of construction and renovation services. The Segment covers activities of:
    - Przedsiębiorstwo Remontowe „PAK SERWIS" sp. z o.o.
    - „Energoinwest Serwis" sp. z o.o. in liquidation
    - „EL PAK Serwis" sp. z o.o. in liquidation
- The Sales Segment performing services of the sale of electricity. The Sales Segment also includes the "PAK – Volt" SA company.

ZE PAK SA Group operates also in other kinds of activities, included in the 'Other' column. In 2017 there is included the activity of the following companies: of Eko-Surowce sp. Z o.o. - in liquidation, Aquakon sp. z o.o. - in liquidation, PAK Adamów sp. z o.o. and PAK Górnictwo sp. z o.o. Due to the acquisition of other activities by PAK Górnictwo Sp. z o.o., which became the core business of this company, in 2017 data of this company are presented in the 'Other' segment. On 30 June 2017, EL PAK sp. Z o.o. (acquired company) and PAK Serwis sp. z o.o. (acquirer) have merged into one Company. The activity of the two companies is included in the 'Renovation' segment.

Transaction prices used in transactions between operating segments are determined on the basis of commercial principles, like in transactions with non-related entities.

Revenues due to transactions between segments are eliminated in the process of consolidation.

The Board monitors separate results of the operating activities of segments in order to decide on allocation of resources, evaluation of this allocation's outcomes, and the results of activities. The basis of assessment of the results of activities is profit or loss on the operating activity and EBITDA.

Segments' results for periods concluded on 31 December 2017 and 31 December 2016 are presented below:

(in thousand PLN)

12 months period ended 31 December 2017

	Generation	**Mining**	**Renovation**	**Sale**	**Other**	**Consolidation adjustment**	**Total**
Sales revenue to external customers	1 757 534	6 481	95 886	575 826	7 348	-	2 443 075
Sales revenue between segments	338 848	808 025	180 441	5	161 371	(1 488 690)	-
Sales revenue	**2 096 382**	**814 506**	**276 327**	**575 831**	**168 719**	**(1 488 690)**	**2 443 075**
Cost of goods sold	(1 795 567)	(760 653)	(244 485)	(566 903)	(159 569)	1 491 781	(2 035 396)
Gross profit / (loss)	**300 815**	**53 853**	**31 842**	**8 928**	**9 150**	**3 091**	**407 679**
Other operating income	4 481	5 878	714	501	239	(489)	11 324
Selling and distribution expenses	(2 568)	(4)	-	(534)	(1 152)	-	(4 258)
Administrative expenses	(42 709)	(48 336)	(17 328)	(4 431)	(6 663)	-	(119 467)
Other operating expenses	(2 322)	(1 667)	(836)	(343)	(273)	255	(5 186)
Finance income	18 611	1 542	468	127	28	(4 583)	16 193
Finance costs	(34 473)	(15 279)	(920)	(94)	(67)	3 181	(47 652)
Profit before tax	**241 835**	**(4 013)**	**13 940**	**4 154**	**1 262**	**1 455**	**258 633**
Income tax expense	(46 265)	(23 479)	(3 898)	(869)	178	(756)	(75 089)
Net profit/loss for the period from continuing operations	**195 570**	**(27 492)**	**10 042**	**3 285**	**1 440**	**699**	**183 544**
Profit / (loss) from operating activities, without financial operations and income tax	**257 697**	**9 724**	**14 392**	**4 121**	**1 301**	**2 857**	**290 092**
Depreciation / Amortization	123 081	69 529	6 339	73	1 900	(1 274)	199 648
Change in impairment	-	22 165	-	-	-	-	22 165
EBITDA	**380 778**	**101 418**	**20 731**	**4 194**	**3 201**	**1 583**	**511 905**

(in thousand PLN)

12 months period ended 31 December 2016

	Generation	Mining	Renovation	Sale	Other	Consolidation adjustment	Total
Sales revenue to external customers	1 742 513	8 103	67 815	878 419	7 861	-	2 704 711
Sales revenue between segments	434 773	823 774	243 879	5	94 635	(1 597 066)	-
Sales revenue	**2 177 286**	**831 877**	**311 694**	**878 424**	**102 496**	**(1 597 066)**	**2 704 711**
Cost of goods sold	(1 875 674)	(695 462)	(297 418)	(869 559)	(103 973)	1 600 733	(2 241 353)
Gross profit / (loss)	**301 612**	**136 415**	**14 276**	**8 865**	**(1 477)**	**3 667**	**463 358**
Other operating income	6 787	18 835	1 237	1	303	(702)	26 461
Selling and distribution expenses	(2 726)	-	-	(470)	(1 164)	-	(4 360)
Administrative expenses	(37 625)	(41 576)	(20 875)	(4 589)	(3 971)	2	(108 634)
Other operating expenses	(1 959)	(2 684)	(769)	(42)	(75)	137	(5 392)
Finance income	5 628	3 389	221	277	6	(404)	9 117
Finance costs	(56 484)	(16 368)	(160)	(2)	(62)	404	(72 672)
Profit before tax	**215 233**	**98 011**	**(6 070)**	**4 040**	**(6 440)**	**3 104**	**307 878**
Income tax expense	(35 607)	(19 333)	(824)	(731)	(507)	(590)	(57 592)
Net profit/loss for the period from continuing operations	**179 626**	**78 678**	**(6 894)**	**3 309**	**(6 947)**	**2 514**	**250 286**
Profit / (loss) from operating activities, without financial operations and income tax	**266 089**	**110 990**	**(6 131)**	**3 765**	**(6 384)**	**3 104**	**371 433**
Depreciation / Amortization	112 206	105 323	6 796	71	1 974	(4 671)	221 699
Change in impairment	-	455	-	-	-	-	455
EBITDA	**378 295**	**216 768**	**665**	**3 836**	**(4 410)**	**(1 567)**	**593 587**

(in thousand PLN)

13. Revenues and costs

13.1. Sales revenue

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Revenues by type		
Electricity sale	1 513 909	1 611 297
Electricity sold from the market	579 571	737 746
Energy certificates of origin	700	812
Construction contracts	82 906	59 506
Compensation related to PPA termination	181 335	207 158
Heat	57 175	60 541
Other	30 579	29 186
Excise	(3 100)	(1 535)
Total	2 443 075	2 704 711

Territorial structure	*12 months period ended 31 December 2017*	*12 months period ended 31 December 2016*
Poland	2 434 894	2 685 820
EU Countries	7 951	17 121
Outside EU	230	1 770
Total sale revenues	2 443 075	2 704 711

13.2. Other operating revenues

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Compensations received	2 258	3 650
Depreciation of fixed assets purchased from MLF*	523	348
Reversal of write-downs against receivables	257	-
Grants settlement	1 549	12 940
Grants received	3 644	-
Reversal of provisions for costs and losses and liabilities write-off	1 558	7 323
Other	1 535	2 200
Total	11 324	26 461

**MLF – Mining Liquidation Fund*

The largest components of the "Other" item in 2017 are revenues from revaluation of materials in the amount of PLN 104 thousand reimbursement of property tax in the amount of PLN 244 thousand, revenues from the sale of scrap in the amount of PLN 112 thousand.

(in thousand PLN)

13.3. Other operating expenses

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Loss on the sale of property, plant and equipment	225	1 384
Creation of provisions	1 493	527
Impairment write-down on receivables	207	438
Compensations paid	72	371
Costs of court and enforcement proceedings	288	565
Electricity-related damage	211	160
Donations given	375	229
Real estate tax for previous years	532	268
Compensatory pensions	236	261
Other	1 547	1 189
Total other operating expenses	5 186	5 392

The main components of the "Other" item in 2017 are the utilization costs in the amount of PLN 197 thousand, the settlement of provisions for energy certificates of PLN 343 thousand, the costs of removing damage in the amount of PLN 322 thousand.

13.4. Financial income

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Interest income	3 527	4 919
Dividend	208	60
Foreign exchange gains	12 378	-
Valuation of interest rate hedging instruments (SWAP)	-	296
Other	80	3 842
Total financial income	16 193	9 117

13.5. Financial costs

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Interest expenses	27 228	37 667
Valuation and realization of derivative financial instruments	7 036	7 379
Foreign exchange losses	-	12 782
Reserve discount for the liquidation of power units	746	429
Actuarial reserves discount	1 530	1 093
Reserve discount for reclamation	9 855	7 682
Other	1 257	5 640
Total of financial costs	47 652	72 672

(in thousand PLN)

In the "Other" item in 2017, there are mainly presented the commissions referring to loans, bank loans and guarantees in the amount of PLN 560 thousand, reversal of the discount for the mining damage provision in the amount of PLN 127 thousand and revaluation of the investment in the amount of PLN 418 thousand.

13.6. Costs by type

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Depreciation / Amortisation	199 648	221 699
Impairment write-downs against property, plant and equipment	22 165	455
Impairment write-downs against inventories	(852)	10 188
Materials	252 602	336 435
External services	112 451	66 041
Taxes and charges, excluding excise duty	201 592	204 688
Costs of allowances for emission of CO_2	289 942	311 328
Employee benefits	461 291	488 005
Other costs by type	39 350	48 354
Cost of goods for resale and raw materials sold and resale of electricity from the market	555 156	747 216
Total cost by type	2 133 345	2 434 409
Items included in cost of goods sold	2 035 396	2 241 353
Items included in selling and distribution expenses	4 258	4 360
Items included in administrative expenses	119 467	108 634
Change in the stocks of finished goods	(28 710)	77 800
Cost of goods and services for internal needs	2 934	2 262

13.7. Depreciation costs and impairment write-downs included in the profit or loss

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Items included in the cost of manufacture of sold products:		
Fixed assets depreciation	176 897	182 044
Depreciation of mining asset	8 812	14 384
Intangible assets depreciation	714	875
Impairment of inventory	-	11 859
Impairment of tangible fixed assets	22 165	(1 338)
Impairment of intangible assets	-	1 338
	208 588	209 162
Items included in selling and distribution costs:		
Fixed assets depreciation	15	85
	15	85

(in thousand PLN)

Items included in administrative costs		
Fixed assets depreciation	12 744	23 878
Intangible assets depreciation	466	433
Impairment of tangible fixed assets	-	455
	13 210	24 766

13.8. Construction agreements

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Revenues from contracts for construction services recognised in the period	82 906	59 506
Revenues invoiced in the period	85 630	48 597
Balance sheet valuation	(2 724)	10 909
Costs applied in the period	82 364	51 153
Expected losses due to the contracts recognised in the period	357	(78)
Results due to performance of the contracts included in the period	185	8 431

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Gross amount payable by contracting parties due to works resulting from the contract	7 080	8 168
Gross amount paid to contracting parties due to works resulting from the contract	5 626	3 990

14. Components of other comprehensive income

Components of other total revenues present as follows:

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Cash flow securities		
Profits (losses) for the period	5 072	7 379
Adjustment resulting from reclassification of profits (loses) included in the profit or the loss	367	(1 383)
Gross cash flow securities for the period	**5 439**	**5 996**
Income tax concerning cash flow securities	(1 033)	(1 139)

(in thousand PLN)

Net cash flow securities for the period	**4 406**	**4 857**
Actuarial gross profits (losses) concerning provisions for post-employment employee benefits	**(2 155)**	**4 613**
Income tax concerning actuarial profits (losses)	409	(876)
Actuarial net profits (losses) concerning provisions for post-employment employee benefits	**(1 746)**	**3 737**
Other gross comprehensive income	**3 284**	**10 609**
Income tax concerning other comprehensive income	**(624)**	**(2 015)**
Other net comprehensive income	**2 660**	**8 594**

15. Income tax

15.1. Tax load

The main components of tax load for the year ended 31 December 2017 and 31 December 2016 are as follows:

Included in the profit or the loss	*12 months period ended 31 December 2017*	*12 months period ended 31 December 2016*
Current income tax		
Current income tax load	13 077	11 491
Deferred income tax load		
Related to creation and reversal of temporary differences	61 990	45 541
Other changes	22	560
Tax load in the consolidated profit or loss	**75 089**	**57 592**
Included in the consolidated statement of the comprehensive income		
Net profit (loss) tax due to revaluation of cash flow securities	(1 033)	(1 139)
Actuarial allowance concerning actuarial profits/losses	409	(876)
Tax advantage/(tax load) included in comprehensive income	**(624)**	**(2 015)**

(in thousand PLN)

15.2. Fixing of an effective tax rate

The agreement of income tax on the gross financial result before taxation according to the statutory tax rate with the income tax calculated according to the effective tax rate of the Group for the year ended on 31 December 2017 and 31 December 2016 is as follows:

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Gross profit before taxation from continuing operations	**258 633**	**307 878**
Tax at the statutory tax rate applicable in Poland, amounting to 19%	**49 141**	**58 497**
Adjustment concerning the current income tax from previous years	(273)	1
Not included tax losses	(82)	(4 639)
Usage of the tax losses not recognised earlier	(786)	(22)
Fixed costs that are not tax deductible costs	1 332	4 387
Revenues that are not taxable	301	(170)
Change related to the different tax rate in Germany (30%)	-	168
Others	25 456	(630)
Tax a tan effective tax rate of 29.03% (in 2016 18.71%)	**75 089**	**57 592**
Income tax in profit and loss account	**75 089**	**57 592**

Explanation of the main components of the item "Other"

In connection with the update of financial projections for PAK KWB Adamów SA, deferred income tax assets of PLN 19 658 thousand will not be used. There are also no assets on the write-down of excavators, which we treat as a permanent difference in the amount of PLN 4 211 thousand.

(in thousand PLN)

15.3. Deferred income tax

Deferred income tax results from the following items:

			Consolidated profit and loss account for 12 months period ended	
	31 December 2017	*31 December 2016*	*31 December 2017*	*31 December 2016*
Deferred tax asset				
Balance sheet provisions	130 959	127 581	3 787	3 787
Overburden and other mining assets	7 946	7 571	375	375
Interest and exchange rate differences	4 832	11 377	(6 545)	(6 545)
Hedging instruments	781	1 910	(2 162)	(2 162)
Valuation of non-terminated agreements for building services	1 610	1 726	(116)	(116)
Tax loss from previous years	30 361	35 964	(5 603)	(5 603)
Impairment write-down on inventories	1 475	1 936	(461)	(461)
Impairment write-down on receivables	667	714	(47)	(47)
Impairment write-downs on fixed assets	3 083	-	3 083	3 083
Difference between the carrying amount and tax value of fixed assets	7	3 537	(3 530)	(3 530)
Settlements with employees	3 813	5 139	(1 326)	(1 326)
Other	25 419	39 487	(14 068)	(14 068)
Total	210 953	236 942	(25 989)	(25 989)

Provision under deferred income tax

(in thousand PLN)

Difference between the balance sheet value and the tax value of fixed assets	487 308	436 426	50 882	50 882
Receivables under PPAs	11 078	16 787	(5 709)	(5 709)
Energy certificates	352	2 615	(2 263)	(2 263)
Interest and exchange rate differences	456	2 531	(2 075)	(2 075)
Valuation of non-terminated construction agreements	1 851	2 247	(396)	(396)
Accrued receivables under contractual penalty fees	-	-	-	-
Mining asset	-	-	-	-
Purchased CO_2 allowances	50 145	73 632	(23 487)	(23 487)
Other	(24)	65	(89)	(89)
Total	551 166	534 303	16 863	16 863
After offsetting the balances at the level of the Group companies, the deferred tax is presented as:				
Asset	**92 687**	**90 998**		
Provision	**432 900**	**388 359**		
The total load of deferred tax:				
– in correspondence with the total income			448	448
– in correspondence with the financial result			6 777	6 777

The item other deferred tax asset on main items as at December 31, 2017 consists of the valuation of preferential loans in Pątnów II Power Plant sp. o.o. in the amount of PLN 8 076 thousand (as at 31 December 2016, the amount of PLN 8 352 thousand), PLN 12 948 thousand is a provision for the redemption of CO2 emission rights in Elektrownia Pątnów II sp. z o.o. (as at 31 December 2016, PLN 11 954 thousand).

The status of tax settlements of the Group companies in respect of tax losses as at 31 December 2017, including deferred tax, is presented below.

As at 31 December 2017 Elektrownia Pątnów II sp. Z o.o. showed a tax loss of PLN 78 639 thousand. The accumulated value of tax losses as at December 31, 2017 amounted to PLN 87 548 thousand. The company created a tax asset on the value of accumulated tax losses, assuming that these losses will be fully settled with tax revenues of future periods. The value of the tax asset created as at 31 December 2017 amounts to PLN 16 634 thousand.

As at 31 December 2016 Elektrownia Pątnów II sp. Z o.o. showed a tax loss of PLN 9 312 thousand. Since the tax loss for 2016, the company has created an asset for deferred tax. Following the findings of the tax audit for 2016 in the area of corporate income tax, the Company adjusted the amount of tax loss for 2016 to PLN 8 910 thousand.

Tax losses, in accordance with the tax regulations in force in Poland, may be deducted from future taxable income generated by the company in successive five tax years, however, the amount of reduction in any of these years may not exceed 50% of the loss amount. As at December 31, 2016, the legal right to deduct 50% of unsettled tax loss for 2011 in the amount of PLN 88 517 thousand was barred. The company included the accounting effects of the limitation of the entire tax loss for 2011 by making write-downs of the tax asset in the financial results for 2013 and 2015. Therefore, the final limitation of the tax loss for 2011 had no effect on the financial result of 2016.

On April 24, 2017, the company received an individual interpretation of tax law provisions regarding the recognition over time of tax deductible expenses, expenses due to the return of Zarządca Rozliczeń SA of funds to cover stranded costs. This interpretation recognizes that the company's position regarding the settlement of the above-mentioned costs is incorrect. In the current tax returns for the years 2014 - 2017, the company assumed that the repayment of stranded costs from the company to Zarządca Rozliczeń SA, whose legitimacy results from the LTC Act, constitute tax deductible costs when these payments are made. On the other hand, the tax authorities consider that these costs are recognized as tax deductible costs on the day they are incurred, i.e. posted in the accounts. In the light of receiving an individual tax interpretation, taking into account unsettled tax losses, the Management Board of the Company assessed that there is no risk of tax arrears on this account. The company appealed against the individual interpretation received. On July 7, 2017, Elektrownia Pątnów II Sp. z o.o. submitted to the Provincial Administrative Court in Poznań (via the Director of the National Tax Information Service) a complaint against the abovementioned individual interpretation of tax law. On January 18, 2018, the Provincial Administrative Court in Poznań, in response to a complaint filed by the Pątnów II Power Plant, issued a verdict abrogating the contested Interpretations of the Director of the National Tax Information dated 20 April 2017. A description of court cases can be found in note 34.1

As at December 31, 2017, PAK KWB Konin SA settled all tax losses for the years 2012-2015 in the amount of PLN 22 327 thousand. As at 31 December 2017, the deferred tax asset is PLN 54 806 thousand, it does not include tax losses.

As at December 31, 2017, PAK KWB Adamów SA reported a taxable income of PLN 782 thousand. Deferred income tax asset is PLN 8 346 thousand. In 2017, there was a decrease in the deferred tax asset resulting from the assessment of the possibility of its settlement resulting from the update of the financial projections. The above was charged to the net financial result, reducing it by PLN 19 385 thousand.

As at 31 December 2016, ZE PAK SA disclosed an asset due to unsettled tax losses for 2013-2014 in the amount of PLN 4 638 thousand and an asset due to tax loss for 2016 in the amount of PLN 25 346 thousand. As at December 31, 2017, the Company achieved taxable profits, thanks to which it was able to account for and present in the financial statements the use of all assets for 2013-2014 and 50% of 2016 assets in the amount of PLN 12 673 thousand.

16. Social services fund assets and liabilities of the Company Social Benefits Fund (MFŚS)

The Act of 4 March 1994 (as amended) on the Company Social Benefits Fund as amended, states that the Social Insurance Fund is formed by employers employing more than 50 full-time employees. The Group forms such a fund and makes periodical write-offs based on the amounts agreed with trade unions. In addition, the Group's companies contribute some social assets to the Fund. The aim of the Fund is to finance social activities, loans granted to the Group's employees and other social costs.

(in thousand PLN)

The subsidiaries, PAK KWB Konin SA, PAK KWB Adamów SA, El PAK Serwis Sp. Z o.o – in liquidation, EKO-Surowce SP. z o.o – in liquidation, Energoinwest-Serwis sp. z o.o. – in liquidation, Aquakon Sp. z o.o. – in liquidation, PAK-Volt SA, do not belong to the Intercompany Social Benefits Fund.

The Group compensated the assets of the Fund with their obligations to the Fund because these assets do not constitute separate assets of the Group. According to the above fact, the net balance as of 31 December 2017 is zloty 5 617 thousand (as of 31 December 2016 – zloty 6 983 thousand respectively).

The below tables present the analytics of assets, liabilities, and costs of the Fund.

	31 December 2017	*31 December 2016*
Loans granted to the employees	4 921	4 221
Cash	7 355	10 612
Liabilities due to the Fund	(6 659)	(7 850)
Balance after compensation	5 617	6 983

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Write-offs for the Fund in the financial period	6 167	9 530

17. Profit per one share

Basic profit per one share is calculated with division of net profit/loss for the period of the parent company's ordinary shareholders by weighted average of number of issued ordinary shares occurring during the period.

Diluted profit per one share is calculated with division of net profit for the period of the parent company's ordinary shareholders by weighted average of number of issued ordinary shares occurring during the period corrected by weighted average of ordinary shares, which would be issued by converting all diluting potential equity instruments into ordinary shares.

Data concerning profit and shares that served to calculated basic and diluted profit per one share were presented below:

	31 December 2017	*31 December 2016*
Net profit / (loss) on continued activities of the parent company's shareholders	183 243	247 674
Profit / (loss) on abandoned activities of the parent company's shareholders	-	-
Net profit / (loss) of ordinary shareholders used for calculation of diluted profit / (loss) per one share	183 243	247 674
The average weighted number of ordinary shares used for calculation of basic and diluted profit / (loss) per one share	50 823 547	50 823 547

(in thousand PLN)

The below table shows the profit per one share in Polish zlotys for the year ended 31 December 2017 and 31 December 2016 presented in the profit and loss account.

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Basic and diluted from profit for the financial year attributable to the shareholders of the parent company	3,61	4,87
Basic and diluted from profit from continuing operations attributable to the shareholders of the parent company	3,61	4,87

In the period between the balance sheet day and the day of development of this financial statement, there were no other transactions concerning ordinary shares or potential ordinary shares.

18. Dividends – paid and proposed for payment

The dividend from ordinary shares for 2016, paid on August 16, 2017, amounted to PLN 65 562 thousand.

The value of the dividend per one share paid for 2016 was PLN 1.29.

Due to the loss incurred in 2015, in 2016 no dividend for 2015 was paid.

Until the publication of these consolidated financial statements, the Management Board did not present any proposals for the distribution of the financial result for 2017.

(in thousand PLN)

19. Tangible fixed assets

12 months period ended 31 December 2017

	Land and perpetual usufruct	*Buildings and constructions*	*Plant and machinery*	*Motor vehicles*	*Other*	*Assets under construction*	*Total*
Gross value as at 1 January 2017	235 209	2 014 362	4 862 243	69 615	29 082	243 951	7 454 462
Direct purchase	2 720	2 348	5 926	700	1 158	89 720	102 572
Repairs	-	-	68 504	20	(56)	(63 973)	4 495
Transfer from fixed assets under construction	26 749	6 646	12 373	738	527	(47 033)	-
Sale and liquidation	(608)	(7 310)	(7 088)	(1 633)	(970)	(11)	(17 620)
Gross value as at 31 December 2017	264 070	2 016 046	4 941 958	69 440	29 741	222 654	7 543 909
Depreciation and impairment write-downs as at 1 January 2017	7 932	1 128 103	2 763 323	38 921	20 766	104 171	4 063 216
Depreciation write-down for the period	3 133	45 343	132 975	6 478	1 727	-	189 656
Impairment write-down	-	1 441	106	17	(124)	20 725	22 165
Sale and liquidation	-	(5 538)	(4 085)	(1 375)	(965)	-	(11 963)
Depreciation and impairment write-downs as at 31 December 2017	11 065	1 169 349	2 892 319	44 041	21 404	124 896	4 263 074
Net value as at 1 January 2017	227 277	886 259	2 098 920	30 694	8 316	139 780	3 391 246
Net value as at 31 December 2017	253 005	846 697	2 049 639	25 399	8 337	97 758	3 280 835

* *this item also includes land exploited for extraction of minerals using the opencast method*

(in thousand PLN)

12 months period ended 31 December 2016

	Land and perpetual usufruct	*Buildings and constructions*	*Plant and machinery*	*Motor vehicles*	*Other*	*Assets under construction*	*Total*
Gross value as at 1 January 2016	224 845	1 927 606	3 968 357	70 298	28 563	1 119 880	7 339 549
Direct purchase	47	25	1 532	332	703	60 920	63 559
Repairs	-	-	3 155	-	-	58 213	61 368
Transfer from fixed assets under construction	11 750	88 537	894 553	-	205	(995 045)	-
Sale and liquidation	(1 433)	(1 806)	(5 354)	(1 015)	(389)	(17)	(10 014)
Gross value as at 31 December 2016	235 209	2 014 362	4 862 243	69 615	29 082	243 951	7 454 462
Depreciation and impairment write-downs as at 1 January 2016	5 431	1 024 186	1 994 014	30 556	19 012	791 121	3 864 320
Depreciation write-down for the period	2 508	53 378	138 718	9 269	2 134	-	206 007
Impairment write-down (change of state)	-	51 530	634 082	-	-	(686 950)	(1 338)
Sale and liquidation	(7)	(991)	(3 491)	(904)	(380)	-	(5 773)
Depreciation and impairment write-downs as at 31 December 2016	7 932	1 128 103	2 763 323	38 921	20 766	104 171	4 063 216
Net value as at 1 January 2016	219 414	903 420	1 974 343	39 742	9 551	328 759	3 475 229
Net value as at 31 December 2016	227 277	886 259	2 098 920	30 694	8 316	139 780	3 391 246

** this item also includes land exploited for extraction of minerals using the opencast method*

As of 31 December 2017, the balance sheet value of fixed assets, under financial lease agreements amounts to 4 195 thousand (as of 31 December 2016 – zloty 61 365 thousand).

Land and buildings of the balance sheet value of PLN 354 237 thousand (as of 31 December 2016 – PLN 368 122 thousand) are covered by a mortgage established to secure bank credits of the Group (note 36).

The value of capitalised external financing costs for the year concluded on 31 December 2017 amounted to PLN 2 961 thousand (in the year ended 31 December 2016 – PLN 3 211 thousand).

19.1. The value impairment test of assets of ZE PAK SA Capital Group

In accordance with IAS 36, at the end of every reporting period, the Group's Management Board evaluates whether there are any prerequisites indicating that there may have occurred loss in value of the component of fixed assets. In case of statement that there are such prerequisites, the Group estimates recoverable number of assets' components. Due to the above, the Group always analyses: prerequisites that may affect loss in value of any of assets' components, as well as determining cash generating units (CGU) within the Group's companies.

As mentioned in note 5.2., the main prerequisite to analyse the value impairment of the components identified by the Management Board is the steady lower market value of the Group's net assets than their balance sheet value. Additional prerequisites, which the Management Board took into account when assessing the need for the test, were the prerequisites resulting from market conditions in the environment, in which the companies in the Group run activities, out of which the most important are:

- Regulations introduced by the Power Market Act of December 8, 2017, which entered into force on January 18, 2018;
- The price of certificates of origin of energy generated in renewable sources ("green certificates") maintained on a relatively low level due to oversupply of renewable energy property rights;
- increasing fluctuations of the CO_2 emission allowances' prices (caused by the aggravating climate policy of the European Union)

The above-mentioned prerequisites were analysed in relation to all centres generating independent cash flows:

According to IAS 36: "A cash-generating unit is the smallest identifiable group of assets that generates cash inflows, which are largely independent of the cash inflows from other assets or groups of assets. If there is any indication that an asset may be impaired, a recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit)."

In distinguishing CGU within the companies of the Group, the independence of generating cash flows in terms of the functioning of the individual companies was analysed.

The parent company of the Group that is ZE PAK SA, apart from the manufacturing operations, within which it is responsible for ensuring a certain level of efficiency of the generating units and implementations of production schedules, is focused on the significant operational and financial functions at the Group level as well.

Elektrownia Pątnów II sp. z o.o. – the second electricity producer in the Group, pursuant to the Act on termination of long-term agreements, is involved in the programme of coverage of stranded costs by the end of 2025.

The final settlement of this programme is planned in 2026.

The lignite coal mines, PAK KWB Konin SA and PAK KWB Adamów SA, conduct the business at several open pits.

In these companies, as profit generating units, smaller groups of assets that generate independent cash inflows were not, however, distinguished because of the many reasons, inflows generated by particular groups of assets are very closely connected with each other. As a result, the mine is expected to provide the power plant with a certain amount of coal; it is irrelevant, from which open pit it will come from. As a result, coal is supplied to the power plant from several open pits interchangeably. The organisational structure and registration systems are subordinated to such an established production target.

The above arguments determined distinguishing the following units generating independent cash flows within the ZE PAK SA Capital Group:

- ZE PAK SA
- Elektrownia Pątnów II sp. z o.o.
- PAK KWB Konin SA
- PAK KWB Adamów SA

Moreover, the remaining CGUs were distinguished within the following segments: Repairs, Sales, and Others.

Conducting the value impairment test of fixed assets, the Group based on the financial model for 2018-2047 reflecting strategic priorities of the parent company – ZE PAK SA

In ZE PAK SA, one centre generating economic benefits has been established, in which the following generation assets operate: Pątnów I power plant, Konin power plant -collector, Konin power plant – biomass unit and Adamów power plant – which ended its operation on 1 January 2018.

For each of the above units, it is possible to determine the economic benefits generated, however, these influences are to a certain degree dependent on each other, and therefore they should be considered together as one centre.

The following assumptions were adopted to estimate the use value of tangible fixed assets:

- Electricity prices have been adopted on the basis of developed forecasts divided into BASE, PEAK and OFFPEAK prepared for ZE PAK SA by an independent external advisor. For the nearest forecast period, prices resulting from concluded contracts were accepted,
- production assumptions result from the adopted investment and renovation program of ZE PAK SA,
- the Company assumed the use of the free CO_2 emission allowances in the amount resulting from Article 10a of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003,
- the costs of lignite coal purchased for generation were specified on the basis of the delivery schedule and the prices agreed with the appropriate schedules in financial projections of the subsidiaries,
- the effects of restructuring costs for the withdrawal of old capacities in Konin Power Plant and Adamów Power Plant were taken into account,
- the effects of restructuring costs for the withdrawal of the old units in the Konin and Adamów Power Plants were taken into account,
- revenues from the capacity market were accepted from 2021; the assumed rates have been estimated by the Group's internal services based on available forecasts of the amount of support for the energy sector,
- the forecast of the margin on the biomass block was estimated assuming that the support mechanism will be the auctions,
- the weighted average cost of capital after tax (WACC) was assumed during the projection period at 8.25%.

The test was performed as at December 31, 2017.

Based on the conducted tests, it was not necessary to recognize impairment losses on property, plant and equipment.

In case of Elektrownia Pątnów II sp. z o.o. due to the participation of this unit in the Stranded Capital Completion Scheme (LTC) and the estimate of such receipts, no impairment of property, plant and equipment was found. Based on available and prospective coal resources, in particular Ościsłowo and Dęby Szlacheckie deposits, the planned operation time of the plant covers the period up to 2047.

Like in relation to the other CGUs operating within the segments of Repairs, Sales and Other, indications of a possible value impairment of assets were not identified as well.

The basis of tests for both brown coal mines is long-term financial projections including periods of operation of both mines and their particular open pits, which were agreed with assumptions accepted in the ZE PAK SA's model. Adjusting the financial projections of mines to periods of operation of the generating units results from the assumption that the only recipients of the products are the companies of the Capital Group.

The financial projections for PAK KWB Konin SA and PAK KWB Adamów SA were built taking into account the following parameters:

(in thousand PLN)

- the volume of production (extraction of coal) and revenue were determined on the basis of forecasts of the main recipient of coal that is ZE PAK SA and Elektrownia Pątnów II sp. z o.o. and the projected price curve of coal, based on an agreement on the financing of open pits,
- stripping and extraction of coal were developed according to the schedule of utilisation of current and predicted open pits, including Ościsłowo till 2036
- the level of investment expenses enabling to build new open pit ensuring supplying the power plants and maintaining specified production capacities during their operation was accepted,
- the effects of employment restructuring processes were taken into account,
- costs of the following events were included:
    - costs of reclamation of open pits
    - pension provisions
    - costs of compensations due to the group dismissals
    - revenues from sale of the asset after the end of open pit utilisation.
- weighted average cost of capital after taxation (WACC) in the projection period for PAK KWB Adamów SA at 8.03% and for PAK KWB Konin SA at the level of 8.25% was adopted; the higher discount rate reflects the higher risk associated with the operation of PAK KWB Konin SA in the long term (longer perspective of the forecast), in particular in relation to investment activities related to the development of new brown coal deposits.

Based on the conducted tests, it was found that there is no need to recognize revaluation allowances for property, plant and equipment for CGU PAK KWB Adamów SA and for CGU PAK KWB Konin SA.

Based on the results of the tests, it was also not necessary to include additional revaluation allowances for CGU ZE PAK SA assets. On the basis of the conducted analysis and test results, there was also no increase in the estimated usable potential of fixed assets for CGU ZE PAK SA, so there was also no reversal of previously recognized impairment losses in the amount of PLN 1 880 000 thousand.

Sensitivity analysis

Changes of financial parameters underlying the evaluation of the recoverable amount would change the present value of the discounted cash flow with the amounts presented below.

The results of the sensitivity analysis showed that a significant impact on the value in use of the tested assets is the issue of taking into account the power market. In the pessimistic scenario, if the market power for MW was included at the level of 50% assumed for testing, while the remaining assumptions remain unchanged, the amount of additional net write-off would be PLN 129.5 million.

Zespół Elektrowni Pątnów-Adamów-Konin SA	*(+) increase by 1.0 percentage points*	*(-) decrease by 1.0 percentage points*
Weighted average cost of capital	(PLN 43 m)	PLN 46 m
	(+) increase by 1%	(-) decrease by 1%.
Change in sales revenues (electricity price)	PLN 54 m	(PLN 54 m)
	(+) increase by 5%	(-) decrease by 5%.
Change in cost of sales (price of 1 EUA)	(PLN 57 m)	PLN 57 m
	(+) increase by 10%	(-) decrease by 10%
change in the market power rate for 1MW	PLN 68 m	(PLN 68 m)

PAK KWB Konin SA	(+) increase by 1,0 p.p.	(-) decrease by 1,0 p.p.
Weighted average cost of capital	(PLN 76 m)	PLN 88 m

(in thousand PLN)

	(+) increase by 1%	(-) decrease by 1%
Change in sales revenues	PLN 44.5 m	(PLN -44.5 m)

In the case of a decrease in revenues from sales by 1.43 % in a perspective of the forecast as the other parameters of the recoverable value determination remain unchanged and in case of increase of the weighted average cost of capital by 0.82 percentage points, while the other model parameters are unchanged, the recoverable value of the CGU would be equal to the balance sheet value.

PAK KWB Adamów SA	(+) increase by 1,0 p.p.	(-) decrease by 1,0 p.p.
Weighted average cost of capital	PLN 3 m	(PLN 3 m)
	(+) increase by 1%	(-) decrease by 1%
Change in sales revenue	PLN 2 m	(PLN 2 m)

In the case of a decrease in revenues from sales by 8.7% in a perspective of the forecast as the other parameters of the recoverable value determination remain unchanged, and in case of a decrease of the weighted average cost of capital by 5.0 percentage points, while the other model parameters are unchanged, the recoverable value of the CGU would be equal to the balance sheet value.

20. Lease

20.1. Liabilities under financial lease agreements and lease agreement with purchase option

Fixed assets used on the basis of financial lease agreements include mostly cars, tracked dozers and loaders, tractors, and trailers.

As of 31 December 2017, and 31 December 2016, future minimal lease payments due to financial lease agreements and lease agreements with purchase option, as well as current value of minimal net lease payments are as follows:

	As at 31 December 2017		*As at 31 December 2016*	
	minimum payments	*present value of payments*	*minimum payments*	*present value of payments*
Up to 1 year	1 768	1 636	7 572	7 189
1 to 5 years	2 962	2 606	4 249	3 962
Over 5 years	-	-	-	-
Total minimal lease payments	4 730	4 242	11 821	11 151
Minus finance expenses	(488)	-	(670)	-
resent value of minimal lease payments, including:	4 242	4 242	11 151	11 151
Short-term	1 636	1 636	7 171	7 189
Long-term	2 606	2 606	3 980	3 962

(in thousand PLN)

21. Intangible assets

Long-term intangible assets – 12 months period ended 31 December 2017

	CO_2 Emission units (EUA)	*Patents and licenses*	*Computer software*	*Other*	*Total*
Gross value as of 1 January 2016	114 503	21 540	1 998	431	138 472
Transfer EUA	(114 503)				(114 503)
Increases	-	(440)	(42)	(4)	(486)
Decreases	2 266	786	25	1	3 078
Gross value as of 31 December 2016	2 266	21 886	1 981	428	26 561
Depreciation and impairment write-downs as at 1 January 2016	-	16 943	1 903	344	19 190
Depreciation write-down for the period	-	1 058	99	23	1 180
Impairment write-down	-	-	-	-	-
Decreases	-	(440)	(44)	(4)	(488)
Depreciation and impairment write-downs as at 31 December 2016	-	17 561	1 958	363	19 882
Net value as at 1 January 2016	114 503	4 597	95	87	119 282
Net value as at 31 December 2016	2 266	4 325	23	65	6 679

In the EUA Transfer, the Group presents transfer of CO_2 allowances between long-term and short-term intangible assets.

(in thousand PLN)

Long-term intangible assets – 12 months period ended 31 December 2016

	CO_2 Emission units (EUA)	*Patents and licenses*	*Computer software*	*Other*	*Total*
Gross value as of 1 January 2016	12 054	19 558	1 949	395	33 956
Transfer EUA	(14 671)	-	-	-	(14 671)
Increases	-	-	(26)	-	(26)
Decreases	117 120	1 982	75	36	119 213
Gross value as of 31 December 2016	114 503	21 540	1 998	431	138 472
Depreciation and impairment write-downs as at 1 January 2016	-	14 525	1 719	323	16 567
Depreciation write-down for the period	-	1 080	207	21	1 308
Impairment write-down	-	1 338	-	-	1 338
Decreases	-	-	(23)	-	(23)
Depreciation and impairment write-downs as at 31 December 2016	-	16 943	1 903	344	19 190
Net value as at 1 January 2016	12 054	5 033	230	72	17 389
Net value as at 31 December 2016	114 503	4 597	95	87	119 282

In the EUA Transfer, the Group presents transfer of CO2 allowances between long-term and short-term intangible assets.

(in thousand PLN)

Short-term intangible assets

	31 December 2017	*31 December 2016*
	CO2 emission units (EUA)	*CO2 emission units (EUA)*
Gross value as of 1 January	273 036	354 389
Purchase of EUA	187 220	258 365
Redemption of EUA	(313 105)	(354 389)
Transfer of EUA	114 503	14 671
Gross value as of 31 December	261 654	273 036
Redemption and impairment as of 1 January	-	-
Impairment write-down of a period	-	-
Depreciation and impairment write-down as of 30 December	-	-
Net value as of 1 January	273 036	354 389
Net value as of 31 December	261 654	273 036

22. Assets for overburden removal and other mining assets

As of 31 December 2017, the item of assets concerning overburden stripping and other mining assets includes the assets related to overburden stripping and other mining assets in PAK KWB Konin in the amount of PLN 72 536 thousand.

	31 December 2017	*31 December 2016*
As of 1 January	80 524	94 057
Increases	824	1 306
Decreases	-	(455)
Depreciation for the period	(8 812)	(14 384)
As of December	72 536	80 524
long-term	72 536	80 524
short-term	-	-

(in thousand PLN)

23. Other assets

23.1. Other financial assets

	31 December 2017	*31 December 2016*
Deposits for debt service security	35 616	76 484
Investments and deposits	14	2 540
Investments and FLZG* deposits	8 365	7 810
Shares	313	167
Other	1 791	2 261
Total other financial assets	46 099	89 262
short-term	35 788	77 317
long-term	10 311	11 945

**MLF – Mining Liquidation Fund*

The main components of the "Other" item are guarantee deposits in the amount of PLN 640 thousand and loans granted to employees in the amount of PLN 277 thousand.

23.2. Other non-financial assets

	31 December 2017	*31 December 2016*
VAT receivables	6 402	22 184
Insurance	1 527	1 561
Other receivables from the state budget	-	-
Other non-financial assets	-	98
Other accruals	2 756	3 359
Delivery prepayments	115	905
Prepayments for intangible assets	-	187
Prepayments for assets under construction	2 451	5 880
Prepayments for tangible assets – land	-	-
Other	296	328
Total other non-financial assets:	13 547	34 502
short-term	11 425	28 776
long-term	2 122	5 726

The largest components of the item "other accruals in 2017" are settlements regarding license fees in the amount of PLN 748 thousand.

(in thousand PLN)

24. Employee benefits

24.1. Pension benefits and other post-employment benefits

The Group's entities pay the retiring employees amounts of one-time retirement benefits and other post-employment benefits in the amount specified by the Collective Labour Agreement. In relation to this, the Group, on the basis on the evaluation made by a professional pension actuary company, creates a provision for the current value of the liability due to one-time retirement and other benefits.

The amount of the provision and the agreement of changes in provisions during the accounting period are presented in the following table:

	Provision for pension, retirement, and post-mortem benefits	*Anniversary premiums*	*Subsidies to electricity/coal benefits*	*Total*
as of 1 January 2017	**28 292**	**3 086**	**23 712**	**55 090**
Current service cost	1 144	265	-	1 409
Interest costs	736	108	830	1 674
Actuarial profits and losses	1 699	(67)	736	2 368
Paid benefits	(2 689)	(680)	(2 835)	(6 204)
Past service cost	4 326	(177)	-	4 149
Other	(4 863)	-	-	(4 863)
as of 31 December 2017	**28 645**	**2 535**	**22 443**	**53 623**
Long-term provisions	12 886	2 157	19 679	34 722
Short-term provisions	15 759	378	2 764	18 901

The main component of the "Other" item is the release of provisions related to the liquidation of Energoinwest sp. z o.o., EL PAK Serwis sp. z o.o., EKO Surowce sp. z o.o. and Aquakon sp. z o.o. The new provisions were created in the company PAK Górnictwo sp. z o.o., which took over the activities of liquidated companies.

	Provision for pension, retirement, and post-mortem benefits	*Anniversary premiums*	*Subsidies to electricity/coal benefits*	*Total*
as of 1 January 2016	**42 310**	**16 352**	**27 794**	**86 456**
Current service cost	2 103	1 543	-	3 646
Interest costs	1 020	425	723	2 168
Actuarial profits and losses	(2 535)	(299)	(1 823)	(4 657)
Paid benefits	(4 079)	(2 351)	(2 982)	(9 412)
Past service cost	(10 527)	(12 584)	-	(23 111)
Other	-	-	-	-
as of 31 December 2016	**28 292**	**3 086**	**23 712**	**55 090**
Long-term provisions	25 159	2 547	20 881	48 587
Short-term provisions	3 133	539	2 831	6 503

(in thousand PLN)

The main assumptions adopted by the actuary as of the balance sheet date for calculation of the amount of the liability are as follows:

	12 months period ended 31 December 2017	
discount rate	3.3%	3.5%
expected inflation rate	2.5%	2.5%
expected remuneration growth rate	depending on the company in rage from 0 % to 3 %	depending on the company in rage from 0 % to 3 %

25. Inventories

	31 December 2017	*31 December 2016*
Production fuel	7 564	9 161
Spare parts and other materials	79 001	74 608
Certificates of origin of energy	11 119	21 406
Goods	74	121
Inventory total according to the lower of two values: acquisition price (costs of production) and the net value possible to acquire	97 758	105 296

Certificates of origin of energy due to the energy production from renewable energy sources, gas sources, and peak load co-generation are presented according to fair value at the end of the month, in which they were produced.

According to the records, as at 31 December 2017, the Group held, in total, 36 836.654 MWh of green certificates including 4 014.442 MWh of green energy for production in June 2017, produced and not yet verified by URE.

In the fourth quarter of 2017, the Group did not receive any certificates. During this period, no property rights resulting from certificates of origin of electricity from renewable energy sources were sold. During the current reporting period, the Group stopped production from renewable sources because of too low prices of market rights.

26. Trade and other receivables

	31 December 2017	*31 December 2016*
Trade receivables	151 814	126 793
Receivables due to compensation related to the termination of the PPAs	58 303	88 350
Receivables due to security of purchase of electricity in the balancing market	7 695	8 674
Other receivables	35 449	22 208
Net receivables	253 261	246 025
Impairment write-down on receivables	41 522	41 947
Gross receivables	294 783	287 972

In the ‘other receivables’ item, as of 31 December 2017, the Group presents mainly receivables due to the security deposit in the amount of PLN 25 676 thousand.

(in thousand PLN)

Terms of transactions with affiliates are presented in the note 37.

Receivables due to supplies and services are not subject to interest and the date of payment is usually within the 14-day period.

The Group has appropriate policy concerning the sale to the verified clients only. Thanks to that, according to the management, there is no additional credit risk exceeding the level specified by non-collectible receivables impairment write-downs, specific to the Group's trade receivables.

As of 31 December 2017, receivables due to supplies and services and other receivables in the amount of PLN 41 522 thousand (as of 31 December 2016: PLN 41 947 thousand) were included in the write-off. Changes in the impairment write-downs on receivables were as follows:

	31 December 2017	*31 December 2016*
Impairment write-down as at 1 January	41 947	41 840
Increase	56	568
Use	(2)	(315)
Redemption	(479)	(146)
Impairment write-down as at 31 December	41 522	41 947

Below is an analysis of trade receivables and other receivables which as at 31 December 2017 and as at 31 December 2016 were past due, but were not considered as irrecoverable and were not written off.

			Expired but recoverable				
	Total without write-down	*Unexpired*	<30 days	30-60 days	60-90 days	90-120 days	>120 days
31 December 2017	253 261	248 044	3 521	410	547	28	711
31 December 2016	246 025	217 297	10 135	6 929	5 246	2 507	3 911

27. Cash and cash equivalents

Cash at bank are subject to interest at volatile interest rates, whose amount depends on the interest rate on one-day bank deposits. Short-term deposits are established for various periods; from one day to three months, depending on current Group’s demand for cash and are subject to interest at fixed interest rates. The fair value of cash and cash equivalents as of 31 December 2017 amounts to PLN 322 201 thousand (as of 31 December 2016: PLN 350 101 thousand).

The balance of cash and cash equivalents in the consolidated cash flow statement consisted of the following items:

Cash structure

	31 December 2017	*31 December 2016*
Cash in hand and at bank:	229 387	229 498
Short-term deposits	92 814	120 603

(in thousand PLN)

Total cash and cash equivalents in the balance sheet	322 201	350 101
Foreign exchange differences	369	(1 454)
Total cash and cash equivalents in cash flow statement	322 570	348 647

Explanation of changes in balance sheet items and changes to items recognized in the statement of cash flows

	31 December 2017	*31 December 2016*
Depreciation:		
Depreciation shown in the income statement	199 648	221 699
Settlement of subsidies	(1 502)	(2 877)
Depreciation shown in the cash flow statement	(2 454)	(10 993)
depreciation shown in cash flow statement	195 692	207 829

The settlement of sale-and-lease-back concerns an excess due to sale of assets components and lease them back in PAK KWB Konin. The amount of PLN 2 454 thousand adjusted for depreciation (in 2016, the amount of PLN 10 993 thousand).

	31 December 2017	*31 December 2016*
Receivables:		
Balance sheet change in trade receivables and other receivables	(7 236)	22 098
Balance sheet change in other long and short-term non-financial assets	19 916	(11 978)
Balance sheet change in amounts due from clients under PPAs	1 089	(4 819)
Change in advances for fixed assets under construction	(3 429)	(1 637)
Other changes	1 361	(541)
Change in receivables shown in the cash flow statement	11 701	3 123

	31 December 2017	*31 December 2016*
Liabilities:		
Balance sheet change in trade liabilities and other financial liabilities, long and short-term	(156 170)	(10 524)
Balance sheet change in other non-financial liabilities	(9 044)	(6 123)
Balance sheet change in amounts paid to clients under PPAs	1 635	(6 090)

(in thousand PLN)

Change in liabilities under investment settlements	(2 992)	57 179
Purchase of debt securities	-	5 030
New lease agreements and payment of lease liabilities	6 750	15 192
Change in liabilities under purchase of allowances of emission CO_2	59 951	(59 951)
Other changes	790	170
Change in liabilities shown in the cash flow statement	(99 080)	(5 117)

	31 December 2017	*31 December 2016*
Change in provisions, prepayments and accruals and employee benefits:		
Change in provisions and prepayments	20 137	(87 883)
Change in long and short-term employee benefits	(1 459)	(31 367)
Decrease of provision from redemption EUA	313 105	354 389
Change in actuarial provisions indicated in other comprehensive income	(2 155)	4 613
Other changes	(829)	(566)
Change in provisions, prepayments and accruals and employee benefits	328 799	239 186

In the item of expenditures and receipts associated with other financial assets in consolidated financial statement there were presented inflows and outflows of the cash earmarked for debt service and received guarantees.

28. Share capital and other capitals

28.1. Share capital

Share capital	*31 December 2017*	*31 December 2016*
50 823 547 shares with a nominal value of PLN 2 each	101 647	101 647

28.1.1. Share nominal value

All the issued shares have a nominal value of zloty 2 each and were paid up.

28.1.2. Shareholders rights

The shares of all series are equally preferred in terms of dividend and return on the capital.

28.1.3. Shareholders with significant share

	31 December 2017	*31 December 2016*
Elektrim SA		
share in capital	0.39%	0.39%
share in voting right	0.39%	0.39%
*Embud II sp. z o.o.**		

share in capital	1.16%	1.16%
share in voting right	1.16%	1.16%
Trigon XIX Fundusz Inwestycyjny Zamknięty		
share in capital	19.68%	19.68%
share in voting right	19.68%	19.68%
Argumenol Investment Company Limited		
share in capital	30.32%	30.32%
share in voting right	30.32%	30.32%
Nationale - Nederlanden OFE		
share in capital	9.97%	9.97%
share in voting right	9.97%	9.97%
Towarzystwo Funduszy Inwestycyjnych PZU SA		
share in capital	6.06%	6.06%
share in voting right	6.06%	6.06%
OFE PZU Złota Jesień		
share in capital	5.24%	5.24%
share in voting right	5.24%	5.24%
Others		
share in capital	27.18%	27.18%
share in voting right	27.18%	27.18%
	100.00%	100.00%

**- in 2016 the company acted under the name Embud sp. z o.o.*

According to the Company's knowledge on the basis of notifications submitted by the shareholders

29. Supplementary capital

As of 31 December 2017, the structure of the supplementary capital origin in the amount of zloty 1 094 493 thousand is as follows:

• from the sale of shares above their nominal value	380 030
• created in accordance with the articles of association above the statutory (minimum) value	587 748
• other, including:	126 715
- Takeover of PAK Odsiarczanie sp. z o.o.	65 922
- Liquidation of fixed assets	60 793

29.1. Other reserve capital

The ZE PAK SA Company was founded as a result of the commercialisation of the Zespół Elektrowni PAK State-owned Company made pursuant to the Act of 13 July 1990 on the privatisation of state-owned companies. The so-called Privatisation Fund, shown as part of the reserve capital in the balance sheet of the company, was created by the Zespół Elektrowni PAK state-owned company on the basis of the Act of 31 January 1989 on financial economy of state-owned companies.

The value of the reserve fund consists of the Privatisation Fund in the amount of zloty 3 472 thousand, which was created from the profit of 1994, on the basis of a resolution of the Extraordinary General Meeting of the newly established Company, and the values related to the redemption of own shares in the amount of zloty 2 405 thousand. Due to the negative result of ZE PAK SA for 2015 in the amount of zloty 1,515,851 thousand, the General Meeting of the Company, on 28 June 2016, adopted a resolution no. 5 on covering the Company's loss for 2015. According to the resolution, the General Meeting allocated the amount of zloty 2 405 thousand from the reserve capital. The total value of other reserve capitals, as of 31 December 2017, is zloty 3 472 thousand.

(in thousand PLN)

Cash accumulated in this fund were to be reserved for employees' purchase from the State Treasury shares after transformation of the enterprise into the company and its privatisation (purchase of up to 10% of the shares for a half price). The Act of 30 August 1996 on the commercialisation and privatisation of state-owned enterprises introduced in 1996 granted employees the right to acquire 15% of the company's shares belonging to the State Treasury free of charge. Therefore, the objectives, which the privatisation fund was to serve, do not exist. However, the capital in the company's liabilities remained.

29.2. Undivided financial result and restrictions on payment of dividend

The undivided profit also includes amounts, which are not subject to division that is they may not be paid in the form of dividend. They are:

- Retained profits/losses of subsidiaries owned by the shareholders of the parent company,
- differences in values of retained profits between the statutory statement and the IFRS statement of the parent company,
- The equivalent of 8% of the statutory write-offs from profit for the capital and other write-offs made on the basis of existing provisions in the contracts of subsidiaries.

In the Group, as of 31 December 2017, the full amount of undivided profit (including the equivalent of reserve and supplementary capitals created within the division of profits in the previous years) is subject to the restriction on payment of dividend. The following conditions are the basis of such an assumption:

- Statutory financial statements of all companies included in the ZE PAK SA Capital Group are prepared in accordance with the Polish accounting standards. The dividend may be paid on the basis of the financial result determined in a separate annual financial statement prepared for the statutory purposes.
- According to the requirements of the Code of Commercial Companies, a parent company is required to create a reserve capital for coverage of losses. At least 8% of the profit for a given financial year, recognised in a separate financial statement of the company is transferred to this category of the capital, until this capital reaches at least one third of the parent company's issued capital. The use of supplementary and reserve capitals is decided by the General Meeting. However, parts of the supplementary capital in the amount of the one-third of the initial capital can be used only to cover the loss demonstrated in the separated financial statement of the parent company and is not divided for other purposes.

As of 31 December 2017, there are no other restrictions on the payment of the dividend.

29.3. Non-controlling interest

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
At the beginning of the period		
Acquisition - defining non-controlling interest at the acquisition date	30 971	30 971
Employee share program - correction of the original settlement	(955)	(955)
The result of subsidiaries in a given year - attribution to non-controlling interests	589	2 612
Settlement PUT options - the recognition of the commitment to purchase employee shares	(30 971)	(30 971)
Settlement PUT option - recognition of the difference between the value of non-controlling interest and obligation at end of period	366	(1 657)
Total	-	-

(in thousand PLN)

Allocation of the result to the non-controlling interests

In the consolidated financial statement, 15% of the PAK KWB Adamów SA's result and 15% of the PAK KWB Konin SA's result for the period from 19 July 2012 – 31 December 2013 and from 1 January 2014 – 31 December 2014 were allocated as a profit of non-controlling shareholders. In 2015, 2016 and 2017 in connection with the ongoing employee shares redemption, the profit for non-controlling shareholders was allocated in proportion to the shares volume of non-controlling shareholders.

Recognition of ZE PAK SA's obligation to purchase the remaining shares in PAK KWB Konin SA and PAK KWB Adamów SA

In accordance with the IFRS, ZE PAK SA recognised the obligation to purchase the shares of PAK KWB Konin SA and PAK KWB Adamów SA possessed by the non-controlling interest on the day of the acquisition of control.

In the shares sale agreement of KWB Konin SA and KWB Adamów SA concluded between ZE PAK SA and the State Treasury on 28 May 2012 (hereinafter "Shares Sale Agreement"), ZE PAK SA submitted an irrevocable offer of purchasing the remaining shares of both mines to the State Treasury, under the terms set forth in this agreement, which will not be acquired from the State Treasury by the entitled employees and their legal successors on the basis of the Act of 30 August 1996 on the commercialisation and certain powers of employees. In accordance with the provisions of this act, the entitled employees of KWB Konin SA and KWB Adamów SA are entitled to acquire free of charge up to 15% of the shares of the company covered by the State Treasury on the date of entering a given company into the register. In accordance with the Shares Sale Agreement, ZE PAK SA's purchase of the remaining mines' shares from the State Treasury, not covered by the entitled employees or by their legal successors, will take place at a price per share equal to, respectively, the price of one share of KWB Konin SA and KWB Adamów SA in the transaction of sale of 85% of KWB Konin SA and KWB Adamów SA's shares of Konin to ZE PAK SA by the State Treasury, index-linked by the consumption products and services price indicator announced by the CSO President. In accordance with the Shares Sale Agreement, the offer of purchasing the remaining shares of KWB Konin SA and KWB Adamów SA are submitted by ZE PAK SA to the State Treasury, which is referred to above, was binding until 28 February 2017. The remaining shares of KWB Konin SA and KWB Adamów SA were purchased from the Treasury.

In addition, in accordance with the Shares Sale Agreement, ZE PAK SA obliged to, under the terms as provided for in this agreement, submit to the entitled employees of KWB Konin SA and KWB Adamów SA, who acquired free of charge the shares from the State Treasury on the basis of the Act of 30 August 1996 on the commercialisation and certain powers of employees, the offer to purchase these shares at a prices equal to, respectively, the price of one share of KWB Konin SA and KWB Adamów SA in the transaction of sale of 85% of KWB Konin SA and KWB Adamów SA's shares of Konin to ZE PAK SA by the State Treasury. In the implementation of this obligation, after the expiry of the prohibition on trading the employee shares specified in article 38 paragraph 3 of the Act of 30 August 1996 on the commercialisation and certain powers of employees, ZE PAK SA began the process of employee share redemption, within which ZE PAK SA offered the people, who expressed the interest in disposal of PAK KWB Konin SA and PAK KWB Adamów SA's shares, to redeem them under terms set forth in the Shares Sale Agreement. By the end of 2016, as a result of that redemption process, most employee shares of PAK KWB Konin SA and PAK KWB Adamów SA were acquired. ZE PAK SA still plans to purchase the employee shares of PAK KWB Konin SA and PAK KWB Adamów SA and continues the redemption process at the currently offered price.

As of 31 December 2017, the remaining amount on the purchase of PAK KWB Konin SA and PAK KWB Adamów SA amounted to PLN 3 755 thousand.

30. Interest-bearing loans and borrowings

Short-term	*Maturity*	*31 December2017*	*31 December 2016*
Bank loan (syndicated) in the amount EUR 240 000 thousand; interest rate at EURIBOR 3M + bank margin	20.07.2019	136 840	142 567
Overdraft facility at BZ WBK in the amount of zloty 50 000 thousand; interest rate at WIBOR 1M + bank margin	30.06.2018	23	28 670
Overdraft in Alior Bank SA in the amount of PLN 67 000 thousand, bearing interest at WIBOR 1M + bank margin	30.05.2018	59 025	63 061

(in thousand PLN)

Working capital loan in Bank Millennium SA in the amount of PLN 76 500 thousand, bearing interest at WIBOR 3M + bank margin	31.12.2017	-	28 765
Investment loan in the amount of PLN 577 000 thousand (Loan A), bearing interest at WIBOR 3M + bank margin	20.03.2020	141 662	146 260
Investment loan in the amount of PLN 90 000 thousand (Loan B), bearing interest at WIBOR 3M + bank margin	20.03.2020	12 023	12 369
Overdraft in Alior Bank SA in the amount of PLN 1000 thousand, bearing interest at WIBOR 1M + bank margin	30.05.2017	-	266
TOTAL		**349 573**	**421 958**

Long-term	*Maturity*	*31 December 2017*	*31 December 2016*
Investment loan (syndicated) in the amount of EUR 240 000 thousand, bearing interest at the EURIBOR 3M rate + bank's margin	20.07.2019	101 431	244 556
Investment loan in the amount of PLN 577 000 thousand (Loan A), bearing interest at WIBOR 3M + bank margin	20.03.2020	150 931	283 045
Investment loan in the amount of PLN 90 000 thousand (Loan B), bearing interest at WIBOR 3M + bank margin	20.03.2020	50 103	60 250
TOTAL		**302 465**	**587 851**

31. Provisions and accruals

31.1. Accruals

	31 December 2017	*31 December 2016*
Provision for bonuses and holiday leaves	28 770	29 371
Provision for employment termination costs	2 173	-
Audit of financial statements	563	570
Other	1 328	1 902
Total	32 834	31 843
short-term	32 834	31 843
long-term	-	-

The main component of the item "Other" is the provision for a penalty for exceeding the amount of dust introduced into the air in 2015 in the amount of PLN 1 190 thousand. The group appealed against this decision to the Provincial Inspectorate for Environmental Protection in Poznań. The case went to the Chief Inspector of Environmental Protection.

(in thousand PLN)

31.2. Change in provisions

	Provision for EUA redemption	*Provision for the fixed assets liquidation costs*	*Provision for the reclamation of ash storage yards*	*Provision for the long-term contract loss*	*Provision for the certificates of origin of energy redemption*	*Reclamation provisions and other provisions related to mining activities*	*Other*	*Total*
As of 1 January 2017	313 105	16 848	1 005	13	7 838	307 837	37 552	684 198
increase	289 942	747	1	397	1 616	70 385	1 023	364 111
decrease	(313 105)	(1 002)	(250)	(40)	(932)	(15 806)	(13 821)	(344 956)
As of 31 December 2017	289 942	16 593	756	370	8 522	362 416	24 754	703 353
long-term	-	16 593	540	-	-	336 292	4 477	357 902
Short-term	289 942	-	216	370	8 522	26 124	20 277	345 451
as of 1 January 2016	354 389	16 419	1 698	148	9 449	330 561	53 487	766 151
increase	313 105	429	-	86	7 838	1 676	1 500	324 634
decrease	(354 389)	-	(693)	(221)	(9 449)	(24 400)	(17 435)	(406 587)
as of 31 December 2016	313 105	16 848	1 005	13	7 838	307 837	37 552	684 198
long term	-	16 848	755	-	-	287 966	6 684	312 253
short term	313 105	-	250	13	7 838	19 871	30 868	371 945

31.3. Description of significant titles of provisions

31.3.1. The provision for liabilities due to the emission of greenhouse gases (EUA)

The Group recognises the provision for the redemption of greenhouse gases emission allowances.

Since 1 January 2013, the next reporting period of 2013 – 2020 concerning emission allowances has been applicable. This period's assumption is granting the Group the free EUA allowances resulting from the production of heat, although power engineering was additionally covered by opportunity of derogation. Derogation resulting from Article 10c of the ETS Directive is based on granting additional free allowances, provided that declared investment expenses for investments reported to the National Investment Plan are paid. The ZE PAK SA submits to the Ministry of the Environment the annual material and financial statements from investment expenses paid for tasks reported to the National Investment Plan, applying for granting free EUAs for the subsequent reporting years at the same time.

In September 2017, the Company submitted a material and financial statement to the Ministry of Environment regarding the free EUAs under article 10c for the incurred investment expenses in the period from 1 July 2016 to 30 June 2017. However, due to the uncertainty in terms of the creation of a dual-commodity market, including the power market at the moment, which will impact directly the modernisation of units number 3 and 4 in the Pątnów Power Plant, the Company did not apply for the free allowances. In connection with the above, the Group did not receive EUAs for 2017 due to art. 10c.

As at January 1, 2017, the Group had physical assets in its EUA accounts in the amount of 13 820 841 tons. In February 2017, the Group received free EUA for heat for 2017 (Article 10a of the ETS Directive) in the amount of 83,317 EUA. In addition, in the first quarter of 2017, the Group completed purchases of emission allowances under futures contracts concluded at the turn of 2015 and 2016 for the production needs of 2016. After these operations, the status of the EUAs held on the Group's accounts in the Union Register as at March 31, 2017 was 15 249 158. After the cancellation process in April 2017, the EUA units in the accounts of the Group in the Union account in the amount of 3 793 059, which will be used for the needs of 2017 cancellations. Since the beginning of 2017, the Group has been making purchases of EUA units on the SPOT market as well as on the forward market. As at December 31, 2017, 9 776 059 EUA units are physically listed on the Group's accounts. The units purchased by the Group will mostly be used for redemption 2017 and partly provide security for the needs of electricity production by the Group's power plants in 2018.

The provision of CO2 for the Group, which the Group intends to redeem for 2017, is charged to basic operating activities. Upon the actual cancellation of entitlements, the previously created reserve will be used.

31.3.2. Provision for reclamation of ash storage yards and costs of liquidation of fixed assets

The Group creates the provision for future costs of reclamation of the land on the basis of legal obligation resulting from the "Integrated Permits." The basis of estimation of the provision size are specialised studies and technical and economical expert reports developed by domestic services or external experts. The value of the provision is estimated and verified on every balance sheet date on the basis of current cost estimates and a discount. As of 31 December 2017, the created provision amounted to PLN 756 thousand.

Due to the legal obligation to liquidate fixed assets after their period of use, the Group creates the provision for projected future costs, which will be necessary to pay for fulfilment of this obligation. As of 31 December 2017, the provision due to this amounted to PLN 16 593 thousand.

31.3.3. Reclamation provisions and other provisions related to mining activities

PAK KWB Konin SA and PAK KWB Adamów SA are obliged to reclaim areas of extraction works pursuant to the Geological and Mining Law act. Due to this, the Group creates the provision both for costs of area reclamation related to current coal extraction on a given open pit and for costs of the final excavation reclamation in the state of advancement of coal extraction in particular open pits on every balance sheet day.

The provision is created on the basis of estimation of future reclamation costs based on reports of independent experts estimating reclamation costs on the order of the Management Board. Estimates concerning projected reclamation costs are analysed periodically; on every reporting date, the volume of provision is verified in accordance with current assumptions within discount rate, inflation, and the volume of extraction.

PAK KWB Konin SA and PAK KWB Adamów SA, within run activities, are obliged to restore to the original condition, or to rebuild damages caused by the mine operations. Due to this, the Group creates the provision for projected costs, to pay which it is obliged on the basis of concluded agreements. Estimates concerning the projected costs related to the mine operations are updated on every reporting date.

In 2017, PAK KWB Konin SA and PAK KWB Adamów SA commissioned an external company to prepare a study on the estimation of the costs of reclamation and management of excavations and mining exploitation areas. As a result of the update, the area, time and directions of reclamation changed, which resulted in an increase in the provision for reclamation. In PAK KWB Adamów SA this is mainly due to a change in the direction of the reclamation of these areas in relation to the original assumptions, conducting inventory of areas subject to reclamation and changes in relation to the planned exclusion of these areas from mining operations. However, in PAK KWB Konin SA, the change in the amount of reclamation reserves results mainly from changes in the surface of the final lake in Jóźwin open-pit and in Drzewce open-pit. The provision for decommissioning and reclamation of mining areas and for the preparation of operational areas at PAK KWB Konin SA and PAK KWB Adamów SA as at December 31, 2017 amounted to PLN 362 416 thousand and increased compared to the year ended December 31, 2016 by PLN 54 579 thousand. While calculating the provision, the Group adopted the following assumptions: discount rate at 3.3%, inflation level at 2.5%.

31.3.4. Provision for redemption of Energy certificates

Due to the sale of electricity to the final recipients, the Group is obliged to redeem the specified number of certificates of origin of energy from renewable energy sources, gas, and peak load co-generation. As of 31 December 2017, the provision due to this amounted to PLN 8 522 thousand.

31.3.5. Other provisions

In PAK KWB Konin, the main items of other reserves as of 31 December 2017 are: provisions for mining damage in the amount of PLN 3 547 thousand, the provisions for pending legal proceedings in the amount of PLN 530 thousand. In PAK KWB Adamów: provisions for permanent taking out of production for the final reservoir of Adamów open pit in the amount of PLN 15 828 thousand, the provision for mining damage in the amount of PLN 3 383 thousand, the provisions for legal proceedings in the amount of PLN 355 thousand.

32. CO2 emission allowances

Since 1 January 2013, the next reporting period of 2013 – 2020 concerning emission allowances has been applicable. This period's assumption is granting the Group the free EUA allowances resulting from the production of heat, although power engineering was additionally covered by opportunity of derogation. Derogation resulting from Article 10c of the ETS Directive is based on granting additional free allowances, provided that declared investment expenses for investments reported to the National Investment Plan are paid.

The Group submitted a material and financial statement to the Ministry of the Environment for the incurred investment expenses from 1 July 2016 to 30 June 2017. However, due to the uncertainty regarding the emergence of a dual-commodity energy market, including power market, which will have a direct impact on the possible modernisation of units nos. 3 and 4 in the Pątnów Power Plant, despite showing further small expenses, the Group has not applied for free allowances in view of the possible need to return them for not carrying out further modernisation of these units. Therefore, the Group did not receive EUAs for 2017 under Article 10c.For the Elektrownia Pątnów II sp. z o.o.'s system, a specified number of CO_2 emission allowances was allocated. However, for this system, any investment task that would cover receivables for CO_2 emission allowances were not reported to the National Investment Plan, so allocation of free EUA units for this system depends on expenses for tasks conducted for the systems of ZE PAK SA. In 2013-2017, ZE PAK SA did not incur significant expenses so that the part of them would meet the requirements for receiving free EUA allowances by Elektrownia Pątnów II. Currently, Elektrownia Pątnów II sp. z o.o. does not assume that it will receive any free allowances for surplus of the expenses incurred by ZE PAK SA.

In the first half of 2017, the Group received free EUA for heat for 2017 (Article 10a of the ETS Directive) in the amount of 83,317 tonnes. In addition, in the first quarter of 2017, the Group completed purchases of emission allowances as part of forward contracts concluded at the turn of 2015 and 2016 for the production needs of 2016. During 2017, the Group continued to purchase CO2 emission allowances both on the SPOT market and in futures contracts, which will mostly be used to cancel in 2017 and partly provide security for the needs of electricity production in 2018. In April 2017, the Group redeemed CO2 emissions for 2016 in the amount of 11 456 099 tons, and after purchases in the following months, the physical holding of the Group's units on accounts in the Union Registry as at

(in thousand PLN)

December 31, 2017 amounted to 9 776 059 tons, of which 7 051 715 tonnes of ZAK SA and 2 724 344 tons of Pątnów II Power Plant sp. z o. o.

Risk of return of free allowances for CO2 emissions due to discontinuation of investments in blocks 3 and 4 and a gas-steam block

Due to the suspension of investments in blocks 3 and 4 and the gas and steam block, the Management Board of the Company estimated the potential risk of returning free CO2 emission rights in the amount of approximately EUR 6.5 million with interest.

In connection with the submission to the European Commission of a revised National Investment Plan for 2013-2020, the Company asked the Minister of the Environment for the possibility of replacing suspended investment tasks with new tasks. In response, the Minister of the Environment asked for a list of tasks whose deadline for completion indicated in the plan is endangered.

On February 28, 2018, the Company filed a letter to the Minister of the Environment, in which it expressed a desire to balance the value of issued CO2 emission rights for investments related to blocks 3 and 4, the costs of planned investments to be converted. By the date of this report, the Company did not receive a response from the Minister of the Environment.

As at the date of this report, there was no risk of potential reimbursement of free CO2 allowances received related to the above investment tasks and no grounds for creating any provisions for this. The report discloses a conditional obligation regarding the return of allowances.

The following tables present the carbon dioxide emission rights granted under the National Allocation Plan, purchased on the secondary market together with the division into the part used for own needs and sold in the periods ended on December 31, 2017 and December 31, 2016.

CO2 emission allowances in the year ended 31 December 2017

(in tons)		*Zespół Elektrowni Pątnów-Adamów-Konin SA*	*„Elektrownia Pątnów II" sp. z o.o.*
	Emission of CO_2	8 260 668	2 605 436
EUA	Balance at the beginning of the period	12 900 660	920 181
	Purchased	3 496 000	3 832 000
	Free of charge	83 317	-
	Redemption*	(9 428 262)	(2 027 837)
	Sale	-	-
	Exchange	-	-
	Balance at the end of the period	7 051 715	2 724 344

** Physical redemption of the allowances for a given year takes place in the first months of the next year.*

(in thousand PLN)

CO2 emission allowances in the year ended 31 December 2016

(in tons)		*Zespół Elektrowni Pątnów-Adamów-Konin SA*	*„Elektrownia Pątnów II" sp. z o.o.*
	CO_2 emission	9 428 262	2 027 836
EUA	Balance at the beginning of the period	9 689 990	2 567 596
	Purchased	12 687 500	703 000
	Free of charge	430 676	-
	Redemption*	(9 907 506)	(2 350 415)
	Sale	-	-
	Exchange	-	-
	Balance at the end of the period	12 900 660	920 181

** Physical redemption of the allowances for a given year takes place in the first months of the next year.*

33. Trade liabilities, other liabilities and accruals

33.1. Trade liabilities and other financial liabilities (short-term)

	31 December 2017	*31 December 2016*
Trade liabilities	100 503	186 493
Liabilities due to the put option	3 755	6 061
Investment liabilities	15 530	12 814
Liabilities to employees due to salaries	14 452	15 325
other	12 176	81 969
total	146 416	302 662

In the other liabilities line as of 31 December 2017, the Group presents mainly liabilities due to financial lease in the amount of PLN 1 636 thousand (PLN 7 189 thousand in 2016). The remaining amount in the other liabilities item as of 31 December 2017 concerns mostly settlements with employees and deductions from the pay roll amounting to PLN 7104 thousand (PLN 5 315 in 2016) and settlements due to security amounting to PLN 1 111 thousand (PLN 1579 thousand in 2016).

Liabilities due to the put option concern obligation of ZE PAK SA to redeem the employee shares pursuant to the PAK KWB Konin SA and PAK KWB Adamów SA's shares sale agreement, in case when employees request for re-sale. The agreement's provisions determine the price and term of redemption. In accordance with IFSR, ZE PAK recognised the obligation to redeem shares owned by non-controlling interests on the day of the acquisition of control. In relation with the ongoing process of the employee shares redemption, as of 31 December 2017, the remaining liability amount is PLN 3 755 thousand.

Principles and terms of payment of above financial liabilities:

Terms of transactions with affiliates are presented in the note 37 of additional information and explanations.

Liabilities due to supplies and services are not subject to interest and are usually settled within either the 14-day, or 30-day period.

Liabilities due to interests are usually settled within either monthly or quarterly periods during the whole financial year.

(in thousand PLN)

33.2. Trade liabilities and other financial liabilities (long-term)

	31 December 2017	*31 December 2016*
Liability due to financial lease	2 606	3 962
Short-term liabilities to other entities – over 12 months	415	483
Other	2 125	624
Total	5 146	5 069

33.3. Other non-financial liabilities

	31 December 2017	*31 December 2016*
VAT tax liabilities	18 238	13 637
Liabilities due to environmental charges	39 115	48 650
Liabilities due to the excise tax	971	543
Liabilities due to social insurance	23 203	24 373
Personal income tax	6 273	6 200
Other budget liabilities	5 115	7 405
Advanced payments for deliveries	936	4 299
Service charge	11 060	10 771
Other	2 476	553
Total	107 387	116 431

Liabilities due to environmental charges concern charges for air pollution, waste storage, intake of water, and wastewater disposal. The year is a settlement period.

Liabilities due to mining fees concern charges for the extracted mineral resulting from the Geological and Mining Law. The half-year is a settlement period.

33.4. Derivative financial instruments

	31 December 2017	*31 December 2016*
Instruments securing floating interest rates (SWAP)	4 112	10 053
Other currency options	897	-
Total	5 009	10 053
short-term	4 139	5 759
long-term	870	4 294

(in thousand PLN)

33.5. Grants and deferred income (long-term)

	31 December 2017	*31 December 2016*
Long-term grants	41 504	43 006
Other	3 005	296
Total	44 509	43 302

The main component of the "Other" item is land obtained free of charge from the Poviat Starosty and the Commune, amounting to PLN 2 852 thousand

33.6. Grants and deferred income (short-term)

	31 December 2017	*31 December 2016*
Settlement of short-term leaseback	-	5 163
Short-term grants	1 502	1 502
Other	5	5
Total	1 507	6 670

34. Contingent liabilities and description of significant judicial cases

Apart from liabilities described in notes 34.1, 35 and 36 below, as of 31 December 2017, the Group have any other contingent liabilities, guarantees and sureties granted.

34.1. Court proceedings

Compensation for the termination of long-term contracts for sale of power and electricity in Elektrownia Pątnów II

Elektrownia Pątnów II sp. z o.o., receives compensation (advances and their annual adjustments) for the coverage of the stranded costs pursuant to the Act of 29 June 2007 on the principles of coverage of costs incurred by producers due to early termination of long-term agreements for the sale of power and electricity. Appropriately calculated advances and adjustments are recognized in basic sales revenues, with a negative adjustment equivalent to a decrease in revenue. On the basis of the decision of the President of the Energy Regulatory Office SA (“the ERO President”), issued on 31 July 2009, the company was obliged to return the compensation scheme administrator, Zarządca Rozliczeń SA, the amount of zloty 52 493 thousand, due to the negative adjustment of stranded costs for 2008. The company’s Management Board did not agree with the ERO President’s decision and appealed to the Regional Court of Warsaw – Court for Protection of Competition and Consumers (“SOKiK”).

Finally, the issue of a negative correction for 2008 was settled in the judgment of the Court of Appeal of November 4, 2014. Pursuant to this judgment and taking into account the previous settlements between Pątnów II Power Plant sp. o.o. and Zarządca Rozliczeń SA, the company had to return PLN 81.5 million to Zarządca Rozliczeń SA. The judgment of the court was included in the company's statement for the third quarter of 2014 (decrease in revenues by PLN 81.5 million).

On 15 April 2015, Elektrownia Pątnów II sp. z o.o. submitted a cassation appeal from this judgement. On February 24, 2016, the Supreme Court refused to accept the cassation complaint. The judgement of the Supreme Court ended the proceedings.

The judgement of the Court of Appeal in Warsaw of 4 November 2014 is legally binding and is subject to execution by Elektrownia Pątnów II sp. z o.o. In accordance with the arrangements made between Elektrownia Pątnów II sp. z o.o. and Zarządca Rozliczeń SA, the amount being the dispute subject was subsequently repaid to Zarządca Rozliczeń SA according to the adopted payment schedule. The las payment was made on July 28, 2017.

Consequently, the issue of settlement of stranded costs for 2008 between Elektrownia Pątnów II sp. Z o.o. and Zarządca Rozliczeń SA has been completed.

Proceedings due to determining the amount of the annual adjustment of the stranded costs for 2016

On 27 March 2017, the President of the Energy Regulatory Office ("the ERO President") initiated ex officio administrative proceedings in order to determine the amount of the annual adjustment of stranded costs for 2016 for Elektrownia Pątnów II sp. z o.o.

On 27 July 2017 the President of ERO issued a decision fixing the annual cost of stranded costs for Elektrownia Pątnów II sp. z o.o. for 2016 in the amount of PLN 88 354 thousand.

On 29 September 2017, Zarządca Rozliczeń SA paid the amount resulting from the decision of the President of ERO for Elektrownia Pątnów II Sp. z o.o.

The proceeding is completed.

Proceedings on failure to comply with the obligations referred to in Article 49a paragraph 1 and 2 of the Act – Energy law

On 27 September 2016, the President of the Energy Regulatory Office initiated administrative proceedings against Elektrownia Pątnów II sp. z o.o. on its failure to comply with the obligations, referred to in Article 49a paragraph 1 and 2 of the Act – Energy law, i.e. obligation of selling electricity generated in the period from 1 January 2012 to 31 December 2012 by means of the so-called pubic trading.

On 12 October and 21 December 2016, Elektrownia Pątnów II sp. z o.o. sent the appropriate explanations and its position in the above-mentioned issue to the ERO President.

On 28 April 2017 ERO President issued a decision to discontinue the aforementioned proceedings.

The proceeding is completed.

Prosecution of individual interpretation of tax law in scope of returns to Zarządca Rozliczeń S.A. the negative corrections resulting from LTC Act

On 7 July 2017 Elektrownia Pątnów II sp. z o.o. submitted to the Provincial Administrative Court in Poznań (through the Director of National Tax Information Office) a complaint about the individual interpretation of the tax law issued by the Director of National Tax Information dated 20 April 2017 in scope of repayment for Zarządca Rozliczeń SA, on the basis of the agreement between the Parties, liability for repayment of stranded costs for 2008 and other future repayments (negative corrections) from Elektrownia Pątnów II Sp. Z o.o. for Zarządca Rozliczeń S.A., that validity will be based on the Act dated 29 June 2007 of the principles of covering the costs incurred by generators in connection with the termination of long-term contracts for sale of power and electricity (Dz. U. z 2017 r., item 569 with changes, hereinafter referred to as "LTC Act").

On 10 August 2017, the Director of the National Treasury Information Division sent to the Voivodship Administrative Court in Poznań the answers to the above mentioned complaint.

In the opinion of Elektrownia Pątnów II sp. z o.o., all the repayments from Elektrownia Pątnów II Sp. z o.o. for Zarządca Rozliczeń S.A. arising from the LTC Act constitutes the costs of obtaining revenues at the actual time of those payments. The Company reserves the right to include these costs in the settlement for the tax year, in which Zarządca Rozliczeń SA was paid / will be paid. The above is included in the regulation in article 42 pint 4 of LTC Act.

The above opinion complies also with the broad case law in this scope.

Having a different opinion the Director of National Treasury Department, who issued the individual interpretation considered the Company's position to be incorrect and stated that the repayments for Zarządca on the basis of the agreement made in 2014-2017 (within the scope of repayments) in 2017 (in scope of future, not made repayments), and other repayments from The Company for Zarządca, which validity will be based on LCT Act, constitute or will constitute the revenue costs on the day of incurring the costs, i.e. posting in accounting books.

On 18 January 2018, the company won a dispute with the Director of the National Tax Information in the aforementioned case, before the Court of Appeals in Poznań. The verdict of the court means that the company correctly recognized the costs of obtaining income from the abovementioned title.

On 27 March 2018, the Director of the National Tax Information appealed against the court's judgment.

The proceeding is in progress.

Proceedings due to failure to perform obligation to maintain stocks of fuel

On 17 September 2008 and 29 May 2009, the ERO President initiated proceedings on imposing a pecuniary penalty on the ZE PAK SA company due to failure to perform the obligation to maintain fuel stocks securing continuity of electricity and heat supplies to recipients as of 31 December 2007, 31 March 2008, 1 July 2008, 1 September 2008, 1 October 2008, 1 November 2008, 1 December 2008, 1 January 2009, 1 February 2009, and 1 March 2009.

On the basis of the decision of the ERO President of 28 December 2010, the pecuniary penalty, due to failure to perform the obligation to maintain fuel stocks in the quantity securing continuity of electricity and heat supplies to recipients, was imposed on ZE PAK SA in 2008 and 2009 in the amount of zloty 1,500 thousand. Initially, the Company created the provision for the costs of the penalty in the full amount in 2010, which it then redeemed in 2015 in connection with the penalty payment.

On 30 January 2014, the Court for Protection of Competition and Consumers decided about a dismissal of the company's appeal against the ERO President's decision. On 30 April 2014, the Company submitted the appeal to the Court of Appeal in Warsaw.

On 13 May 2015, the Court of Appeal in Warsaw dismissed the Company’s appeal against the judgement of the Court for Protection of Competition and Consumers of 30 January 2014 that consequently upholds the decision of the ERO President.

On 11 December 2015, the Company submitted a cassation appeal from the judgement of the Court of Appeal of Warsaw of 13 May 2015 before the Supreme Court.

On 22 March 2017, the Supreme Court issued a judgement, which revoked the contested sentence of the Court of Appeal in Warsaw of 13 May 2015 and handed over the case to the Court of Appeal in Warsaw for repeated examination and stating on costs of cassation proceedings.

On April 11, 2018, the Warsaw Court of Appeal passed a judgment, which changed the verdict of the Court of Competition and Consumer Protection of January 30, 2014 – by repealing the decision of the President of the Energy Regulatory Office of December 28, 2010. From this judgment, the ERO President is entitled to file a cassation appeal.

The proceeding is not completed.

Proceedings on refund of excise duty overpayment

In light of the regulations mandatory within the European Union, especially regulations of Article 21 paragraph 5 of the Energy Directive, in relation to Article 6 paragraph 1 of the Horizontal Directive, after 1 January 2006, the object of excise tax is sale of energy at the last stage of trade, i.e. sale by the distributor to the final recipient (consumer). Taxation with this tax does not cover an earlier stage of trade, e.g. between the producer of electricity and its distributor. In this case, the tax obligation arises at the time of supply of electricity to the consumer.

As at 1 March 2009, the Act of 6 December 2008 on excise duty entered into force, according to which the sale of electricity to an entity which is not its final customer is not subject to excise duty.

Due to the above fact, pursuant to Article 75 § 1, in relation to Article 75 § 2 of the Act of 29 August 1997 – Tax Ordinance, ZE PAK SA submitted applications for stating overpayment of the excise tax for 2006, 2007, 2008, as well as January and February 2009 for the total amount of PLN 626 million, with the justification that pursuant to the regulations of the EU law and the judicial decisions of the Provincial Administrative Courts, the activities executed by ZE PAK SA are not subject to the excise tax. Particular applications were recognised at the following levels: the Customs Office in Kalisz, the Customs Chamber in Poznań, and, currently, the Provincial Administrative Court in Poznań („PAC”), as well as the Supreme Administrative Court. Due to the position of judicature presented in the course of court proceedings, the amount of overpayment, the repayment of which the Company submits, has been reduced to the amount of damages caused by economic analyses, i.e. currently up to the amount of approximately PLN 108 million.

Moreover, in association with the rulings of the Administrative Courts regarding other power companies, in the subject of overpaid excise duty and the resolution I GPS 1/11 of the National Administrative Court (”NSA”) of 22 June 2011 (where the NSA ruled that transferring the tax load in price, excludes the possibility to return the overpayment), notwithstanding the ongoing administrative proceedings, on 10 February 2012, the Company initiated a civil-law proceedings, filling an application to summon the State Treasury to a conciliation hearing regarding the amount of PLN 626 406 thousand, to the District Court Warszawa Śródmieście. A conciliatory settlement was not reached since during the hearing of 16 April 2012, the representatives of the Treasury did not agree to settle. Simultaneously, the Company, waiting for the results of the tax proceedings regarding the previously submitted application for overpayment, submitted in writing, on 14 September 2012, in the Customs Chamber in Poznań, additional explanations in the form of results of a detailed economic analysis, the purpose of which was to demonstrate whether the Company suffered loss related to the payment of excise tax to which it was not obliged. The Company's opinion is that the submitted document also applies to other overpayment applications from the entire period embraced by the proceedings, i.e. between January 2006 and February 2009. Ultimately, all applications were included in the cause lists of the Provincial Administrative Court (WSA) and the Supreme Administrative Court (NSA). As of the date of development of this statement, the status of the proceeding is as follows:

- Twenty two cases for the period of January 2006 – November 2007 (excluding November 2006) were conducted again from the start by the Head of the Customs Office, after the cases returned from the Supreme Administrative Court. The Company submitted monthly economic analyses of suffering the prejudice. After the negative decisions of the Head of the Customs Office and then of the Head of Customs Chamber, complaints were submitted to the Provincial Administrative Court in Poznań, Hearings before the Provincial Administrative Court in Poznań took place on 4 and 18 November 2015. In all cases, negative judgements for the Company were issued. In February 2016, the Company submitted cassation appeals to the Supreme Administrative Court. The Supreme Administrative Court dismissed the Company's cassation appeals in the abovementioned 22 cases at the hearings held on April 10 and 11, 2018.
- 14 proceedings for the period of December 2007 – February 2009 (excluding July 2008) on 26 January 2017, hearings took place before the Provincial Administrative Court in Poznań. In all the cases, the Company's appeals against the Customs Chamber in Poznań were dismissed. The Company submitted applications for a written justification of the judgement, which were obtained on 7 March 2017, to the Provincial Administrative Court. Currently, the Company analyses justifications and prepares the applications of cassation appeals to the Supreme Administrative Court,
- the proceeding for November 2006 was concluded with a negative judgement of the Supreme Administrative Court of 8 December 2011,
- the proceeding for July 2008 reached the recognition of our cassation appeal by the Supreme Administrative Court. On the hearing on 29 April 2015, the Supreme Administrative Court dismissed the Company's cassation appeal and pointed out that it fully agrees with the Provincial Administrative Court in Poznań in the judgement, against which the cassation appeal was submitted.

Notwithstanding the foregoing proceedings, ZE PAK SA lodged a complaint against the actions of the Polish authorities to the European Commission ("EC"), pursuant to art. 258 of the Treaty on the Functioning of the European Union. The opinion issued by the EC may oblige the Polish tax authorities to pass a ruling beneficial to ZE PAK SA. On 21 March 2017, ZE PAK SA received a "pre-closure letter" from the EC, which initially denied the relevance of ZE PAK SA's position, however, at the same time giving the right to a second comment on the subject, which ZE PAK SA exercised. On 9 June 2017, a letter summarising the reasoning of ZE PAK SA, in terms of the overpaid excise tax. Currently, ZE PAK SA is awaiting the EC to take the final position on the case in question.

In case of the Elektrownia Pątnów II sp. z o.o., the proceedings for all periods (one case) were included in the cause lists of the Provincial Administrative Court after a negative decision of the Head of Customs Chamber. The aforementioned company does not have access to comparative analyses of suffering the prejudice. On 4 November 2015, a hearing in the Provincial Administrative Court in Poznań took place. On 18 November 2015, a negative ruling was given. On 8 February 2016, the company filed a cassation appeal to the Supreme Administrative Court. Currently, Elektrownia Pątnów II sp. z o.o. is awaiting the setting of a hearing before the Supreme Administrative Court. The Supreme Administrative Court dismissed the Company's cassation complaint at the hearing held on April 11, 2018.

Proceedings on an environmental decision issued to PAK KWB Konin SA concerning lignite deposit in Tomisławice

PAK KWB Konin SA is a party in the administrative proceedings related to the environmental decision regarding the lignite deposit in Tomisławice. On 7 August 2007, the Head of Wierzbinek Commune issued an environmental decision regarding the lignite open cast. On 5 December 2008, this decision was contested by nine physical persons supported by the Greenpeace organisation due to alleged major infringement of the regulations of the law.

On 25 March 2009, the Self-government Appeal Court dismissed the application to reverse the environmental decision. The plaintiffs applied for the judicial review. On 4 May 2009, after the judicial review, the Self-government Appeal Court sustained its previous decision. The plaintiffs again appealed against the environmental decision. On 5 May 2010, the Provincial Administrative Court in Poznań ruled that the environmental decision, pursuant to which the license for the extraction of lignite at the Tomisławice deposit was granted, infringes the regulations of the law in a major manner. PAK KWBK SA and the Self-government Appeal Court submitted an appeal against this judgement. On 21 March 2012, the Supreme Administrative Court overturned the contested decision of the Provincial Administrative Court in Poznań and referred the matter for reconsideration. On 6 November 2012, the Provincial Administrative Court in Poznań announced the decision repealing the decision of the Self-government Appeal Court of 25 March 2009 refusing to declare the invalidity of the environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune, related to the extraction of lignite from the Tomisławice open pit by PAK KWBK SA On 7 January 2013, PAK KWBK Konin SA submitted a cassation appeal from the described decision.

After the review on the hearing on 7 October 2014, the Supreme Administrative Court dismissed the cassation appeal of PAK Kopalnia Węgla Brunatnego Konin SA from the judgement of the Provincial Administrative Court in Poznań of 6 November 2012 repealing the decision of the Self-government Appeal Court in Konin of 25 March 2009 refusing the annulment of the environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune related to the extraction of lignite from Tomisławice open pit.

Dismissal of the cassation appeal of PAK Kopalnia Węgla Brunatnego Konin SA means that the judgement of the Provincial Administrative Court in Poznań of 6 November 2012 became legally binding and the case regarding the statement of invalidity of the environmental decision will be examined again by the Self-government Appeal Court. On 1 October 2015, the Self-government Appeal Court issued a decision to suspend the proceedings on the statement of invalidity of the environmental decision issued by the Head of Wierzbinek Commune in connection with the unfinished European Commission proceedings against the Polish government on breach of the provisions concerning the environment protection in connection with the lignite deposit in Tomisławice. In the case of a ruling on suspending the proceedings, a separate proceeding is under way.

The decision of the Supreme Administrative Court in Warsaw of 7 October 2014 does not invalidate the environmental decision issued by the Head of Wierzbinek Commune and does not halt the extraction and utilisation works at Tomisławice open pit. The environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune is still in legal transactions, and until the issue of a final judgement by the Self-government Appeal Court, it exerts legal effects.

Proceedings on an environmental decision on lignite deposit in Ościsłowo

On 13 March 2017, PAK KWB Konin SA received the decision of the Regional Director for Environmental Protection in Poznań (“RDOŚ in Poznań”) of 10 March 2017, refusing the establishment of the environmental conditions for the investment titled: “Extraction of lignite and associated minerals from the Ościsłowo Open Pit.” The decision of RDOŚ in Poznań is not final. PAK KWB Konin SA appealed accordingly to the General Directorate for Environmental Protection in Warsaw. The appeal included a request to revoke the appealed ruling in its entirety and determine the environmental conditions for the execution of the above-mentioned project. On 30 November 2017, General Director of Environmental Protection in Warsaw has decided to repeal a decision in its entirety (contested by PAK KWB Konin SA - a subsidiary of the Company) of the Regional Director for Environmental Protection in Poznań ("RDOŚ in Poznań") dated March 10, 2017, refusing to specify environmental conditions for the project entitled: " Extraction of lignite and associated minerals from Ościsłowo Open Pit" and forward the case for reconsideration by RDOŚ in Poznań.

PAK KWB Konin SA, by letter of December 18, 2017 filed an objection against the abovementioned decision of GDOŚ in Warsaw to the Provincial Administrative Court in Warsaw (WSA). In the opinion of PAK KWB Konin S.A. there were grounds for issuing a reformatory decision by GDOŚ in Warsaw, i.e. amending the contested decision of RDOŚ in Poznań and substantive decision in this matter, not referring the matter for reconsideration. The other party also opposed the WSA. Both objections were dismissed by the WSA. The verdict was passed on March 1, 2018. On April 12, 2018, PAK KWB Konin SA filed a cassation complaint with the Supreme Administrative Court in Warsaw against the verdict of the WSA in Warsaw of 1 March 2018.

At present, the case is being reconsidered by RDOŚ in Poznań, which informed about June 5, 2018 as the new date of settling the matter.

The proceedings for issuing the environmental decision were initiated on 16 September 2015.

34.2. Tax settlements

Tax settlements and other regulated areas of activities (for example, customs or foreign exchange matters) may be the subject of inspection of the administrative authorities entitled to impose high penalties and sanctions. The lack of reference to fixed legal regulations in Poland causes ambiguities and inconsistencies of the laws in force. Common differences in opinions as to the legal interpretation of the tax law, both inside national authorities, as well as between them and companies, cause uncertainty and conflicts. Such phenomena result in the significantly higher tax risk in Poland than these normally existing in the countries of a more developed tax system.

Tax settlements may be subject to inspection for a period of five years, starting from the end of the year of the tax payment. As a result of the conducted inspections, the current tax settlements of the Group may be increased by additional tax liabilities. In the Group's opinion, as of 31 December 2016 and 31 December 2015, appropriate provisions for the recognised and calculable tax risk were created.

In 2017, the audit of the corporate income tax for 2016 was carried out in the company Elektrownia Pątnów II sp. z o.o. In the opinion of Elektrownia Pątnów II sp. z o.o. all returns / repayments from Elektrownia Pątnów II sp. o.o. for Zarządca Rozliczeń SA arising from the LTC Act constitute tax deductible costs when the repayments are actually made. Elektrownia Pątnów II sp. z o.o. has the right to include these costs in the settlement for the tax year in which the settlement was / will be made to Zarządca Rozliczeń SA. This is determined by the regulation contained in art. 42 section 4 of the LTC Act. The company's above-mentioned opinion is also in line with broad court decisions in this area.

Having a different opinion the Director of National Treasury Department, who issued the individual interpretation considered the Company's position to be incorrect and stated that the repayments for Zarządca on the basis of the agreement made in 2014-2017 (within the scope of repayments) in 2017 (in scope of future, not made repayments), and other repayments from The Company for Zarządca, which validity will be based on LCT Act, constitute or will constitute the revenue costs on the day of incurring the costs, i.e. posting in accounting books.

On January 18, 2018, the Provincial Administrative Court in Poznań responded to the abovementioned complaint of Elektrownia Pątnów II sp. o.o., issued a verdict abrogating the contested Interpretations of the Director of the National Tax Information dated 20 April 2017. In the justification of the judgment, the WSA shared the position of Elektrownia Pątnów II sp. z o.o. that in the present case, contrary to the tax authority's position, general rules defining the day of tax deductible costs, which were set out in the Act on Corporate Income Tax (hereinafter 'u.p.d.o.p'), cannot be applied, in particular in art. 15. In the present case, the provision of Article 42 section 4 of the LTC Act as "Lex Specialis" to the provisions of the Law on u.p.d.o.p.

The verdict of the Provincial Administrative Court in Poznań confirmed that the Pątnów II Power Plant sp. Z o.o. proceeded correctly including all refunds / repayments from Elektrownia Pątnów II sp. o.o. to Zarządca Rozliczeń SA under the LTC Act to the tax deductible costs at the time of actual repayment.

For Elektrownia Pątnów II sp. Z o.o. the above sentence means lowering the tax risk and confirming the correct tax asset settlement for the years 2014-2016. The above verdict of the Provincial Administrative Court, at the same time, constitutes a security for the position of Elektrownia Pątnów II sp. z o.o., which disagreed with the result of the 2016 tax audit carried out in 2017 on the basis of income tax from legal persons.

In the minutes of the inspection of October 31, 2017, the Head of the Second Wielkopolska Tax Office in Kalisz shared the position expressed by the Director of the National Tax Information in the interpretation of 20 April 2017.

On November 14, 2017, Elektrownia Pątnów II sp. z o.o. raised objections to the aforementioned tax inspection protocol and disagreed with the position of the tax authorities, in the scope of the Tax Office's questioning of the manner of recognition as tax-deductible costs, expenses due to the return of funds to cover stranded costs by Zarządca Rozliczeń SA At the same time, Elektrownia Pątnów II sp. z o.o. indicated that the most reasonable solution would be to abstain from all actions in this case until a judicial decision on the complaint regarding the individual interpretation of tax law, issued by the Director of the National Tax Information dated 20 April 2017, was obtained.

On 27 March 2018, the Director of the National Tax Information filed a cassation complaint from the Judgment of the Provincial Administrative Court in Poznań of January 18, 2018.

With reference to the above, on 17 April 2018 Elektrownia Pątnów II sp. Z o.o. received the decision of the Head of the Second Wielkopolska Tax Office in Kalisz to initiate tax proceedings regarding the settlement of the corporate income tax for 2016.

As at the date of the report, Elektrownia Pątnów II sp. Z o.o. expects that in the next step, the Head of the Second Wielkopolska Tax Office in Kalisz will suspend the tax proceedings initiated in April 2018 pending resolution of the matter concerning the recognition by the Tax Office of the method of recognition in 2016 as tax deductible expenses, expenses due to the return of the Clearing Administrator funds to cover stranded costs.

(in thousand PLN)

35. Liability repayment securities

In order to protect the repayment of liabilities, the Group uses many forms of protections. Mortgages and registered pledges are the most common ones.

As of 31 December 2017 and 31 December 2016, the Group had liabilities protected with its assets and other protections of payment of liabilities:

Liabilities secured with the assets

Agreement	*Kind of security*	*31 December 2017 Security amount*	*currency*	*31 December 2016 Security amount*	*currency*
Syndicated loan agreement of 13 March 2014 for PLN 667 million for ZE PAK SA	Registered pledge on a collection of items Registered pledge on bank accounts Joint contractual mortgage established on real estate	Up to 2 040 000	PLN	Up to 2 040 000	PLN
Syndicated loan agreement dated 14 January 2011 for EUR 240 million for Pątnów II Power Plant	Registered and financial pledge on shares of ZE PAK in PAK Infrastruktura and PAK-HOLDCO Registered and financial pledge on shares of PAK-HOLDCO in Elektrownia Pątnów II Joint contractual mortgage established on the property of Pątnów II and PAK Infrastruktura Registered pledge on a collection of items Registered pledge on bank accounts	Up to 400 000 Up to 339 750	EUR PLN	Up to 400 000 Up to 339 750	EUR PLN
Multi-purpose line of November 20, 2013 for PLN 76.7 million for PAK KWB Konin	Registered pledge on fixed assets	Up to 153 400	PLN	Up to 100 500	PLN
	Mortgage on perpetual usufruct right	-		Up to 100 500	
Agreement of the guarantee line of June 8, 2007 for PAK Serwis	Registered pledge on fixed assets	Up to 5 674	PLN	-	PLN

Other securities of liabilities

Guarantees given

Kind of security	*31 December 2017 Security amount*	*currency*	*31 December 2016 Security amount*	*currency*
Guarantees of good performance of the contract	14 500	PLN	14 581	PLN
Guarantees to remove defects and faults	4 135 419	PLN EUR	4 264 279	PLN EUR
Payment guarantees	145	PLN	131	PLN

(in thousand PLN)

Guarantee of advance payment	1 329	PLN	5 658	PLN

In addition, the Group uses as collateral the repayment of liabilities, assignments from sales contracts, assignment from insurance policies, power of attorney to bank accounts and a statement on submission to enforcement.

In addition, intra-group guarantees are used in the Capital Group as collateral for repayment of liabilities.

The table below shows the sum of granted guarantees.

	31 December 2017	*currency*	*31 December 2016*	*currency*
Intra-Group Guarantees	50 000	PLN	143 500	PLN

36. Obtained guaranties and sureties

Kind of security	*31 December 2017* *Security amount*	*currency*	*31 December 2016* *Security amount*	*currency*
Guarantees of good performance of the contract	19 752	PLN	44 036	PLN
Guarantees to remove defects and faults	-	EUR	34	EUR
	2 245	PLN	2 889	PLN
Payment guarantees	18	EUR	-	EUR
Guarantee of advance payment	32 004	PLN	47 512	PLN
Guarantees of good performance of the contract	5 149	EUR	-	EUR
Guarantees to remove defects and faults	2 399	PLN	6 958	PLN

The Group has sureties received, these are only intra-group guarantees.

The value of guarantees received is in line with the value of sureties granted described in Note 35.

37. Information about related entities

The following table presents total amounts of transactions concluded with affiliates for the current and next financial years:

Related entity		*Sales to related entities*	*Purchase from related entities*	*Receivables from related entities*	*Liabilities towards related entities*
Elektrim SA	2017	-	120	-	-
	2016	-	121	-	-
Megadex Serwis Sp. z o.o.	2017	3	-	-	-
	2016	1	47 182	210	5 432
Polkomtel sp. z o.o.	2017	128 970	3 979	16 859	475
	2016	120 642	4 530	15 400	891
Laris Investments sp. z o.o.	2017	463	821	251	-
	2016	501	974	217	22

(in thousand PLN)

CPE sp. z o.o.	2017	-	1 089	-	11
	2016	-	-	-	-
Plus Flota sp. z o.o.	2017	-	628	-	357
	2016	-	-	-	-
Total	**2017**	**129 436**	**6 637**	**17 110**	**843**
	2016	**121 144**	**52 807**	**15 827**	**6 345**

37.1. Loan granted to a member of the Management Board

Both in the financial year ended 31 December 2017 and in the one ended 31 December 2016, the Parent Company did not grant any loans and similar benefits to members of the management and supervisory staff.

37.2. Other transactions involving members of the Management Board

Both in the financial year ended 31 December 2017 and in the one ended 31 December 2016, there were no transactions with members of management and supervisory staff.

37.3. Remuneration of Chief executive Staff of the Group

37.3.1. Remuneration paid or payable to the members of the Management Board and to the members of the Supervisory Council of the Group

	12 months period ended	*12 months period ended*
	31 December 2017	*31 December 2016*
Management Board of the parent company		
Short-term employee benefits	2 400	2 989
Benefits for termination of the contract of employment	-	28
Supervisory Board of the parent company		
Short-term employee benefits	993	1 095
Management Boards of subsidiaries		
Short-term employee benefits	4 235	5 453
Post-employment benefits	19	-
Benefits for termination of the contract of employment	105	-
Supervisory Board of subsidiaries		
Short-term employee benefits	16	14
Total	7 768	9 579

37.3.2. Remuneration paid or entitled to other members of the main management

	12 months period ended	*12 months period ended*
	31 December 2017	*31 December 2016*
Short-term employee benefits	14 701	15 389
Jubilee awards	-	96
Post-employment benefits	15	7

(in thousand PLN)

Benefits for termination of the contract of employment	317	247
Total amount of remuneration paid to the chief executive staff (except for members of the Management Board and the Supervisory Board)	15 033	15 739

38. Information about the remuneration of the statutory auditor or the entity entitled to audit accounts

The following table presents the remuneration of an entity entitled to audit accounts paid or due to the year ended 31 December 2017, and for the year ended 31 December 2016, divided into types of services:

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Compulsory examination and unit review and consolidated financial statements	194	212
Other services	23	104
Total	217	316

39. Goals and rules of financial risk management

Apart from derivatives, the main financial instruments, used by the Group, consist of bank credits, loans granted from affiliates and other institutions, funds, and short-term deposits. The main goal of these financial instruments is to obtain funds for the Group's activities. The Group also has other financial instruments, such as receivables and liabilities due to supplies and services created directly within its conducted activities.

The Group also concluded transactions with the use of derivatives, above all, the contracts for a change in interest rates (interest rate swaps). The goal of these transactions includes the interest rate risk management arising within the Group's activities, and resulting from financing resources used by it.

The rule which is applied by the Group currently and through the whole period included in the statement is non-conducting of the exchange of financial instruments.

The main kinds of the risk resulting from the Group's financial instruments include the interest rate risk, liquidity risk, foreign currency risk, and credit risk. The Management Board verifies and consults the rules of management of each of these kinds of risk – these rules were discussed shortly below. The Group also monitors the market price risk regarding all its held financial instruments.

39.1. Interest rate risk

Exposure of the Group to risk caused by the changes of interest rates mainly concerns long-term financial liabilities.

The Group uses financial liabilities, mostly variable rate credits and loans.

In order to minimise interest rate risk, the Group concluded contract for interest rates change (interest rate swaps), within which it agreed to change, within specified time intervals, the difference between the amount of interests calculated according to the fixed and the variable rate of the agreed main amount. The transactions are to protect incurred financial liabilities.

Interest rate risk – the sensitivity gap

In the interest rate sensitivity gap analysis, the Group uses yield curve shift by potential possible change of benchmark interest rates during the coming year. For the needs of the interest rate sensitivity gap analysis, average levels of benchmark interest rates in a given year were used. The scale of potential interest rate sensitivity gap was estimated on the basis of volatilities implied of ATMF options for the interest rate quoted on the inter-bank market for foreign currencies, for which the Group has the exposition to interest rate risk from the balance sheet date.

(in thousand PLN)

	31 December 2017		*Interest rate risk sensitivity study as of 31 December 2017*							
			WIBOR				*EURIBOR*			
Classes of financial instruments			*WIBOR + 44*		*WIBOR - 44*		*EURIBOR + 10.05*		*EURIBOR - 10.05*	
	Carrying amount	*value at risk*	*Profit/loss*	*Other comprehensive income*	*Profit/loss*	*Other comprehensive income*	*Profit/loss*	*Other comprehensive income*	*Profit/loss*	*Other comprehensive income*
Other financial assets	46 099	43 995	37	-	(37)	-	36	-	(36)	-
Trade and other receivables	253 261	-	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	-	-	-	-	-
Cash and cash equivalents	322 201	322 201	1 249	-	(1 249)	-	38	-	(38)	-
Interest-bearing loans and borrowings	(652 038)	(652 038)	(1 820)	-	1 820	-	(239)	-	239	-
Trade payables and other financial liabilities	(151 562)	-	-	-	-	-	-	-	-	-
Derivative financial instruments	(5 009)	(5 009)	-	-	-	-	-	125	-	(125)
Total	**(187 048)**	**(290 851)**	**(534)**	**-**	**534**	**-**	**(165)**	**125**	**165**	**(125)**

(in thousand PLN)

Classes of financial instruments	**31 December 2016**		**Interest rate risk sensitivity study as of 31 December 2016**							
			WIBOR				*EURIBOR*			
			WIBOR + 62		*WIBOR - 62*		*EURIBOR + 18.92*		*EURIBOR – 18.92*	
	Carrying amount	*Value at risk*	*Profit / loss*	*Other comprehensive income*	*Profit / loss*	*Other comprehensive income*	*Profit / loss*	*Other comprehensive income*	*Profit / loss*	*Other comprehensive income*
Other financial assets	89 262	86 834	68	-	(68)	-	143	-	(143)	-
Trade and other receivables	246 025	-	-	-	-	-	-	-	-	-
Derivative financial instruments	296	-	-	-	-	-	-	-	-	-
Cash and cash equivalents	350 101	350 101	1 399	-	(1 399)	-	235	-	(235)	-
Interest-bearing loans and borrowings	(1 009 809)	(1 009 809)	(3 861)	-	3 861	-	(732)	-	732	-
Trade payables and other financial liabilities	(307 731)	-	-	-	-	-	-	-	-	-
Derivative financial instruments	(10 053)	(10 053)	-	-	-	-	-	587	-	(587)
Total	**(641 909)**	**(582 927)**	**(2 394)**	-	**2 394**	**-**	**(354)**	**587**	**354**	**(587)**

39.2. Currency risk

The Group is exposed to currency risk due to concluded transactions. Such a risk relates to liabilities due to loans and advances. In 2017, two companies of the Group applied instruments to limit the risk resulting from changes in foreign exchange rates. ZE PAK SA hedged the euro exchange rate for a part of cash flows related to the purchase of CO2 emission allowances. To hedge the exchange, forward transactions were made with the settlement date in March 2018. The Pątnów II power plant secured the euro exchange rate for a part of the flows related to the repayment of the consortium loan instalment, also applying a forward transaction with the settlement date in April 2018. Potential possible changes in exchange rates have been calculated on the basis of the annual volatilities implied for currency options quoted on the interbank market for a given currency pair from the balance sheet date.

The Group identifies the exposure to EUR/PLN exchange rate changes. The below table presents the gross financial result sensitivity for exchange rate changes rationally possible to occur, assuming non-variability of other risk factors for these classes of financial instruments exposed to the exchange rate change risk.

(in thousand PLN)

Classes of financial instruments	*31 December 2017*		***Analysis of sensitivity to interest rate risk as of 31 December 2017***			
			EUR/PLN			
			EUR/PLN + 6.2%		**EUR/PLN - 6.2%**	
			4.4295		**3.9123**	
	Carrying amount	***Value at risk***	***Profit/loss***	***Other comprehensive income***	***Profit/loss***	***Other comprehensive income***
Other financial assets	46 099	35 630	2 209	-	(2 209)	-
Trade and other receivables	253 261	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	-
Cash and cash equivalents	322 201	38 235	2 371	-	(2 371)	-
Interest-bearing loans and borrowings	(652 038)	(238 271)	(14 773)	-	14 773	-
Trade payables and other financial liabilities	(151 562)	(1 860)	(115)	-	115	-
Derivative financial instruments	(5 009)	-	-	-	-	-
Total	**(187 048)**	**(166 266)**	**(10 308)**	**-**	**10 308**	**-**

(in thousand PLN)

Classes of financial instruments	**31 December 2016**		**Analysis of sensitivity to interest rate risk as of 31 December 2016**			
			EUR/PLN			
			EUR/PLN + 7.75%		**EUR/PLN – 7.75%**	
			4.7669		**4.0811**	
	Carrying amount	***Value at risk***	***Profit / loss***	***Other comprehensive income***	***Profit / loss***	***Other comprehensive income***
Other financial assets	89 262	75 813	5 875	-	(5 875)	-
Trade and other receivables	246 025	3 754	291	-	(291)	-
Derivative financial instruments	296	-	-	-	-	-
Cash and cash equivalents	350 101	124 422	9 643	-	(9 643)	-
Interest-bearing loans and borrowings	(1 009 809)	(387 123)	(30 002)	-	30 002	-
Trade payables and other financial liabilities	(307 731)	(60 927)	(4 722)	-	4 722	-
Derivative financial instruments	(10 053)	-	-	-	-	-
Total	**(641 909)**	**(244 061)**	**(18 915)**	**-**	**18 915**	**-**

39.3. Commodity prices risk

The company is exposed to influence and the adverse impact of risk factors associated with the volatility of cash flows and financial results due to the changes in the prices of commodity prices. Exposure to the commodity prices risk is reflected by the volume of purchases of basic raw materials, which are mostly lignite and biomass of wood and agricultural origin.

The volume and costs of consumption of the main raw materials are presented in the table below:

	2017		*2016*	
	Volume (tons)	*Consumption cost (in PLN thousand)*	*Volume (tons)*	*Consumption cost (in PLN thousand)*
Fuel				
Lignite	11 666 228	763 820	12 549 649	755 463
Forestry biomass	3 917	499	367 137	51 962
Agricultural biomass	908	189	94 785	22 876
Fuel oil	12 203	19 079	13 963	19 473
Sorbent	159 761	13 084	235 717	17 643

39.4. Credit risk

The credit risk is a potential credit event, which may be materialised in the form of the following factors: the counterparty's insolvency, partial repayment of receivables, significant delay in repayment of receivables, or another not predicted derogation from contractual terms.

The Group concludes transactions only with reputable companies of good credit rating. All clients who want to use trade credit terms, are subject to procedures of initial verification. Moreover, thanks to current monitoring of receivables, the Group's exposure to the risk of unrecoverable receivables is insignificant.

The main recipients of electricity include the companies with a significant position in the electricity trade sector, such as Energa Obrót, ENEA Trading, Tauron Polska Energia, Alpiq Energy, InterEnergia and PSE Operator. The transactions concluded on the exchange market are settled on a day-to-day basis by the Towarowa Giełda Energii SA Company, which minimises the credit risk.

In relation to other financial assets of the Group, such as funds and their equivalents, financial assets available for sale, and some derivatives, the Group's credit risk occurs as a result of incapability of payment by the other party of the agreement, and the maximum exposure to this risk is equal to the balance sheet value of these derivatives.

39.5. Liquidity risk

The Group monitors risk to a shortage of funds by means of the tool for periodic planning of liquidity. This tool takes into account maturity dates of both investment and financial assets (e.g. receivables accounts, other financial assets), as well as projected cash flows from operating activities.

The goal of the Group is maintenance of balance between continuity and flexibility of financing through use of various resources of financing, such as overdraft facilities, bank credits, debentures, preferred shares, financial lease agreements, and lease agreements with purchase option.

The tables below present financial liabilities of the Group as of 31 December 2017 and 31 December 2016 according to the maturity date based on contractual non-discounted payments.

(in thousand PLN)

31 December 2017	*Less than 3 months*	*3 - 12 months*	*1 - 5 years*	*Over 5 years*	*Total*
Interest bearing loans and borrowings	75 064	281 629	321 592	-	678 285
Trade payables and other financial liabilities	64 728	81 688	5 146	-	151 562
Derivative financial instruments	39 176	25 618	812	-	65 606
	178 968	**388 935**	**327 550**	**-**	**895 453**

31 December 2016	*Less than 3 months*	*3 - 12 months*	*1 - 5 years*	*Over 5 years*	*Total*
Interest bearing loans and borrowings	100 041	329 180	634 191	-	1 063 412
Trade payables and other financial liabilities	240 997	61 665	5 069	-	307 731
Derivative financial instruments	14 446	3 716	3 973	-	22 135
	355 484	**394 561**	**643 233**	**-**	**1 393 278**

Derivative instruments indicated in above tables were presented in gross values of non-discounted payments. However, these contracts can be settled either in gross values, or net amounts.

The tables shown below present agreements of these values to balance sheet values of derivative instruments:

(in thousand PLN)

31 December 2017	*On demand*	*Less than 3 months*	*3 – 12 months*	*1 – 5 years*	*Over 5 years*	*Total*
Inflows	-	(102)	(203)	(55)	-	(360)
Outflows	-	950	1 983	812	-	3 745
Net amounts	-	(1 052)	(2 186)	(867)	-	(4 105)
Discounted using appropriate interbank rates	**-**	**(1 949)**	**(2 190)**	**(870)**	**-**	**(5 009)**

31 December 2016	*On demand*	*Less than 3 months*	*3 – 12 months*	*1 – 5 years*	*Over 5 years*	*Total*
Inflows	-	(154)	(365)	(302)	-	(821)
Outflows	-	1 516	3 716	3 973	-	9 205
Net amounts	-	(1 670)	(4 081)	(4 275)	-	(10 026)
Discounted using appropriate interbank rates	**-**	**(1 671)**	**(4 088)**	**(4 294)**	**-**	**(10 053)**

(in thousand PLN)

40. Financial instruments

40.1. Balance sheet value and fair value of particular classes of financial instruments

The table shown below presents a comparison between balance sheet values and fair values of all financial instruments of the Group, divided into particular classes and categories of assets and liabilities according to IAS 39.

		Balance sheet value			
Financial assets	Category according to 39	*31 December 2017*	*31 December 2016*	*31 December 2017*	*31 December 2016*
Other financial assets	PiN	46 099	89 262		
Trade receivables and other receivables	PiN	253 261	246 025		
Derivative financial instruments	WwWGpWF	-	296		
Cash and cash equivalents	UdtW	322 201	350 101		
Financial liabilities					
Interest-bearing bank credits and loans, including:		652 038	1 009 809		
long term	PZFwgZK	302 465	587 851		
short term	PZFwgZK	349 573	421 958		
Liabilities due to supplies and services and other financial liabilities	PZFwgZK	151 562	307 731		
Derivative financial instruments		5 009	10 053		

Used abbreviations:

UdtW – *Financial assets maintained to the maturity date,*

WwWGpWF – *Financial assets/liabilities evaluated in the fair value by the financial result,*

PiN – *Loans and receivables*

DDS – *Financial assets available for sale,*

PZFwgZK – *Other financial liabilities evaluated according to the depreciated cost.*

(in thousand PLN)

As of 31 December 2016 and 31 December 2015, the Group had following financial instruments evaluated in the fair value:

	31 December 2017	*Level 1*	*Level 2*	*Level 3*
Derivatives hedging assets	-	-	-	-
Derivatives hedging liabilities	-	-	5 009	-

	31 December 2016	*Level 1*	*Level 2*	*Level 3*
Derivatives hedging assets	-	-	296	-
Derivatives hedging liabilities	-	-	10 053	-

The fair value of financial instruments other than derivatives as at December 31, 2017 and December 31, 2016 did not deviate significantly from the carrying amounts, mainly due to the fact that for short-term instruments the effect of discounting is not material and the fact that the transactions are concluded at market conditions; for this reason, the fair value of these instruments has been presented at the carrying amount.

The valuation of interest-bearing loans and credits after the initial recognition is carried out according to the depreciated cost method, taking into account the contractual costs related to obtaining a given loan or borrowing as well as discounts and earned bonuses.

As at December 31, 2017, Interest Rate Swap derivatives and forward transactions for currency purchase were valued at fair value. The Interest Rate Swap valuation methodology is presented in note 40.3. For the purposes of valuing foreign exchange contracts, the difference between discounted future cash flows is calculated between the forward price on the valuation day and the transaction price, according to quotations prepared by the relevant bank, multiplied by the nominal value of the contract in a foreign currency. The valuation of these instruments has been classified to level 2 of the fair value measurement hierarchy.

In the period ended 31 December 2017 and the one ended 31 December 2016, there were no shifts between the level 1 and the level 2 of the fair value hierarchy, and none of instruments was shifted to the level 3 of the fair value hierarchy

(in thousand PLN)

40.2. Items of revenue, costs, profits and losses included in the income statement divided into categories of financial instruments

12 month period ended 31 December 2017

	Revenues /(costs) due to interests (including effect of valuation with depreciated cost)	*Profits / (losses) due to exchange rate differences*	*Redemption / (creation) of impairment write-downs*	*Profits/(losses) due to derivative instruments*	*Other*	*Total*
Financial assets						
Cash and cash equivalents	3 179	(1 956)	-	-	-	1 223
Other short-term financial assets	1	(10 020)	-	-	(10)	(10 029)
Deliveries and services receivables	33	(38)	(16)	-	80	59
Other receivables	315	-	-	-	-	315
Derivative instrument	-	-	-	368	-	368
Financial liabilities						
Credit and loan liabilities (long- and short-term ones)	(26 065)	24 190	-	-	(527)	(2 402)
Deliveries and services liabilities	(143)	202	-	-	-	59
Other financial liabilities (without instruments)	(226)	-	-	-	-	(226)
Derivative instruments	-	-	-	(7 404)	-	(7 404)
Other liabilities	(793)	1	(11 166)	-	(1 273)	(13 231)
Total	(23 699)	12 379	(11 182)	(7 036)	(1 730)	(31 268)

(in thousand PLN)

12 month period ended 31 December 2016

	Revenues /(costs) due to interests (including effect of valuation with depreciated cost)	*Profits / (losses) due to exchange rate differences*	*Redemption / (creation) of impairment write-downs*	*Profits/(losses) due to derivative instruments*	*Other*	*Total*
Financial assets						
Cash and cash equivalents	4 724	1 355	-	-	-	6 079
Other short-term financial assets	11	2 753	1	-	(33)	2 732
Deliveries and services receivables	113	(34)	(113)	-	-	(34)
Other receivables	72	49	-	-	45	166
Derivative instrument	-	-	-	1 306	-	1 306
Financial liabilities						
Credit and loan liabilities (long- and short-term ones)	(34 703)	(16 607)	-	-	(4 049)	(55 359)
Deliveries and services liabilities	(80)	(296)	-	-	-	(376)
Other financial liabilities (without instruments)	(632)	-	-	-	-	(632)
Derivative instruments	-	-	-	(7 379)	-	(7 379)
Other liabilities	(2 250)	(3)	(9 650)	-	(1 047)	(12 950)
Total	(32 745)	(12 783)	(9 762)	(6 073)	(5 084)	(66 447)

(in thousand PLN)

40.3. Interest rate risk

The below table presents the interest rate gap constituting the Group's exposure to interest rate risk and concentration of this risk divided into currencies and kind of interest rate taking into account the effect of protection transactions Interest Rate Swap exchanging the stream of cash interest payments based on the variable EURIBOR rate for the fixed rate in EUR.

	Type of interest rate	*Carrying amount as of 31 December 2017*	*Carrying amount as of 31 December 2016*
Financial assets at interest rate risk – PLN	Fixed	-	-
	Variable	292 331	236 701
Financial assets at interest rate risk – Other currencies	Fixed	-	-
	Variable	73 866	200 708
Financial liabilities at interest rate risk - PLN	Fixed	-	-
	Variable	413 767	622 686
Financial liabilities at interest rate risk – Other currencies	Fixed	118 839	193 703
	Variable	119 432	193 420
Net exposure -PLN	Fixed	-	-
	Variable	(121 436)	(385 985)
Net exposure - other currencies	Fixed	(118 839)	(193 703)
	Variable	(45 566)	6 815

Interest rate of financial instrument of variable interest rate is updated in periods shorter than one year. Interests on financial instruments of the fixed interest rate are fixed through the whole period to the date of maturity of these instruments. Other financial instruments of the Group not included in the above tables are not subject to interest and they are not subject to interest rate risk.

40.3.1. Hedging

The Group secures interest rate risk related to the incurred corporate credit denominated in EUR of variable interest rate based on the EURIBOR 3M benchmark interest rate using derivative transactions. The instrument securing exposure to interest risk rate is the Interest Rate Swap transaction, within which the Groups exchanges stream of cash interest payments based on the variable EURIBOR 3M rate for payments of fixed interest rate at 3.1050%. The Groups indicates designated derivative instruments as protecting instruments in the model of cash flow security, and includes them in accordance with protections accounting rules.

In the tables shown below, basic parameters of derivative transaction indicates as security instruments, including periods, when cash flows due to cash flow securities and when they will influence the financial result, as well as their fair value in zloty as of 31 December 2017 and 31 December 2016 are presented.

Instrument type	*Nominal value in the transaction currency [euro]* 31 December 2017*	*Fair value in zloty 31 December 2017*	*Expected duration of hedged item's realisation 31 December 2017*
IRS transaction	28 492	(4 112)	in quarterly periods, in January, April, July, and October each year, until the date of maturity of IRS, i.e. July 2019

** the nominal values depreciated in accordance with the credit repayment schedule*

Instrument type	*Nominal value in the transaction currency [euro]* 31 December 2016*	*Fair value in zloty 31 December 2016*	*Expected duration of hedged item's realisation 31 December 2016*
IRS transaction	43 785	(10 053)	in quarterly periods, in January, April, July, and October each year, until the date of maturity of IRS, i.e. July 2019

** the nominal values depreciated in accordance with the credit repayment schedule*

The change in the fair value of cash flow securities transferred onto the equity is presented below:

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Opening balance	(6 883)	(14 742)
Effective part of profits / losses on a security instrument	6 352	585
Amounts charged to the income statement, including:	2 776	(7 274)
– adjustment of costs of interest	2 776	(7 274)
– adjustment under ineffective hedging	-	-
Closing balance	(3 307)	(6 883)
Deferred tax assets – recognized in the revaluation reserve	628	1 308
Closing balance including deferred tax	(2 679)	(5 575)

In 2017, two companies of the Group applied instruments to limit the risk resulting from changes in foreign exchange rates. ZE PAK SA hedged the euro exchange rate for a part of cash flows related to the purchase of CO2 emission allowances. To hedge the exchange, forward transactions were made with the settlement date in December 2017 and March 2018. Elektrownia Pątnów II sp. z o.o. hedged the euro exchange rate for a part of the flows related to the repayment of the syndicated loan instalment, also applying a forward transaction with the settlement date in April 2018.

Type of concluded transactions	*Currency cross*	*Transaction amount (nominal value in euro thousand) 31 December 2017*	*Net market value (fair value in zloty thousand) 31 December 2017*	*Maturity*
Purchase of EUR transaction (forward)	(EUR/PLN)	8 936	(805)	March 2018
Purchase of EUR transaction (forward)	(EUR/PLN)	5 600	(92)	April 2018

The Group also hedges the risk of changes in prices of CO_2 emission allowances by using forward transactions to purchase allowances for its own needs. The tables below present a summary of forward transactions active as at December 31, 2017 and December 31, 2016.

31 December 2017

Type of concluded transactions	*Number of purchased allowances*	*Total value of transactions in EUR thousand*	*Currency of transactions*	*Maturity*
Forward transactions	2 622 000	17 224	EUR	Up to 1 year
Forward transactions	300 000	2 242	EUR	Up to 2 years

31 December 2016

Type of concluded transactions	*Number of purchased allowances*	*Total value of transactions in EUR thousand*	*Currency of transactions*	*Maturity*
Forward transactions	3 997 000	30 180	EUR	Up to 1 year

41. Capital management

The main goal of the management of the Group's capital is maintenance of good credit rating and safe equity ratios, which would support the Group's operating activities and increased the values for its shareholders.

The Group manages the capital structure, and, as a result of changes of economic conditions, introduces amendments to it. In year, ended 31 December 2017 and 31 December 2016, there were no introduced amendments to goals, rules and processes applying in this area.

The Group monitors the balance of its capitals using the leverage ratio, which is calculated as a relation of net debt to the sum of capitals enlarged with net debt. The Group includes interest bank credits and loans, liabilities due to supplies and services, and other liabilities, decreased by the cash and cash equivalents in the net debt. The capital includes the equity decreased by reserve capitals due to unrealised net profits.

	31 December 2017	*31 December 2016*
Interest-bearing credits and loans	652 038	1 009 809
Derivative financial instruments (liabilities)	5 009	10 053
Trade liabilities and other financial liabilities	151 562	307 731
Minus cash and its equivalents	322 201	350 101
Net debt	486 408	977 492
Equity	2 264 272	2 143 658
Capitals from revaluation of security instruments	(2 678)	(7 084)
Total capital	2 266 950	2 150 742
Net capital and debt	**2 753 358**	**3 128 234**
Leverage ratio	17,67%	31,25%

(in thousand PLN)

42. Employment structure

The average employment in the Group for the years ended 31 December 2017 and 31 December 2016 was developing as follows:

	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*
Management Board of the parent company	4	5
Management Boards of the Group's entities	14	23
Administration	304	377
Sales department	108	62
Production division	5 053	5 278
Other	464	616
Total	5 946	6 362

43. Significant events after the balance sheet date

After the balance sheet date to the date of preparation of these annual financial statements for 2017, there were no significant events except those described in the additional explanatory notes.

Adam Kłapszta /President of the Board/	*Aneta Lato-Żuchowska /Vice President of the Board/*	*Zygmunt Artwik / Vice President of the Board /*	*Elżbieta Niebisz / Vice President of the Board /*	*Aneta Desecka /Chief Accountant/*

ZESPÓŁ ELEKTROWNI PĄTNÓW – ADAMÓW – KONIN SA
CAPITAL GROUP

MANAGEMENT BOARD'S REPORT
FROM THE CAPITAL GROUP'S OPERATIONS IN 2017

This is a translation of the document issued originally in Polish language.
The Polish original should be referred to in matters of interpretation.

19 APRIL 2018

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1. SELECTED FINANCIAL DATA

Selected consolidated financial data	*zloty thousand* *12 months 2017 period from 01.01.2017 to 31.12.2017*	*zloty thousand* *12 months 2016 period from 01.01.2016 to 31.12.2016*	*euro thousand* *12 months 2017 period from 01.01.2017 to 31.12.2017*	*euro thousand* *12 months 2016 period from 01.01.2016 to 31.12.2016*
Sales revenue	2 443 075	2 704 711	575 559	618 121
Operating profit/loss	290 092	371 433	68 342	84 885
Profit/loss before tax	258 633	307 878	60 931	70 361
Net profit/loss for the period	183 544	250 286	43 241	57 199
Net profit attributable to equity holders of the parent	183 243	247 674	43 170	56 602
Total comprehensive income	186 204	258 880	43 867	59 163
Net cash flow from operating activities	478 798	536 051	112 799	122 506
Net cash flow from investing activities	(57 624)	(183 708)	(13 576)	(41 984)
Net cash flow from financing activities	(447 250)	(387 014)	(105 367)	(88 446)
Net increase / (decrease) in cash and cash equivalents	(26 076)	(34 671)	(6 143)	(7 924)
Net profit per share (in zloty/euro per share)	3.61	4.87	0.85	1.11
Weighted average number of shares	50 823 547	50 823 547	50 823 547	50 823 547
	as of 31.12.2017	*as of 31.12.2016*	*as of 31.12.2017*	*as of 31.12.2016*
Total assets	4 455 712	4 801 300	1 068 286	1 085 285
Fixed assets	3 447 776	3 702 058	826 626	836 812
Current assets	1 006 898	1 099 242	241 410	248 472
Total equity	2 264 272	2 143 658	542 874	484 552
Share capital	101 647	101 647	24 371	22 976
Share capital attributable to equity holders of the parent	2 264 272	2 143 658	542 874	484 552
Total liabilities	2 191 440	2 657 642	525 412	600 733
Long-term liabilities	1 191 958	1 389 715	285 780	314 131
Short-term liabilities	999 482	1 267 927	239 632	286 602
Book value per share (in zloty/euro per share)	44.55	42.18	10.68	9.53
Weighted average number of shares	50 823 547	50 823 547	50 823 547	50 823 547

Above financial data were converted into EUR according to the following exchange rates:

- data on the statement of comprehensive income and the statement of cash flows according to the arithmetic average of the average NBP exchange rates from each last business day of the month of the financial period from January 1, 2017 to December 31, 2017, which is EUR/PLN 4.2447, and from January 1, 2016 to December 31, 2016, which is EUR/PLN 4.3757.
- data on individual items of the statement of financial position according to the average exchange rate of the EUR/PLN specified by the NBP as at December 29, 2017, i.e. EUR/PLN 4.1709, and as at December 30, 2016, i.e. EUR/PLN 4.4240.

2. DESCRIPTION OF THE COMPANY AND THE CAPITAL GROUP

2.1. Basic information on the Company and the Capital Group

Basic information on the Company

Zespół Elektrowni Pątnów – Adamów – Konin SA (hereinafter referred to as ZE PAK SA or Company) operates in the form of a joint-stock company, pursuant to the regulations of the Code of Commercial Companies as well as other regulations of the generally applicable Polish law. The Company was established as result of transformation of Zespół Elektrowni Pątnów – Adamów – Konin state-owned company with registered office in Konin into a company wholly owned by the State Treasury under the business name of Zespół Elektrowni „Pątnów – Adamów – Konin" Spółka Akcyjna. The deed of transformation was signed on 29 December 1994 in the presence of the notary public Elżbieta Brudnicka from the Notarial Office in Warsaw. On 31 December 1994, the Company was entered into the commercial register section "B" by the District Court in Konin under number RHB 847. Based on the decision of the District Court in Poznań, 22nd Commercial Department of KRS dated 21 June 2011, the Company was entered into the Register of Entrepreneurs. Currently the Company is entered into the Register of Entrepreneurs kept by the District Court Poznań Nowe Miasto i Wilda, IX Commercial Department, under the KRS number 0000021374. The Company was established for an unlimited period of time.

Name:	Zespół Elektrowni „Pątnów – Adamów – Konin" Spółka Akcyjna
Legal status:	stock company
Abbreviated name:	ZE PAK SA
Registered office and address:	ul. Kazimierska 45, 62-510 Konin, Polska
Telephone number:	+48 63 247 30 00
Fax number:	+48 63 247 30 30
Website:	www.zepak.com.pl
Email address:	zepak@zepak.com.pl
KRS number:	0000021374
REGON number:	310186795
NIP number:	665-000-16-45

According to the Company's Articles of Association, the primary subject of the Company's operations is the production and sales of electricity as well as the production and sales of heat. The Company produces energy from conventional sources as well as by biomass combustion. The Company can conduct operations within the territory of the Republic of Poland as well as abroad.

The Company's shares are listed on the regulated market operated by Giełda Papierów Wartościowych SA w Warszawie (Warsaw Stock Exchange). The Company's shares are dematerialised and marked by Krajowy Depozyt Papierów Wartościowych SA (National Depository for Securities) with the following stocks code: ISIN PLZEPAK00012.

In 2017, the share capital of ZE PAK SA has been not changed. As of 31 December 2017 amounts to zloty 101 647 094.00 and is divided into 50 823 547 bearer shares class A with a face value of zloty 2.00 each, which represent 50 823 547 votes at the Company's General Meeting, comprising 100% of the total votes at the Company's General Meeting.

The Company has no branches (establishments).

Basic information about the Capital Group

As of 31 December 2016 the ZE PAK Capital Group (hereinafter referred to as the "Group", "Capital Group" the "ZE PAK SA Group") is composed of a dominant entity Zespół Elektrowni Pątnów – Adamów – Konin SA (hereinafter referred to as "ZE PAK SA" or "Company") and thirteen subsidiaries i.e. Elektrownia Pątnów II sp. z o.o., PAK – Volt SA, PAK Kopalnia Węgla Brunatnego Adamów SA (hereinafter referred to as the "PAK KWB Adamów SA"), PAK Kopalnia Węgla Brunatnego Konin SA (hereinafter referred to as the "PAK KWB Konin SA"), Przedsiębiorstwo Remontowe PAK SERWIS sp. z o.o. (hereinafter referred to as the "PAK SERWIS sp. z o.o."), PAK Górnictwo sp. z o.o., PAK – HOLDCO sp. z o.o., PAK Infrastruktura sp. z o.o., PAK Adamów sp. z o.o., EL PAK Serwis sp. z o.o. in liquidation, Aquakon sp. z o.o. in liquidation, Eko-Surowce sp. z o.o. in liquidation, Energoinwest SERWIS sp. z o.o. in liquidation. All the above-mentioned companies are consolidated.

The companies of the biggest importance for the Group due to their scale of activity are: ZE PAK SA, dealing with production of electricity and heat, Elektrownia Pątnów II sp. z o.o., dealing with production of electricity, and PAK KWB Adamów SA and PAK KWB Konin SA, dealing with lignite mining. In addition to companies from the aforementioned main areas of activity, the Group also includes other companies that deal, among others, with the execution of construction and assembly works, maintenance works, service, production and trade activities aimed at satisfying the needs and comprehensive industry service.

The production facilities of the Group include three lignite-fired power plants located in the central part of Poland in Wielkopolskie voivodship. These are: Pątnów II – equipped with a supercritical power unit, Pątnów I and Konin – equipped additionally with power unit with a boiler dedicated to biomass firing. Total installed gross power output of the production facilities as at the date of this report is 1896 MW.

The Group's main mining assets are concentrated in two companies: PAK KWB Konin, which currently operates on Jóźwin, Tomisławice and Drzewce open casts, PAK KWB Adamów operating on Adamów open cast.

Majority of the Group's sales revenue is derived from sale of electricity. This is supplemented by revenues from sale of heat, contracts for construction repair services and certificates of Energy origin. An additional source of sales revenues, depending on the level of production costs, energy prices on the market and production volume, are revenues from the termination of long-term contracts (Power Purchase Agreements) for the sale of electricity, generated by Elektrownia Pątnów II sp. z o.o. The Group, having lignite mines in its structure, provides power plants with an access to uninterrupted lignite supplies for own production installations located in the immediate vicinity of the mines. The vertically integrated Group enables optimization of coal inventories and supplies by coordinating coal mining with the demand for this fuel. The demand for biomass is covered on the basis of contracts concluded with suppliers.

The structure of ZE PAK SA Group as at December, 31 2017 is presented at Picture 1.

Apart from the Capital Group, the Company owns shares in Zakłady Pomiarowo-Badawcze Energetyki Energopomiar sp. z o.o. with headquarters in Gliwice and providing measurement, research and consultancy services regarding, among others power engineering. ZE PAK SA holds one share in the aforementioned company with the value of PLN 151 201.01, which constitutes 2.81% of the total capital.

The main shareholder makes the Group affiliated with other entities, in which Zygmunt Solorz holds substantial direct or indirect share.

Picture 1: Structure of the Group as of December, 31 2017

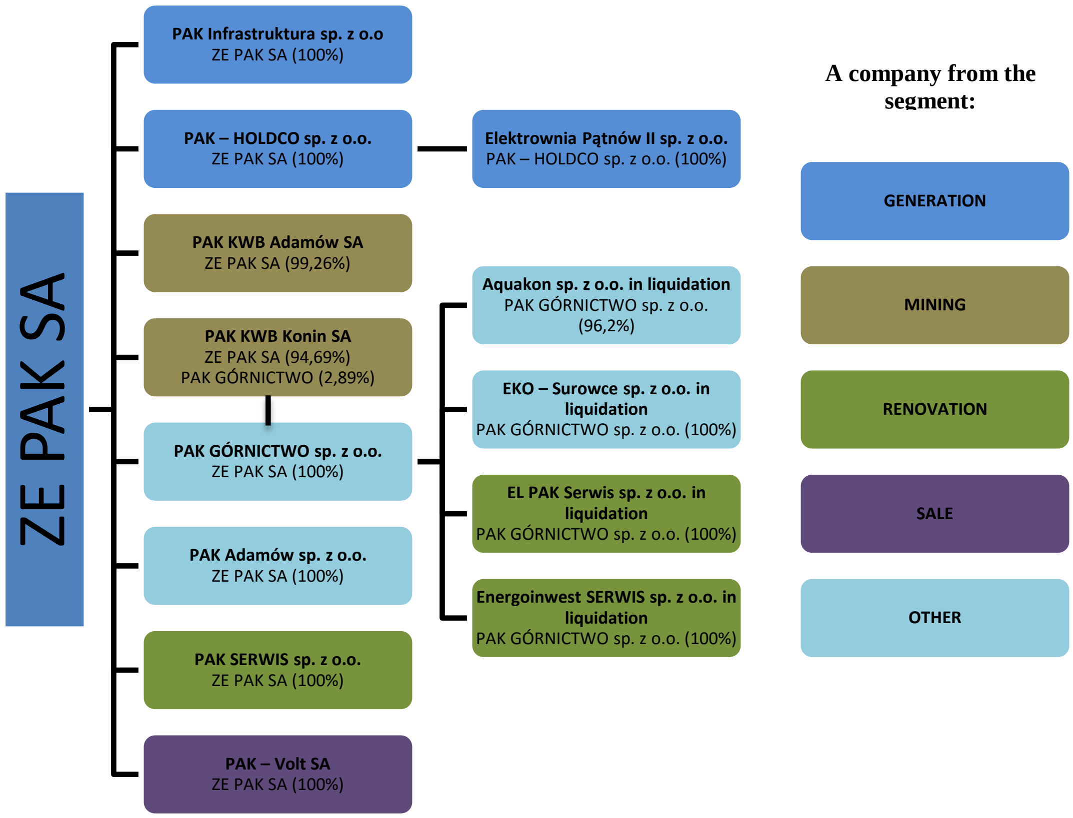


Table 1: Description of the Group's companies (excluding ZE PAK SA)

Entity	*Registered office*	*Scope of operations*	*Group's share in the capital in %* 31.12.2017	31.12.2016
„Elektrownia Pątnów II" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Electric Energy production and distribution from the 464 MW power unit	100.00%*	100.00%*
PAK Kopalnia Węgla Brunatnego Konin SA	62-540 Kleczew ul. 600-lecia 9	Lignite extraction	97.58%*	96.23%*
PAK Kopalnia Węgla Brunatnego Adamów SA	62-700 Turek Warenka 23	Lignite extraction	99.26%	98.41%
Przedsiębiorstwo Remontowe „PAK SERWIS" sp. z o.o.	62-510 Konin ul. Przemysłowa 158	Construction and repair services	100.00%	100.00%
„PAK GÓRNICTWO" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Exploration and recognition of lignite	100.00%	100.00%
PAK – Volt SA	00-834 Warszawa ul. Pańska 77/79	Trade of electricity	100.00%	100.00%
„PAK – HOLDCO" sp. z o.o.	62-510 Konin ul. Kazimierska 45	Holding activity	100.00%	100.00%
„PAK Infrastruktura" sp. z o.o.	62-510 Konin ul. Kazimierska 45	General construction of engineering objects, not classified elsewhere	100.00%	100.00%
PAK Adamów sp. z o.o	62-510 Konin Ul. Kazimierska 45	Buying and selling real estate	100.00%	-
„Aquakon" sp. z o.o. in liquidation	62-610 Sompolno Police	Mechanical services, repairs, reclamation of land, production and trade of mineral water	96.2%*	92.57%*
Eko-Surowce sp. z o.o. in liquidation	62-540 Kleczew ul. 600-lecia 9	Vulcanization services, sales of lignite	100.00%*	96.23%*
Energoinwest Serwis	62-510 Konin	Repair-construction service	100.00%*	100.00%*

sp. z o.o. in liquidation	ul. Spółdzielców 3			
EL PAK Serwis sp. z o.o. in liquidation	62-510 Konin ul. Przemysłowa 158	Repair and maintenance of electric equipment, repair and maintenance of machines	100.00%*	100.00%*

* *Entities with partial or total indirect share via other companies from ZE PAK Group.*

2.2. Basic rules and changes to basic rules of ZE PAK SA Capital Group management

In order to provide appropriate solutions for key issues related to management of the Capital Group, in which ZE PAK SA is the parent company and, at the same time, the owner of capital, seeking a satisfactory return on the funds engaged, a separate Legal and Organizational Department was established within the organizational structure of the Company. The main task of this Department is supervision over the operations of the ZE PAK Capital Group and other companies in which the Company holds shares. This unit coordinates the consistency of the operations of all entities in the Group and monitors their compliance with the legal regulations in force as well as the interests of the whole Capital Group. The Department is subject to direct sovereignty of Vice President of the Management Board involved in Corporation issues.

According to the policy of the Group, in the key subsidiaries, the members of the Management Boards ZE PAK SA are Members of these companies Management Boards, and in other companies of the Group are members of the Supervisory Boards. In addition, in order to ensure proper functioning of the corporate governance body, the Management Board of ZE PAK SA recommends to the Supervisory Board of ZE PAK SA, the candidature of other Supervisory Board members of the Group companies.

In the organizational structure of the Company, organizational division units that bring together organizational units of the Company (departments, offices, divisions, etc.) managed by individual members of the Management Board of ZE PAK SA are created. The Supervisory Board divides internally the competencies among the members of the Management Board by entrusting a Management Board member with a specific organizational division unit. The members of the Management Board of ZE PAK SA co-operate, agree, and coordinate the actions regarding the Company's matters as well as secure proper co-operation of the organizational division units and units managed by them. The areas of the Company's activity managed by individual members of the Management Board are defined by the Company's organizational regulations specifying the Company's organization of the enterprise.

In the past year the following changes in the Group's structure have been recorded:

- As a result of the repurchase process of a part of shares from eligible employees and the transfer of shares of bought back shares from the State Treasury, the share of companies from ZE PAK SA in PAK KWB Konin SA shareholding increased to 97.58% and in PAK KWB Adamów SA up to 99.26%.

- On May 9th, 2017 PAK Górnictwo sp. z o.o. signed agreements with PAK KWB Konin SA, PAK Serwis sp. z o.o. an EL PAK sp. z o.o. as a result of which this company acquired shares in the following companies: EL PAK Serwis sp. z o.o., Aquakon sp. z o.o., Eko-Surowce sp. z o.o., Energoinwest Serwis sp. z o.o. On August 1, 2017, the Extraordinary General Meeting of Shareholders of these four acquired companies adopted resolutions on the dissolution of companies and the opening of their liquidation as of 1 August 2017. The initiated liquidation process is a consequence of the restructuring of the auxiliary activity towards the main segments of the Capital Group. The activities carried out by the abovementioned companies will be carried out by PAK Górnictwo sp. Z o.o. that takes over the rights and obligations of the liquidated companies.

- On 30 June 2017, EL PAK sp. z o.o. (acquired company) and PAK Serwis sp. z o.o. (acquirer) have merged into one Company, pursuant to Art. 492 § 1 point 1 of the CCC by transferring all the assets of EL PAK sp. z o.o. to PAK Service sp. z o.o. This change in the Group's structure is also a consequence of the consolidation of auxiliary activities to the Group's main segments.

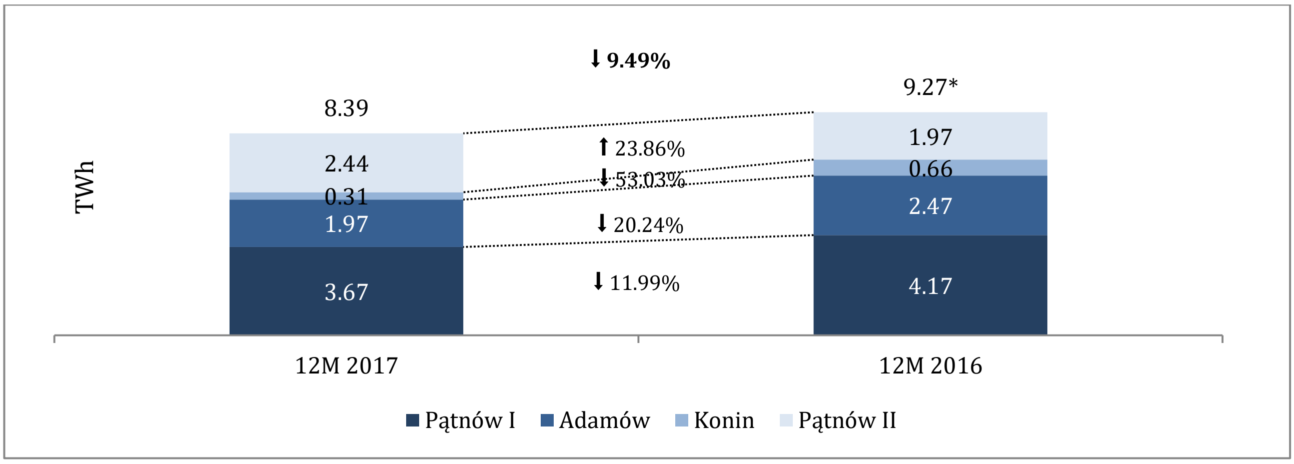
- On 16 October 2017 a new subsidiary has been set up – PAK Adamów Sp. z o.o., in which ZE PAK SA holds all the shares. The appointment of the new subsidiary company is related to preparation of the processes of terminating the activity of Elektrownia Adamów.

2.3. Basic products, goods, services, markets and sources of supply characteristics

The Company's operations are focused in several areas. The main area is doubtlessly generation of electricity, lignite extraction, electricity wholesale trading, which is supplemented by sales of energy certificates, operations undertaken to ensure an adequate amount of CO2 allowances as well as generation and sales of heat. In addition, the Group also includes other companies, which are engaged, among others, in: carrying out construction and assembly works, maintenance works, services, production and trade operations for the purpose of satisfying their own needs as well as providing comprehensive services to the industry. In 2017, the Group mainly conducted its operations in the Polish market. The only exception included operations related to transactions regarding the CO2 allowances, which were executed between ZE PAK and EPII as well as foreign partners.

The Group is the fourth largest producer of electricity in Poland and bases its production mainly on lignite. The net electricity production in Pątnów I power plant in 2017 reached 3.67 TWh, in Adamów power plant 1.97 TWh, in Konin power plant 0.31 TWh and in Pątnów II power plant 2.44 TWh. Total net energy production in all power plants of the Group in 2017 was lower by 9.49% compared to the previous year. In ZE PAK SA Group, the distribution of generations in individual power plants is primarily determined by the economics of production, operator requirements and geological conditions in the mines supplying coal to the power plant.

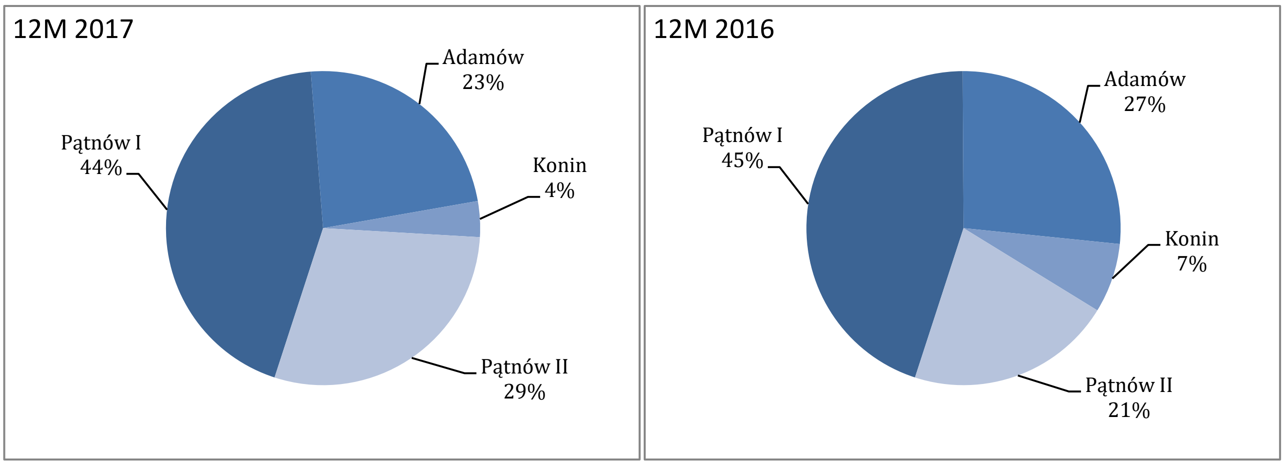
*Chart 1: Net electricity production**



* *Net electricity production together with the electricity production from the units 1 and 2 in Pątnów I during investment in I quarter 2016 in the amount of 0.03 TWh.*

Source: internal data

Chart1: The structure of production divided into individual power plants

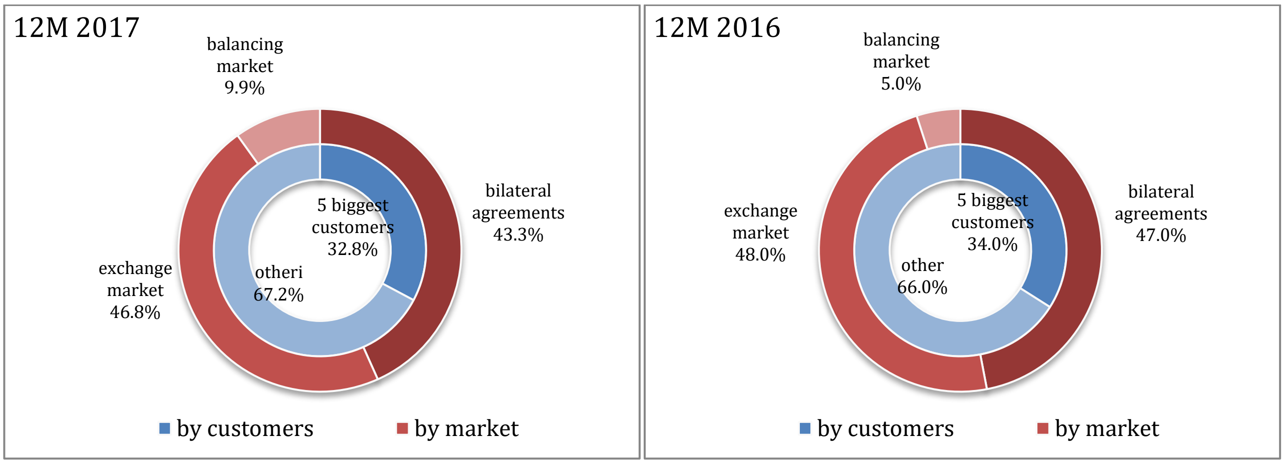


Source: Internal data

In 2017, the Group sold 11.76 TWh of electricity, i.e. nearly 12.95% less than in 2016.

The main direction of electricity sales in 2017 was sales on the stock market, which accounted for 46.8% of the total volume of energy sold[1]. As part of bilateral contracts concluded mainly with electricity trading companies operating on the Polish market, the Group's companies sold 43.3% of the yearly energy sales volume realized in 2017, of which the Group's five largest counterparties accounted for 32.8% of total sales, while transactions with final customers accounted for 3.0% of the total volume of electricity sales. The structure of sales is supplemented with the electricity balancing market, where the Group companies sold 9.9% of the total volume of electricity sales last year.

Chart 2: Electricity sale structure by customers (internal ring) and by market (external ring)



Source: internal data

Revenues from the sale of electricity (total - generated and from turnover, reduced by excise duty) accounted for 85.56% of the total revenues from the sale of the Group, while revenues from the received compensations to cover the so-called "Stranded costs" in Elektrownia Pątnów II constituted 7.42% of the Group's sales revenues.

The heat generated in the Group's power plants is sold to local customers. The main customers are city heat energy enterprises and local industrial producers. In 2017, the Group covered almost the entire heat demand of municipal thermal energy companies in Konin and Turek. Last year, the Group's power plants sold 1,912 TJ of heat. Heat sales accounted for approximately 2.34% of the Group's total sales revenues.

In 2017, revenues from the sale of rights of origin were exceptionally low compared to previous years. The low revenues from this source were mainly caused by the very slight production of energy from the biomass block. The continuing trend of low prices of green certificates, constituting a support system, among others for producers of energy from biomass, caused a decision about a significant decrease in production of energy from this source. The company sold some of the certificates received for the previous periods, however their market price was usually lower than the one at which they were booked at the time of manufacture. The sale of red certificates related to energy and heat production in cogeneration determined the positive balance of revenues from the sale of property rights. In 2017, the Group generated 0.15 TWh of red certificates. The share of revenues from the sale of property rights from energy certificates of origin in 2017 accounted for only 0.03% of the total revenue of the Group.

From significant sources supplementing the revenue structure, it is worth mentioning the activities related to the execution of construction and assembly works. PAK Serwis sp. z o. o., one of the Group's companies, deals with the implementation of such tasks for the needs of the Group and external entities. The main external customers are entities from the industrial construction sector and the electricity generation and distribution sector. Revenues obtained from this service provided to external entities in 2017, accounted for 3.39% of the total revenue of the Group's sales. The remaining activity generated 1.26% of total revenues in the previous year.

[1] Elektrownia Pątnów II sp. z o. o., as an electricity producer entitled to receive compensations to cover the so-called "stranded costs" under the term of "the Act on the principles of coverage of costs incurred by producers due to early termination of long-term agreements for the sale of power and electricity," in accordance with the provisions of the Energy Law, is obliged to sell the entire generated electricity on the exchange market or by way of an open tender. However, by decision of the President of the Energy Regulatory Office, Elektrownia Pątnów II sp. z o. o. has been exempted from the obligation of public sale in relation to 60% of the net electricity generated by the Pątnów II Power Plant until the end of 2019.

The main raw material used by the Group for energy production is lignite, which is extracted almost exclusively for the needs of the power plant. This is mainly due to the fact that lignite coal extracted in Poland is soft coal, and its long-distance transport is not viable due to its high water content. The extracted lignite coal is delivered directly from open pit mines to nearby power plants. For this reason, lignite mining in the ZE PAK SA Group is closely correlated with the amount of electricity generated by power plants located in the vicinity of the mines.

Practically, the whole amount of coal mined in both mines is delivered to the power plants of the ZE PAK SA Capital Group; an insignificant amount (less than 1%) is used for the needs of the mines or sold to other recipients.

In the Group, biomass is also used as a raw material for energy production – it is burned in a boiler dedicated to this purpose and located in Elektrownia Konin. However, last year, as a result of unfavourable trends on the green certificates market, production from the biomass block was stopped.

3. DESCRIPTION OF ACTIVITIES

3.1. Significant events in the accounting year as well as events after the balance sheet date affecting the current and future activities

Significant events in the accounting year

The process of obtaining formal permits in order to launch Ościsłowo open pit

As part of the activities aimed at ensuring the raw material for the Group's generation assets, project works on prospective lignite deposits are continued. PAK KWB Konin SA carries out the activities aimed at getting all the necessary decisions and documents allowing for obtaining a permit to grant a mining concession to the company. The current activities are concentrated on Ościsłowo open pit. The planned open pit is to provide coal necessary for energy generation in Elektrownia Pątnów II and renovated blocks in Elektrownia Pątnów I. Before getting the mining concession a number of formal and legal consents as well as documents specifying the way of conducting the mining operations, its scope and impact on the surroundings of the planned investment must be obtained. An environmental decision is one of them. An institution authorized to issue an environmental decision for the project "Extraction of lignite and associated minerals from the Ościsłowo Open Pit" is Regional Director for Environmental Protection in Poznań ("RDOŚ in Poznań"). On 16 September 2015, proceedings against this authority regarding the issue of an environmental decision for Ościsłowo open pit were initiated. As part of the documentation necessary in the proceedings, inter alia, a report on the environmental impact of Ościsłowo open pit and expert opinion on the impact of the designed open-pit on uniform surface and underground waters as well as protected areas were prepared. PAK KWB Konin SA with due diligence provides data and supplements the documentation necessary for the proper conduct of the proceedings. The date of issuing the environmental decision has been postponed several times. On March, 10 2017 RDOŚ in Poznań made a decision refusing the establishment of the environmental conditions for the investment. The decision of RDOŚ in Poznań was not final and PAK KWB Konin SA appealed accordingly to the General Directorate for Environmental Protection in Warsaw within the time allowed by law. The appeal included a request to revoke the appealed ruling in its entirety and determine the environmental conditions for the execution of the above-mentioned project. In the opinion of the Management Board of the Company, there are real reasons to expect that the final decision will be positive if the solutions proposed by PAK KWB Konin SA are applied. On November 30, 2017, General Director of Environmental Protection has decided to repeal a decision in its entirety (contested by PAK KWB Konin SA - a subsidiary of the Company) of the Regional Director for Environmental Protection in Poznań ("RDOŚ in Poznań") dated March 10, 2017, refusing to specify environmental conditions for the project entitled: " Extraction of lignite and associated minerals from Ościsłowo Open Pit", and forward the case for reconsideration by RDOŚ in Poznań.

PAK KWB Konin SA, by the letter of December 18, 2017 filed an objection against the abovementioned decision of GDOŚ in Warsaw to the Provincial Administrative Court in Warsaw (WSA). In the opinion of PAK KWB Konin S.A. there were grounds for issuing a reformatory decision by GDOŚ in Warsaw, i.e. amending the contested decision of RDOŚ in Poznań and substantive decision in this matter, and not referring the matter for reconsideration. The participant in the opposition proceedings to construct the open pit Ościsłowo also appealed to the Provincial Administrative Court. Both objections were dismissed by the WSA. The judgement was issued on March 1, 2018. On April 12, 2018, PAK KWB Konin SA filed a cassation complaint with the Supreme Administrative Court in Warsaw against the verdict of the WSA in Warsaw of 1 March 2018.

The case is being reconsidered by RDOŚ in Poznań which informed about June 5, 2018 as the new date of settling the matter.

Another condition necessary for the implementation of the project is the change of the local spatial development plan in the area to be covered by the planned outcrop. Decisions in this respect are taken by the self-governments of the three communes in which the Ościsłowo deposit is planned to be exploited. In December 2016, the Minister of Agriculture issued the approval for dedicating the agricultural lands of Ślesin and Skulsk communes in the area of the construction of the Ościsłowo brown coal open pit for non-agricultural purposes. Also in December 2016, media reports on an archaeological discovery on the part of the land for the planned open pit were published. On September 26, 2017, Wielkopolski Voivodship Monument Conservator initiated administrative proceedings regarding the entry of the archaeological site "Góry stan. 24, AZP area 52-40 / 193 - a multiphase cemetery", i.e. a burial ground of cell-less funerary culture tombs from the Neolithic period and a burial mound of the Lusatian culture from the Bronze Age. The area covered by the protection and its scope may prove to be important from the perspective of the implementation of the investment. On February 9, 2018, Wielkopolska Voivodship Conservator in Poznań issued a decision on the entry of the archaeological site "Góry stan. 24, AZP area 52-40 / 193 - multiphase cemetery" in the village of Góry, gm. Wilczyn area Konin. However, this decision has not become legally binding as a result of appealing to the Minister of Culture and National Heritage by one of the parties to the proceedings. It is worth noting that in the past, on the other open pits exploited by the mines, archaeological and excavation works took place many times. PAK KWB Konin SA cooperated in the past and is going to cooperate in such cases with all relevant institutions.

Relations between the Management Board and a social side

On January 18, 2017, trade unions operating in the Company filed a letter in accordance with the Act of May 23, 1991 on the resolution of collective disputes, including demands on, inter alia, the statutory bonus, the reimbursement of unpaid contributions to the employee pension scheme and the development of a support program for employees of the Adamów power plant. The Management Board of the Company responded to requests made by trade unions, presenting its position regarding individual demands together with the appointment of relevant arguments to justify the position taken, indicating, inter alia, for the unjustified demands or consequences of regulations contained in the provisions of art. 4 of the Act on the resolution of collective disputes regarding the inadmissibility of a collective dispute.

On July 26, also unions operating in the mines initiated a collective dispute at PAK KWB Konin SA in response to organizational and restructuring changes carried out in the Capital Group. At present, there are 4 collective disputes in the Group between trade union organizations and the Management Boards of individual Group companies.

The end of production at Elektrownia Adamów

On January, 1st, 2018, Elektrownia Adamów, being a part of Zespół Elektrowni Pątnów-Adamów-Konin SA, was closed. Five power units with a capacity of 120 MW each were producing electricity for the need of National Power System as well as they were supplying heat to local customers. The power plant stopped the production due to the environmental requirements. The installation in Elektrownia Adamów used derogation from the IED Environmental Directive in the scope of 17.5 thousand working hours, beginning from January 1st, 2016. Efforts were made to extend the operation of the power plant until the depletion of local lignite deposits, nevertheless, the decision of European Commission was negative.

Majority of the staff working in Elektrownia Adamów, i.e. 120 employees signed agreements regulating the end of their work in ZE PAK SA. About 25 people are still employed at Elektrownia Adamów to handle technical processes that will have to be sustained for some time. 33 employees have been transferred to other power plants of the Group - these are mainly people who due to the approaching time of acquiring pension rights are in the so-called "Protective period". The remaining group of about 60 employees did not use the possibility to sign the agreement voluntarily or as a result of failure to meet the conditions required in the offered agreement.

Significant events after the balance sheet date

In the period after the balance sheet date no significant events for the Group's operation were identified.

3.2. Significant agreements concluded in the accounting year

Significant agreements for the Group's activity

Because of the characteristics of the activity and the market, in which the ZE PAK SA Capital Group operates, the basic agreements concluded with main suppliers and recipients in the course of usual activities are of a standard nature. The agreements of the supply of the main raw material, which is brown coal, are of a multiannual nature and the suppliers are subsidiaries of ZE PAK SA. In the area of the electricity sales and purchase of CO_2 emission allowances, the Group's companies conclude framework agreements with particular counterparts setting out the basic terms and conditions of cooperation. However, purchase/sale alone are executed in separate transactions in relation to specific quantities using current market prices.

Agreements regarding the obtained credits and loans

In 2017, ZE PAK SA Group's companies signed the following agreements regarding credits and loans:

1. Elektrownia Pątnów II sp. z o.o. signed an annex to the syndicated loan agreement for EUR 240 million dated 14 January 2011 and the agreements on the bank accounts dated 14 January 2011. On the basis of the Annex, the amount of held reserves securing the repayment of debt was reduced and currency hedging transactions were permitted. The Parties to the annex were: Elektrownia Pątnów II sp. z o.o., ZE PAK SA, PAK-Holdco sp. z o.o. and PEKAO SA, mBank SA and Bank EBRD.
2. PAK KWB Konin SA signed Annex No. 6 with Alior Bank SA extending the repayment date of the loan – multi-purpose line by 29 June 2017. Available credit limit is PLN 46 700 thousand. The interest rate is based on the WIBOR 1M rate plus the bank's margin.
3. PAK KWB Konin SA signed Annex 7 with Alior Bank SA extending the repayment date of the loan - multi-purpose line until 30 May 2018 for credit products and until 31 December 2018 for guarantee products. The available credit limit has been increased to PLN 76 700 thousand and divided into a sublimit for overdraft facility up to PLN 66 700 thousand and a sublimit for guarantees up to PLN 10 000 thousand. The interest rate on the overdraft facility is based on the WIBOR 1M rate plus the bank's margin.
4. PAK KWB Konin SA signed Annex No. 10 with Bank Zachodni WBK SA extending the repayment date of the loan by 30 June 2018. The available credit limit for financing current business operations is PLN 50 000 thousand. The interest rate is based on the WIBOR 1M rate plus the bank's margin.
5. PAK KWB Konin SA signed Annex No. 2 to the contract for bonds with PKO BP, extending the program until December 31, 2019.
6. PAK SERWIS sp. o.o. signed annexes No. 5 and 6 with PEKAO SA to the multi-purpose credit limit agreement extending the term of the agreement until November 30, 2018. The multi-purpose credit limit available is PLN 20 000 thousand. The interest rate is based on the WIBOR 1M rate plus the bank's margin.
7. PAK SERWIS sp. o.o. signed a debt limit agreement with Raiffeisen Bank Polska SA The validity period for the overdraft facility is July 31, 2018, for the revolving loan - November 15, 2018. The available limit is: PLN 5 000 thousand for all overdrafts, revolving loans, guarantees in zloty and other currencies, the maximum limit for guarantees is PLN 4 152 thousand.

Agreements regarding the granted loans

On 19 and 27 April 2017 PAK Infrastruktura sp. o.o. from ZE PAK SA Capital Group signed two loan agreements for another company from the Group, i.e. Energoinwest Serwis sp. o.o. The amount of each loan was PLN 1 500 thousand. The loans are to be repaid in instalments, the final repayment date of both loans is 30 April 2022. The loan interest rate was determined on market terms. In connection with the takeover of Energoinwest Serwis sp. o.o. through PAK Górnictwo sp. o.o. obligations resulting from loan agreements have been transferred to PAK Górnictwo sp. o.o.

Granted and obtained guaranties and sureties

Table 2: List of guaranties and sureties granted in 2017

	zloty thousand	*euro thousand*
	31 December 2017	
Granted guaranties	***10 357***	***201***
- for companies from the Group		
Granted sureties	50 000	-
- for companies from the Group	50 000	-

Table 3: List of guaranties and sureties obtained in 2017

	zloty thousand	*euro thousand*
	31 December 2017	
Obtained guaranties	***25 469***	***5 167***
- from companies from the Group	-	-
Obtained sureties	50 000	-
- from companies from the Group	50 000	-

The agreement concluded between affiliated companies on terms different from market terms

In 2017, in the ZE PAK SA Capital Group, there were no agreements concluded between affiliated companies on terms different from market terms.

3.3. Investment programme execution

Key investments during execution

Currently, ZE PAK SA Group does not implement any large investment projects. Investment activity focuses primarily on the implementation of the necessary tasks to ensure the maintenance of current efficiency and more efficient use of production and mining assets. Investment expenditures expended in 2017 concerned the preparation and implementation of tasks necessary for the day-to-day operation.

Elektrownia Pątnów

The main purpose of disbursement of the investment expenses in 2017 was to finance the continuation of modernisation of the coal handling system, which is to guarantee a process system with a large handling capacity for feeding the basic fuel to the boilers. By the end of 2017, almost the entire range of modernization of coal handling system was completed. The task of sealing the wall between the boiler room and the engine room over the modernized blocks 1 and 2 was also continued. The task is to reduce dust from the boiler room towards the engine room, improve the structural and fire safety of facilities, improve safety and hygiene aspects of crew work. In the past year, the implementation of the task consisting in reconstruction of sewage management in the engine room building of modernized units 1 and 2, whose purpose is to organize water management in the engine room building, has been started. The deadline for completion of all described tasks is planned in the first half of 2018.

Elektrownia Konin

According to the declarations, the Company started to implement a task, the effect of which is to be the possibility to produce both electricity and heat from the biomass unit at the Konin power plant. For this purpose, the contractor of the investment undertaking the task in the "turnkey" formula was selected, and in the second half of 2017 the task was commenced. The implementation of the assumed concept will enable the heating of network water fed to the city of Konin using the steam produced by the biomass block. This block will become a source of RES producing electricity for the National Power System and thermal energy for heating the city of Konin. The planned date of commissioning the modernized TG-6 turbine along with the new auxiliary systems was set for the first quarter of 2018. As part of the implementation of the above-mentioned project, the Energy Regulatory Office was also requested to change the concession for the production of electricity and heat in cogeneration for Konin power plant.

PAK KWB Konin SA i PAK KWB Adamów SA

In the mining segment, PAK KWB Konin SA, as a part of the Capital Group, carried out investment tasks on active outcrops aimed at maintaining production capacity. On Jóźwin, Drzewce and Tomisławice open pits there are carried out the works related to the need to build drainage systems resulting from the progress of mining operations and the need to prepare the area for future exploitation. The largest expenditures were incurred for the purchase of land on Jóźwin and Tomisławice pits, and the construction of a drainage and electricity supply system on these pits. At PAK KWB Adamów SA, a bulldozer designed for the reclamation of Kozmin mine was purchased.

3.4. Risk management

While conducting its operations, the Group is exposed to a series of risks, occurring actually, potentially or theoretically, existing in the industry as well as on the markets where the Group's companies operate. These are factors having their source within the Group as well as and in its environment. Taking into account the formalization of the risk-related sphere in the Group's operations, a comprehensive document was created, entitled "Risk Management Principles for the ZE PAK SA Capital Group" ("Management Principles"). The principles of Management have been developed and implemented in order to define and determine the risks limits occurring or likely to occur in the ZE PAK SA Capital Group and to determine mechanisms for minimizing risk exposure in the course of conducting operations in the energy and mining sectors and minimizing the effects of risk, which due to the specific nature of the core business of the ZE PAK SA Capital Group, cannot be completely eliminated.

The first stage was to determine the Group companies in which activities can identify risks of material importance for the operation of the entire Group, and then apply the appropriate rules of conduct. The following entities have a significant impact on the Group's core business: ZE PAK SA, Pątnów II sp. Z o.o., PAK KWB Konin SA, PAK KWB Adamów SA, and PAK - Volt SA. Other Group's companies do not have a direct impact on operational risks.

Business model and strategy of the Capital Group were determined within the principles mention earlier. The leading principle of the business model implemented by the Group in the area of business operations (mining, production and trade) is to maximize production and profit while respecting the principle of risk minimization. In order to achieve the business goals, the Group allows for incurring risk, but only to the extent and on the principles set out in the Management Rules. All kinds of the business risk and the situations resulting in the exposure to the risk are constantly minimized, unless the Management Rules or the Management decisions clearly allow for specific deviations. Relating to the structure of the Capital Group and organizational charts of particular subsidiaries, specific roles and scope of responsibility for decisions and activities connected with the realized strategy and market policy have been determined and extracted. A special role, strictly related to the observance and correct application of the Rules of Management, is performed by a task team, called the "Risk Management Committee", acting as an advisory and consultative body of the Management Board of ZE PAK SA. The team was appointed by the Ordinance of the President of the Management Board. The main tasks of the Risk Management Committee are identification and substantive assessment of all economic risks worth more than PLN 10 million related to the Group's business operations.

As part of risk management, the Group identified certain areas of risks related to the implementation of the assumed business objectives:

1) raw material risks;
2) production risks;
3) market risks and associated financial risks;
4) operational risks related to the operation of IT systems;
5) risk in the area of information security.

For each area of risk identified above, specific types of risks have been identified for a strictly specific area. The risk type has been described comprehensively, including the theoretical examples of its occurrence in the operational activity of the Group. For each type of risk, specific forms of action were also developed in order to minimize or exclude it; an appropriate measure was also assigned and, where possible, so-called "Key performance indicator", i.e. the minimum level of performance was determined.

The managers and employees of organizational units assigned to particular risk area are the subject to control, in scope of compliance with the Management Principles, in accordance with their scope of activity. The management of organizational units is responsible for correct and compliant with the Management Rules performance of tasks by subordinate units and independent positions. The Management Rules also describe the detailed process of correct reporting on the identified risk as well as how to proceed in case of identifying a violation of the principles described in the document.

According the Management Principles, the compliance with the procedures and ways of proceeding described in the document can be abandoned only after obtaining the written approval of ZE PAK SA Management Board. In such a situation a special procedure, described also in in the Management Principles, is applied.

3.5. Description of use of emission earnings

In 2017, PAK KWB Konin SA, a company subject to consolidation within the Capital Group, made nine issues of bonds - the total amount of bonds issued in 2017 amounted to PLN 130 000 thousand, the bonds were fully covered by the companies from the Group. The proceeds from the issue of bonds were used to finance the current operations of PAK KWB Konin SA.

The total amount of bonds purchased in 2017 by PAK KWB Konin SA amounted to PLN 130 000 thousand, and the entire purchase covered bonds acquired by the Group companies.

4. MAIN BUSINESS RISKS

The process of forecasting future results of Zespół Elektrowni Pątnów-Adamów- Konin SA Capital Group must include a wide range of factors, actually, potentially, or theoretically, existent in the branch and markets, in which the Group conducts its activities. These are factors which originate both from the inside of the Group as well as from its environment. In the opinion of the Board, they can be divided into factors, which occur constantly in all periods as well as those, which occur incidentally in the period, which is concerned by a given periodical report.

The most important factors with constant impact on the Group's results include the following:

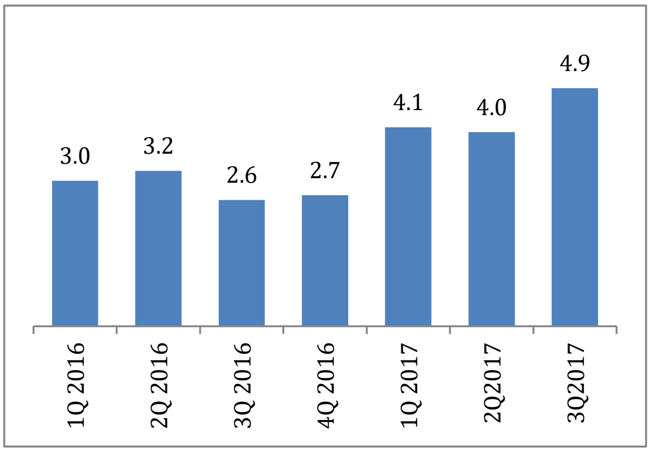
- macro-economic trends in the Polish economy and the demand for electricity;
- regulatory environment;
- electricity prices;
- prices and supply of certificates of origin;
- extraction and supply costs of coal and other fuel;
- CO_2 emission allowances costs;
- compensation for the stranded costs related to the termination of PPA of Elektrowni Pątnów II sp. z o.o.;
- seasonality and meteorological conditions;
- investment expenses; in particular, these entitling to obtain free CO_2 emission allowances;
- EUR/PLN exchange rate, the level of interest rates.

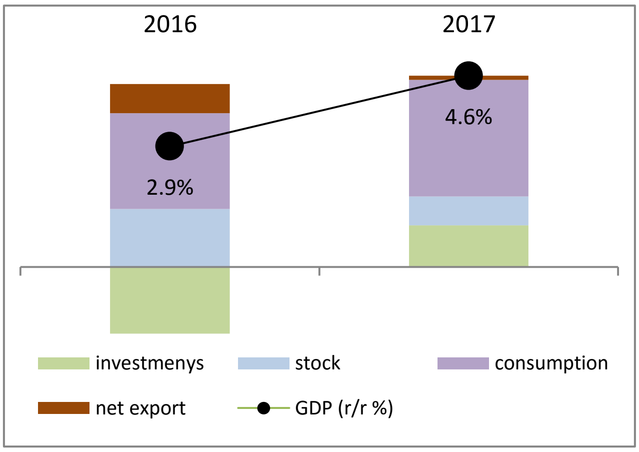
Moreover, important factor that may have a significant impact on the Group's financial results in the coming quarters are the results of the value impairment test of assets. In accordance with IAS 36, the value impairment test of assets is carried out after the occurrence of certain conditions. The last tests were carried out on 31 December 2017 and their result did not justify the change of the asset components value. The used valuation models of assets show sensitivity to a range of parameters, among others, the ones described in this section. Therefore, in the face of deterioration of the operational perspectives, both the market ones and those having its origin in the legal conditions, the assumptions for the valuation models of assets can change, and consequently the value impairment tests results may cause the necessity of verifying the value of the amount of the write-downs against the asset components. Another analysis of the reasons justifying the potential necessity to conduct the value impairment tests of the asset components will be executed at the end of the next reporting period.

Macro-economic trends in the Polish economy and the demand for electricity

While conducting activities within the territory of Poland and obtaining most revenues from the sale of electricity, it is necessary to take into consideration the macro-economic trends in the Polish economy. A very significant factor is the increase in the real GDP and industrial production in Poland, the development of the service sector as well as the increase in individual consumption. All the aforementioned factors significantly affect the demand for electricity and its consumption.

Chart 3: GDP dynamics (%) in relations to analogous quarter of the previous year and yearly GDP dynamics by components



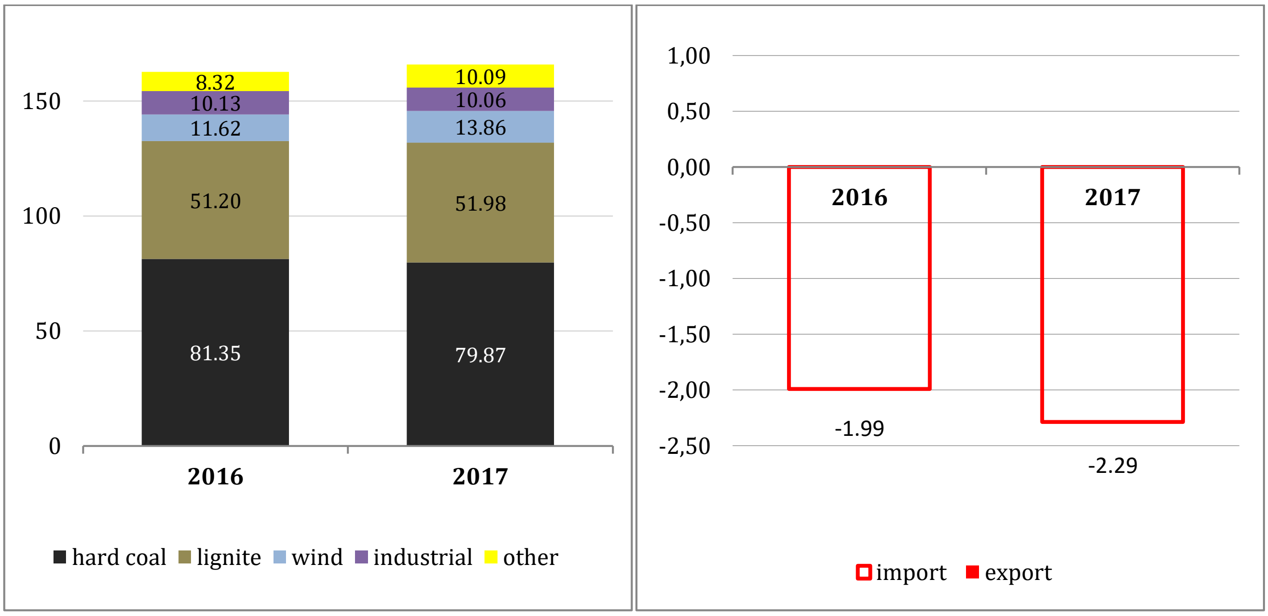


Source: GUS data

According to the initial estimates of the Central Statistical Office (GUS), gross domestic product ("GDP") calculated in fixed prices of the previous year increased in real terms in 2017 by 4.6%, compared to an increase of 2.9% in 2016. Taking into account the dynamics of GDP in the third and fourth quarter of 2017, this annual result was not a surprise. However, the first half of the year did not announce such high dynamics, also the forecasts for growth in 2017 were increasing along the following quarters. Dynamics of last year was the highest in six years (since 2011). The GDP growth in 2017 was again largely determined by consumption. Household expenditures increased by 4.8%, after an increase of 3.9% in 2016, as a result of which the contribution of consumption to the GDP growth rate amounted to 2.8%. Investments, although they increased in 2017 by 5.4%, after a breakdown of 7.9% a year earlier, their contribution to GDP growth was 1%.

The factors supporting consumer demand in 2017 remained similar as in the previous year, the most important are: a drop in the registered unemployment rate to 6.6% at the end of 2017 from 8.2% recorded at the end of 2016 and a significant increase in wages. The cumulative impact of these factors caused a demand impulse that positively influences the contribution of consumption to GDP growth in 2017. The strength of consumption in 2017 is additionally confirmed by the high base effect of the 2016 readings. In contrast to the previous year, in 2017, the component regarding fixed capital formation positively affected GDP dynamics. The increase in this component could be influenced by a certain cyclical nature of investment processes, less legislative uncertainty and the launch of investment programs by the public sector. In the case of investments, the low base effect from the previous year acted in favour of dynamics. However, it should be remembered that the low contribution of investment to GDP growth as compared to a relatively high consumption contribution may in future periods reduce the growth potential. It is worth mentioning that the impact of net exports on GDP growth in 2017 was much lower than in the previous year, which can be somehow related to the strengthening of the zloty in the second half of the year. The impact of change in inventories was positive, however, less than a year earlier.

Chart 4: Structure of electricity production and the balance of the electricity exchange with foreign countries (gross amounts) – TWh



Source: own development based on PSE data

The data concerning the functioning of the National Power System and the Balancing Market, presented by Polskie Sieci Elektroenergetyczne SA, show that the national electricity consumption[2] in 2017 was 168.14 TWh and increased by 2.13% in comparison to the previous year. The increase in consumption was recorded in all the months of 2017, with the exception of June and December, when slight decrease were recorded. Acceleration of the pace of economic

[2] Based on the Table: Structure of electricity production in domestic power plants, the amounts of exports of electricity and domestic electricity consumption – monthly and cumulative amounts from the beginning of the year – gross amounts included in PSE SA's website.

development, including the dynamics of industrial production growth and atmospheric conditions, especially in the first half of the year, influenced the energy consumption in 2017. The greatest demand for power in 2017 was recorded on 9 January at approx. 5:30 p.m., at the level of 26.231 MW[3] – simultaneously, it was the highest level of demand for power in the history of National Power System. In 2017 the total electricity production increased by 1.98%. Taking into account the entire year balance sheet, there was recorded the decrease of generating energy from the main raw material (in terms of produced energy volume), i.e. the hard coal by 1.82%. The electricity production from lignite coal increased by 1.52%. Once again, the generation of wind farms increased by 19.2% annually. The increase in generation from wind sources resulted mainly from better wind conditions, because the increase in the reachable capacity of wind farms was much lower and in 2017 amounted to 0.67% to 5 774.3 MW[4]. In the past year, the generation of gas increased by nearly 24.16% compared to 2016. Electricity produced from hard coal accounted for 48.15% of total electricity production, energy from lignite coal 31.34% and wind turbines generated 8.35% of total energy. The direction of foreign exchange has not changed. Last year Poland was again a net electricity importer, the surplus of imports over exports amounted to 2.29 TWh.

Regulatory environment

Entities operating on the power market are subject to strict regulations, such as, e.g., the Energy Law, the act on renewable energy sources ("RES"), regulations regarding the obligation of selling a part of generated power to the public, as well as supporting defined power generation technologies, and the regulations and directives of the European Commission and international conventions, on, i.e., environmental protection and climate change (including CO_2 emissions). It is also necessary to take into consideration the regulations of the tax law as well as interpretations and recommendations issued by the Energy Regulatory Office.

On April 28, 2017, representatives of the European Union Member States voted for new standards to tighten emission standards for industry (so-called BREF / BAT), which will have a significant impact on the future of conventional power plants. Poland and several other countries were against the so-called BAT conclusions. Adaptation of large industrial installations, including those generating energy and heat, to new, more stringent emission standards for SO2, NOX, dusts and permissible mercury levels introduced for the first time, plus the admissible average annual levels of hydrogen chloride, hydrogen fluoride and ammonia, in the absence of derogation from the conclusions BAT will be associated with expensive investments. Power generation installations will have to adapt to the new emission requirements within 4 years from the date of publication of the decision adopting the regulations, i.e. until the end of July 2021. Both the costs and the schedule of adjustment investments for installations subject to restrictions will be a huge challenge for the Polish energy system in the coming years.

The Water Law Act was adopted by the Sejm (Lower House of the Parliament) on 18 July 2017 and concluded by the President on 3 August. The provisions of the Act govern the rules of using water resources and define fees associated with using these resources. The new burden arising from the act will apply to the largest agricultural farms and the power sector, as well as the industries using large amounts of waters. Water intake up to 5k litres per day is to be free of charge. Up till now, there have been no applicable pricing systems for water for cooling purposes in thermal power plants and generation hydro plants. Under the new regulations, in the case of the power sector, the fee for using water resources shall be PLN 0.70 per m^3 of the difference between the volume of underground waters consumed for these purposes and the volume of water from cooling systems of the power plants or CHPPs, introduced to the waters or the ground. Another rate applies to surface waters - it is PLN 0.35 per m3 of the difference between the volume of underground waters consumed for these purposes and the volume of water from cooling systems of the power plants. The rate for the so-called cooling waters, coming from cooling systems of the power plants, which are, e.g., later sent to rivers, shall be: PLN 0.68 if the water temperature is above 26 degrees Celsius and does not exceed 32 degrees; PLN 1.36 if it is higher than 32 degrees and does not exceed 35 degrees; PLN 4.24 if it exceeds 35 degrees. According to a declaration from the Ministry of Environment, passing the new law will enable meeting the prerequisites of the EU Water Framework Directive. The provisions of the revised law entered into force at the beginning of 2018.

On 14 August 2017, the Polish President signed an amendment to the Act on renewable energy sources. A major change in the new regulations is the withdrawal from a fixed value of the so-called replacement fee, previously at PLN 300.03/MWh and binding it with market prices of energy certificates of origin - green certificates and blue

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[3] Based on the Table: Requirements run on days where there was a minimum and maximum domestic demand for power available on the PSE SA website.

[4] Based on the Table: Balance of power at the morning rush hour of domestic demand for power in the average values of working days in a month included in PSE SA's website.

certificates. The fee is supposed to be at 125% of the weighted average price of given certificates from the previous year, but not more than PLN 300.03/MWh.

On December 29, 2017, the President signed the Power Market Act. The act regulating the functioning of the power market is one of the key legal acts for energy producers. According to the authors, this act is to ensure the profitability of construction of new power units and modernization of existing units, without which the energy system is in danger of a power deficit. Due to the age of currently operated power units, it is to be expected that in the next years, a significant part of the power plants built in the 1960s and 1970s will have to be shut down. Modernization of a part of generating units (especially 200 MW class blocks) may be a solution for the current problems, however current wholesale energy prices are not conducive to making large investment commitments associated with old repairs and construction of new units. The solution to the problem of missing resources is to be the power support mechanism. The power market introduces support in the form of additional remuneration - power payments - for generation sources for the fact that within the time specified in the contract, if necessary, for example energy shortage, will have sufficient power. So they can provide the energy they need. Such an additional source of income is to be an impulse for energy producers to willingly finance the modernization or construction of new capacities. Offers for the amount of expected remuneration for power will be selected in special auctions, which will start in December 2018. Exceptionally, three auctions should take place then - for the power in the following years: 2021, 2022, and 2023. From 2019, one auction will be held annually - for a five-year power reservation. Auctions will win the cheapest offers with maximum consideration for technological neutrality. Similarly, offers of domestic bidders will be considered, but also - at a certain level - foreign sources, as well as DSR services, i.e. limiting energy consumption and demanded power. The project assumes that the greater the investment into the generating source, the longer the power contract it can receive. Longer contracts will also be awarded to units with low CO2 emissions and providing enough heat for municipal heating systems. On 27 February 2018, the European Council officially approved the reform of the EU Emissions Trading Scheme (EU ETS) for the period after 2020. In the opinion of their initiators, subsequent reforms of the EU ETS system, through interference with the market system model, contribute to the achievement of the assumed goals of reduction of greenhouse gas emissions by 2030. The most important proposition assumes: the total emissions ceiling is to be reduced every year by 2.2% (linear reduction factor - LRF), moreover the rate of reduction can be increased once again in 2024, after prior examination of the effectiveness of the implemented mechanisms. By the end of 2023, the number of allowances transferred to the market stability reserve (Market Stability Reserve, MSR) is expected to double temporarily, and in 2023 a new mechanism limiting the validity of allowances in the market stability reserve to a certain level will enter into force. After the reform, MSR is to absorb up to 24% of the excess of emission allowances every year for the first four years of the reformed system. The provisions of the new EU ETS Directive are to be regularly reviewed. The Council's decision closes the legislative process on the new EU ETS directive. The next step is publication in the EU official journal. The new regulations will come into force after 20 days.

Electricity prices

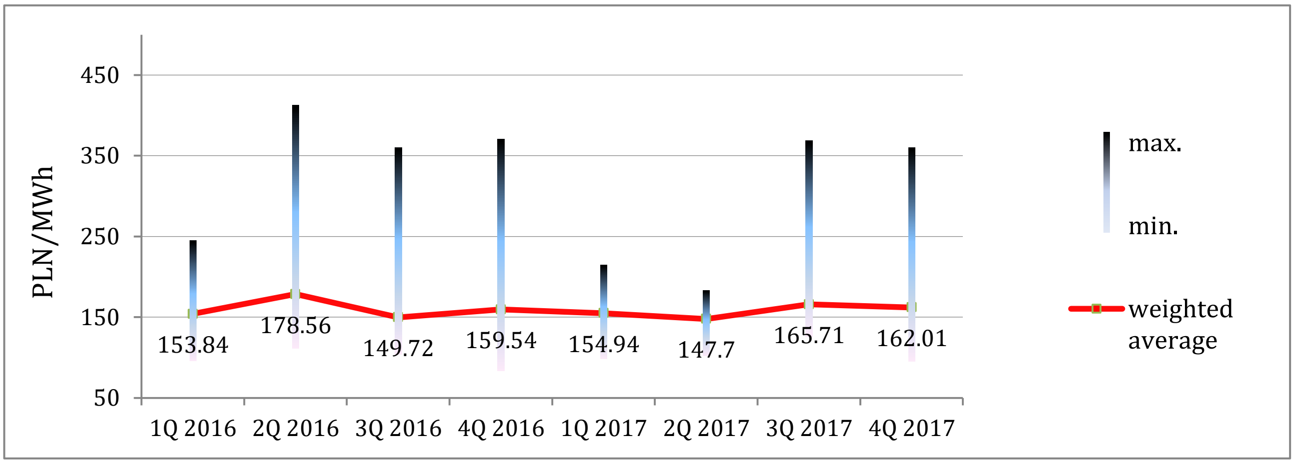
The Group generates most of its revenues from the production and sales of electricity, therefore the price for which it sells electricity is very important for the results of its activities.

In 2017, the weighted average energy price decreased in relation to the previous year. The weighted average of the IRDN (Day-Ahead Market Index) on the Polish Power Exchange (PPE) for 2017 was at the level of 155.56 PLN / MWh, which means a decrease in relation to 2016 by 5.15 PLN / MWh, i.e. by 3.2%. Characteristic is the fact that only for the second quarter the weighted average price was higher in 2016 than in 2017, in the remaining quarters the 2017 quotations were higher. However, the difference in the weighted average price between the second quarter of 2016 and 2017 was exceptionally large, i.e. 30.86 PLN / MWh. It was the second quarter that was the period of increased volatility and high prices in 2016, while in 2017 it was characterized by the lowest prices and low volatility. In 2017, the second half of the year brought higher price levels and greater volatility. The factors significantly influencing the level of stock exchange quotations on the SPOT market remained the same, and the most important ones among them are: the size of wind generation, the state of the reserve in the PPS system, the volume of transmission capacities available for cross-border exchange, and weather conditions. According to PSE data, on January 9, 2017 the highest power demand in the history of the National Power System was recorded at the level of 26,231 MW. However, even such a high demand did not disturb the system operation mode and did not caused extremely high prices, because the system was well balanced in this period. The year 2017 was not characterized by such a large dynamics of the increase in installed wind power as the previous two years. At the end of 2017, in the system there was installed 5 774.3 MW[5] of wind turbine power, which means a symbolic increase of only about 38.4 MW, but due to excellent wind conditions,

[5] Based on the Table: Balance of power at the morning rush hour of domestic demand for power in the average values of working days in a month included in PSE SA's website

especially in the third and fourth quarter, the increase in electricity production from wind farms amounted to 19.2%[6]. It is worth noting, however, that last year the power installed in the system increased due to new conventional units. The steam and gas block in Włocławek with the power of 463 MW and the largest in Poland block for hard coal with the power of 1075 MW in Kozienice are the largest of the units that joined the National Power System in the past year. In 2018, it is expected that the works in Płock will be finalized, a 600 MW gas and steam block and possibly the first coal block in Opole (900 MW), although in this case delays in the schedule were reported. Another factor that influenced the market prices of electricity in the past year, especially in the second half of it, was the increase in the prices of raw materials, including hard coal, the main raw material used to produce energy in Poland, and the increase in prices for CO2 emission permits. Despite the fact that last year coal prices in Poland did not grow as dynamically as on global markets, in 2017 on the basis of the Polish Energy Market Index in sales to the professional and industrial power industry there was an increase by almost 12%[7]. In the second half of the year, the price of CO2 emission allowances also increased (more detailed discussion under "CO2 allowances costs" below). It was these two factors mentioned above that probably caused an increase in electricity prices in the second half of 2017. The highest quarterly weighted average price in 2017 was reported in the third quarter at 165.71 PLN / MWh.

Chart 5: Energy prices (IRDN)



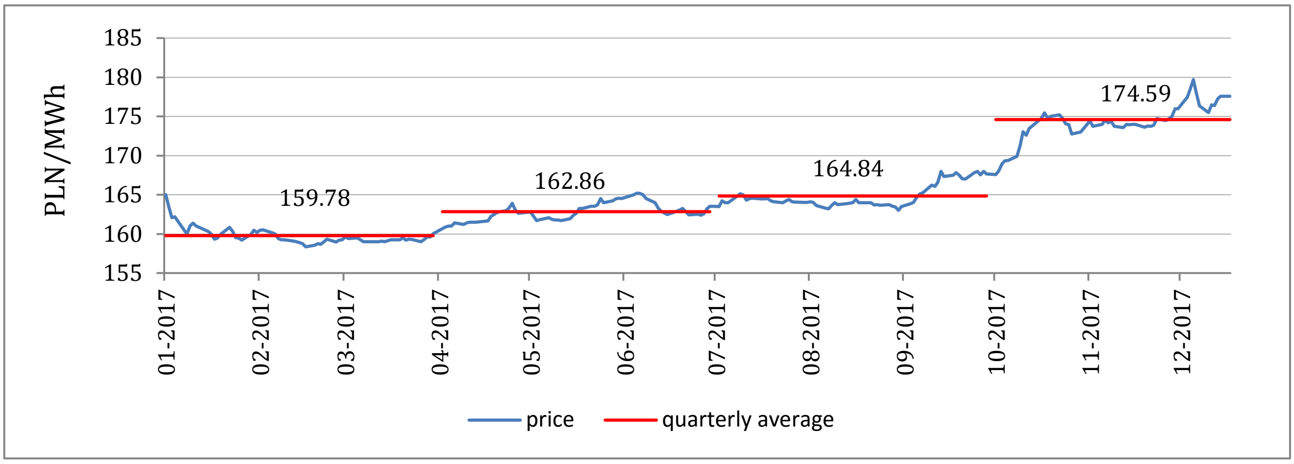
Source: Own elaboration based on TGE data

On the forward electricity market of the Polish Power Exchange, the most liquid instrument, the annual BASE_Y-18 contract, with time passed was recorded at increasingly higher levels. The highest dynamics of growth could be observed at the turn of the third and fourth quarter. It is easy to notice a certain correlation with the spot market, where also higher levels were observed in the second half of the year. The factors determining the increases in both markets were similar. Higher and higher quotations of energy raw materials, including hard coal, growing quotation of emission allowances and expectations for this trend to continue in the next year.

[6] Based on the PSE data "Structure of electricity generation in domestic power plants, the amounts of exports of electricity and domestic electricity consumption – monthly and cumulative amounts from the beginning of the year – gross amounts."

[7] Based on the Quotations of PSCMI 1 / Q of the Polish Power Market Index 1 for sale to professional and industrial power plants available on the ARP SA website.

Chart 6: The price of the futures contract for the supply of electricity (band) for 2018



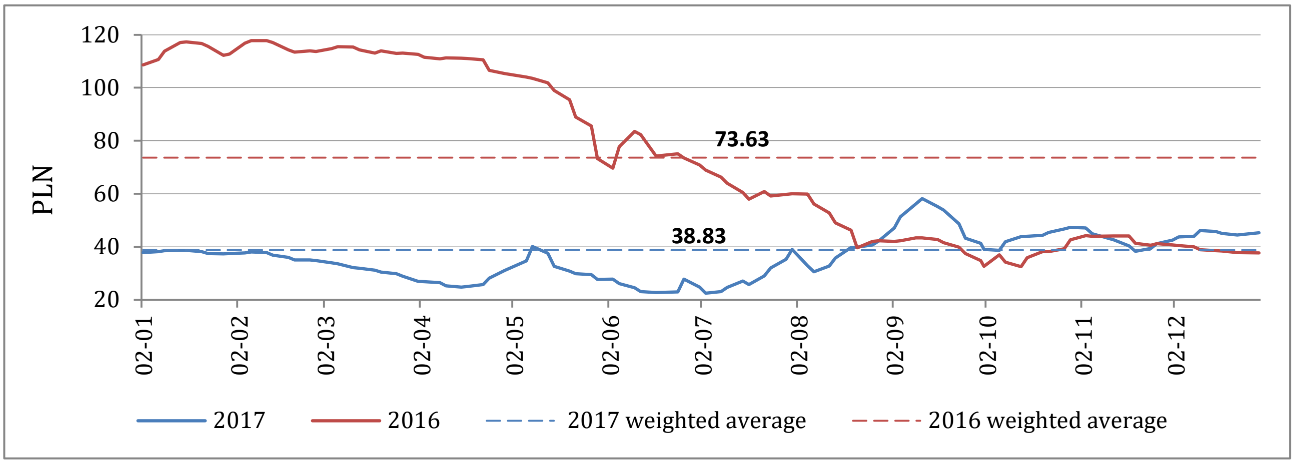
Source: Own elaboration based on TGE data

Certificates of origin

Due to the fact that one of the power units at ZE PAK SA is dedicated to combusting biomass (forest and agricultural), and in addition, the Group utilizes high-efficiency co-generation in order to generate heat, a producer is entitled to green and red certificates, provided certain regulatory requirements are met. The number of obtained certificates of origin depends on the level of generation from a given sources and is usually higher than the number, which the Company is obliged to present for redemption, which in the case of a surplus allows to sell specific volumes to other market participants. However, biomass unit generation largely depends on the green certificates market price levels. During periods, when the total generated biomass energy and green certificate prices do not ensure reaching the assumed financial effect, the generation may be decreased or halted, which also automatically decreases the amount of generated green certificates. In the case of a shortage, the certificates must be purchased on the market.

2017 year on the market of property rights resulting from certificates of origin from renewable energy was slightly different from the previous two years when quotations of green certificates were almost constantly falling. In the past year, there have been symptoms indicating a break in this lasting downward trend. While prices continued to decline until April, a rather dynamic rise was recorded in the middle of the second quarter. The price increase was admittedly short-lived, because prices soon started to fall again, setting a minimum annual listing at the level of PLN 22.46 / MWh. However, another growth impulse initiated in the third quarter has already managed to raise prices in a sustainable manner. Stopping the long-term downward trend on the green certificates market in 2017 can be combined with the expectations of market participants on legislative solutions that, in the assumption of their creators, would lead to eliminate the oversupply that has been accompanying the market for several years. There are two events worth mentioning, being important for the market in 2017. The latest amendment to the Act on Renewable Energy Sources provides that the substitute fee, which is an alternative to the redemption of green certificates of energy origin, will depend on market quotations of green certificates and its value will be equal to 125% of the weighted average market price of certificates of origin from the previous year, but no more than 300.03 PLN/MWh. In August, the Ministry of Energy announced the obligation of RES for 2018 at the level of 17.5% for energy from all renewable sources except for agricultural biogas, as well as 0.5% for energy from agricultural biogas and the obligation for 2019, for energy from all renewable sources, with the exception of agricultural biogas plants 18.5%, and the obligation for energy coming from agricultural biogas plants at the level of 0.5%. In the fourth quarter, however, declines returned to the market. The reduction of the excess number of certificates on the market was certainly not supported by the high wind generation in the third and fourth quarters, which, despite similar installed capacity, significantly increased in relation to the same period of the previous year. The average weighted price of green certificates in 2017 was at 38.83 PLN / MWh, which means a decrease of 34.8 PLN / MWh, or 47.26% compared to the weighted average price for 2016.

Chart 7: Average price of certificate of origin for RES produced energy



Source: own development based on the TGE data

Fuel costs and supplies, coal extraction costs

A fuel cost is the most important part of the costs related to the electricity and heat generation in companies of the ZE PAK SA Group. The prices of fuel largely determine the competitiveness of particular electricity production processes. The ZE PAK SA Group's power plants produce most of their electricity from brown coal, but they also use forest and agricultural biomass. Furthermore, heavy and light heating oil is used in minimum quantities for heating purposes in the process of electricity production.

Two brown coal mines, PAK KWB Konin SA and PAK KWB Adamów SA, which are the suppliers of brown coal to the ZE PAK SA Group's power plants, satisfy the demand of generation assets for this basic fuel. Therefore, the ZE PAK Group does not rely on external suppliers and eliminates the exposure to potential fluctuations of brown coal prices. Nevertheless, the Group is exposed to the fluctuations in prices of other fuels used (mainly biomass) and part of the costs related to the extraction of brown coal depends on the factors which remain outside the direct control of the Group.

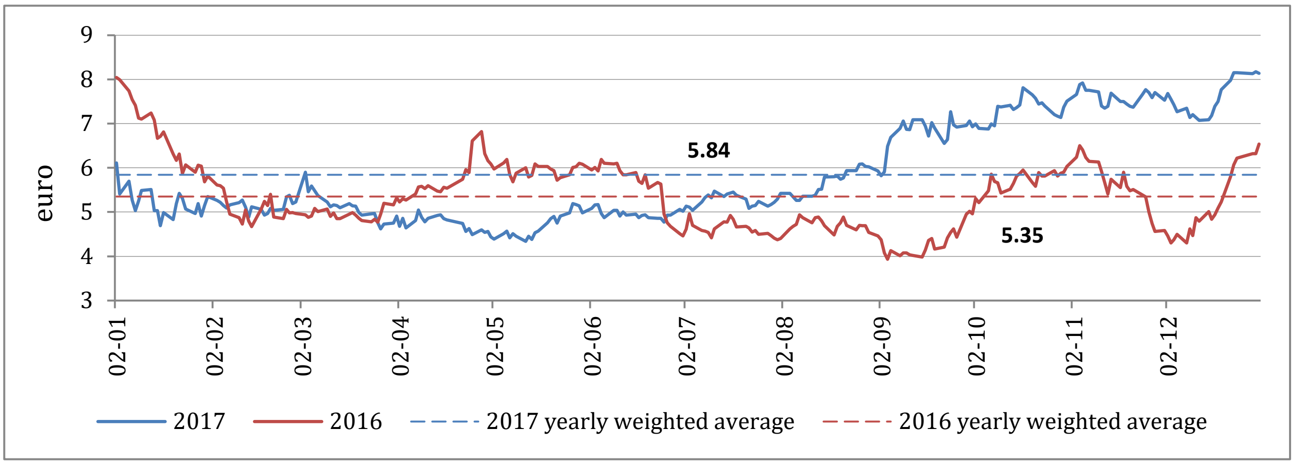
The deposits exploited by the Group's mines have specified richness. The opportunity to achieve the expected level of electricity production in the long term is partially dependent on the ability of extracting from the currently exploited deposits and launching the exploitation of new brown coal deposits, which would be economically viable. As part of activities to ensure the raw material for the Group's generation assets, PAK KWB Konin executed designing works at the perspective brown coal deposits. In order to develop the perspective deposits, it is necessary to obtain all necessary formal approvals and permits, culminated with obtaining a license to extraction. The process of obtaining approvals and permits is a multi-step and stretched in time. In view of the above, there is a risk of delays and postponements in the schedule of developing subsequent deposits which, in turn, may entail risks of interruptions of coal supplies for the Group's generating assets. The opportunity to start the extraction from the prospective coal deposits in the future may be limited by many factors beyond the control of the Group. The main risk factors include: failure to obtain the necessary licenses, adverse settlements of the local government authorities in terms of shaping the special policy, lack of opportunity to obtain adequate financing

CO_2 emission allowances costs

The activities in the scope of generating electricity and heat from conventional sources are associated with the need to incur the CO2 emission costs. In view of the fact that these costs represent an important item in the structure of the costs incurred by the producers of energy from lignite, the impact of emitted quantities of CO2 and the price of CO2 emission allowances (EUA) is of great importance to the activities' results. In 2017, the Group received a small amount of free CO2 emission allowances, i.e. 83 317 EUA, resulting from the allocation for heat generation. Therefore, practically the entire volume of emission allowances needed for the ZE PAK SA Group will have to be purchased on the primary (auctions) and secondary (ICE, EEX and bilateral contracts) markets.

The course of price quotations for CO2 emission allowances in 2017 can be divided into two periods. The first half of the year is a consolidation of quotations limited from the bottom by the minimum level of quotations in 2017, i.e. EUR 4.34. The second half of the year is a clear upward trend. The factors supporting the demand for energy from conventional sources in Europe (and thus the demand for CO2 emission rights) were low temperatures in January, relatively high temperatures and a lower amount of precipitation in the summer. Weather conditions caused greater intensity of use of coal-fired power plants, and thus contributed to the increase in demand for EUA. The second factor favouring the demand for EUA, especially in the first months of 2017, was the situation of the nuclear power sector in France where the announcements of the necessary withdrawal of power units caused increased demand for energy produced, among others, from coal in neighbouring countries. The third factor supporting the upward trend, especially in the second half of 2017 were purely political reasons, joint calls from representatives of the government administration of France and Germany to quickly complete work on changes to the current EU ETS CO2 trading system, which, as a consequence, by interference in the market mechanism, would according to the authors of this plan, increase the price of emission rights. Poland as a party participating in the work on changes in the CO2 trading system was opposed to too radical steps that could affect the price increase of emission allowances and, consequently, also of energy prices. The arithmetic average of EUA quotations in 2017 was EUR 5.84, which means an increase of EUR 0.49, i.e. 9.16% compared to the 2016 arithmetic average.

Chart 8: The price of a forward contract for the delivery of EUA



Source: Own elaboration based on ICE data

Compensation for the stranded costs related to the termination of the „Long-term Contract" („PPA")

The long-term contract for the sale of power and electricity (PPA) was concluded between Elektrownia Pątnów II sp. z o.o. and Polskie Sieci Elektroenergetyczne SA. The contract was a long-term agreement in the scope of supply of electricity according to the established price formula.

Due to the early termination (on 1 April 2008) of PPA of Elektrownia Pątnów II sp. z o.o., pursuant to the Act of 29 June 2007 on the principles of coverage of costs incurred by producers due to early termination of long-term agreements for the sale of power and electricity, Elektrownia Pątnów II sp. z o.o. is entitled to receive sufficient compensation. The amount of compensation is estimated according to an applicable formula specified in the Act. Elektrownia Pątnów II sp. z o.o. is covered by the said act by the end of 2025.

Seasonality and meteorological conditions (including mainly wind conditions)

The demand for electricity and heat, especially among consumers, is subject to season fluctuation. So far, the practice showed that the consumption of electricity was higher in the winter (mainly due to low temperatures and shorter days) and lowered in the summer (due to the summer period, higher ambient temperatures, and a longer day). In the last couple of years, there is an increase in the demand for electricity in the summer, which is caused mostly by the rising number of used cooling devices and air conditioning.

Irrespective of the factors described above, meteorological conditions are becoming more and more important for the Group's production level. In the past, the operations of the Group were not subject to significant seasonality of demand, due to low costs, the work of blocks was carried out continuously (in the basis) for almost a whole year. Currently, taking into account the growing share of RES in the energy generation segment, including primarily wind sources, weather conditions are becoming more and more important in the estimation of the Group's production volume, with particular regard to wind conditions. Statistically, periods of the best wind conditions are the first and the fourth quarter. It should be taken into account that in periods when wind conditions are extremely good and the production of wind turbines is high, the demand for the Group's production may be subject to periodic reductions, similarly in periods of lower wind production can increase.

Investment expenses

Activities in the coal mining and energy production sector require significant investment expenditures. The Group's generation assets require periodic renovations and ongoing modernizations, both due to the tightening of environmental protection requirements and the need to increase the efficiency of electricity production. The level of investment outlays had a material impact, and, according to expectations, it may still have a significant impact on the results of operating activities, the level of indebtedness and cash flow. Delays in implementation, changes in the investment program and exceeding the budget may have a serious impact on future capital expenditures as well as on results, financial situation and development prospects. In addition, some of the investment projects planned by the Group, reported to the National Investment Plan, involve the allocation of free units authorizing to CO2 emissions, however, if these investments are not implemented, the ability to use the free allocation is also prevented.

EUR/PLN exchange rate, the level of interest rates

Despite the fact that the Group conducts its activities in Poland, where it incurs costs and gains revenues in zloty, there is a couple of significant factors which make the financial results dependent on the exchange rate of EUR/PLN and the level of WIBOR and EURIBOR interest rates. The most important factors include:

- a significant part of the debt (that is the corporate credit taken by Elektrownia Pątnów II sp. z o.o.) is denominated in EUR, which means that the depreciation of the value of zloty in relation to EUR has negative impact on financial results, because it increases the financing costs in zloty related to the foreign currency debt, whereas the depreciation of the value of EUR in relation to zloty has positive impact on financial results, because it decreases the financial costs in zloty related to the debt in foreign currency;
- transactions connected with EUA purchase are settled in EURO;
- The company from the renovation segment periodically provides services to foreign contractors earning revenues in EUR,
- ZE PAK SA and Elektrownia Pątnów II sp. z o.o. use debt financing based on a variable interest rate.

In 2017, two Group's companies used instruments to limit the risk resulting from changes in foreign exchange rates. ZE PAK SA hedged the euro exchange rate for some of the flows related to the purchase of CO2 emission allowances. To hedge the exchange, forward transactions were made with the settlement date in December 2017 and March 2018. Elektrownia Pątnów II sp. o.o. hedged the euro exchange rate for a part of the flows related to the repayment of the syndicated loan instalment, also applying a forward transaction with the settlement date in April 2018. Currency risk in the case of revenues from construction services is partially offset by costs incurred in the same currency with respect to the same contracts. Management Boards monitor the financial situation and market situation on an ongoing basis, and may, if necessary, decide on the necessity of using financial instruments to hedge against exchange rate risk. In accordance with the principles applied in the ZE PAK SA Group, any transactions will be hedging and will be matched to the hedged item in terms of volume and maturity date. The decision on the choice of the hedging instrument will also include: price, market liquidity, product simplicity, ease of valuation and accounting, and flexibility. The Group's exposure to the risk caused by changes in interest rates relates primarily to long-term financial liabilities related to the financing of investments in ZE PAK SA and Elektrownia Pątnów II sp. Z o.o. The Group has financial liabilities, mainly loans and loans with variable interest. In order to minimize the interest rate risk, the Group has concluded interest rate swaps (interest rate swaps), under which it agrees to exchange, at specified intervals, the difference between the amount of interest accrued at a fixed and variable interest rate on the agreed principal amount. These transactions are aimed at securing the incurred financial liabilities and relate to the syndicated loan of Elektrownia Pątnów II sp. o.o. based on the variable EURIBOR rate. IRS instruments were used for hedging.

5. DESCRIPTION OF THE FINANCIAL AND ECONOMIC SITUATION

5.1. Principles of development of the financial statement

The Group develops the financial statements on the basis of the International Financial Reporting Standards approved by the European Union. The above standards, known collectively as International Financial Reporting Standards (IFRS), also include the International Accounting Standards (IAS) and Interpretations issued by the Standing Interpretations Committee and the International Financial Reporting Interpretations Committee.

The significant principles of accounting used in the Group's Consolidated Financial Statement are discussed in note no. 10 of the Group's Consolidated Financial Statement for 2017.

5.2. Specification of the basic economic and financial values

Consolidated profit and loss account and the consolidated income statement

Sales revenues in 2017 amounted to PLN 2 443 075 thousand and in comparison to 2016 decreased by PLN 261 636 thousand, i.e. 9.67%.

The largest drop in revenues in 2017 occurred as part of revenues from the sale of electricity. The drop in revenue from the sale of electricity from own production and from resale (minus excise duty) in 2017 compared to the previous year amounted to PLN 257 128 thousand, i.e. 10.95%. The lower volume of electricity sales resulted from both lower sales of electricity from own production and sales of electricity from trading. The volume of electricity sales from own production decreased by 0.84 TWh to 8.39 TWh, while the volume of energy from trading decreased by 0.87 TWh to 3.37 TWh. On the other hand, there was an increase in the energy sales price, calculated as revenues from energy sales (own sales, turnover and system services) divided by the sales volume, to the level of 177.78 PLN / MWh, i.e. by 2.05%. Higher sales prices achieved did not manage to offset the loss of revenues which caused a drop in volume.

Revenue from the LTC solution (long-term sale of power and electricity) in 2017 amounted to PLN 181 335 thousand (including PLN 58 303 thousand adjustment), while in 2016 it amounted to PLN 207 158 thousand (including PLN 88 353 thousand adjustment). The advances in both years were at a similar level, i.e. PLN 123 028 thousand and PLN 118 805 thousand, respectively, hence the difference in the amount of income obtained is the result of the amount of the adjustment. The adjustment for 2017 was calculated at a lower level compared to 2016 due to the company's achievement in 2017 of higher revenues from sales of energy and system services and incurring lower costs within the meaning of the Act of 29 June 2007 on the rules for covering costs incurred by generators due to the early termination of long-term contracts for the sale of power and electricity.

In 2017, lower revenues from sales of thermal energy were realized, i.e. by PLN 3 366 thousand. The decrease was caused by a lower realized sales volume by 105.85 GJ, i.e. by 5.25%.

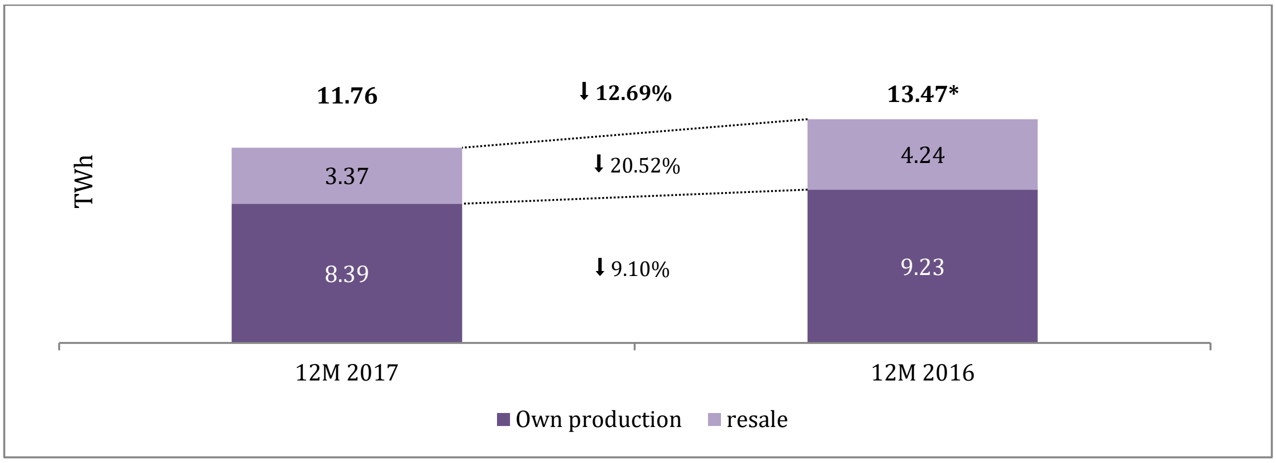
Revenues from the sale of property rights from certificates of origin in 2017 amounted to PLN 700 thousand. In 2016, PLN 812 thousand was recorded on this account. Revenues obtained from energy certificates in 2017 mainly concerned red certificates, as due to very small biomass production, the Group generated trace amounts of green certificates, additionally part of the green certificates stock was sold (in the first half of 2017) at prices lower than their prices at the end of 2016, which caused an additional cost and resulted in lowering the sales revenue.

Revenues from construction services contracts in 2017 in relation to revenues earned in the previous year increased by PLN 23 400 thousand, i.e. by 39.32%. The main reason was the increase of contractual commitment of PAK Serwis to external customers in the implementation of investments in the energy sector.

Table 4: Specification of consolidated sales revenues

	zloty thousand	*zloty thousand*	*zloty thousand*	*%*
	12 months period ended 31 December 2017	*12months period ended 31 December 2016*	*change*	*dynamics*
Revenues from the sale of electricity from own production (reduced by excise duty)	1 510 809	1 609 762	(98 953)	(6.15)
Revenues from the sale of electricity from resale on the market	579 571	737 746	(158 175)	(21.44)
LTC compensations	181 335	207 158	(25 823)	(12.47)
Construction agreements	82 906	59 506	23 400	39.32
Heat	57 175	60 541	(3 366)	(5.56)
Property rights from certificates of origin of energy	700	812	(112)	(13.79)
Other revenues	30 579	29 186	1 393	4.77
Total	**2 443 075**	**2 704 711**	**(261 636)**	**(9.67)**

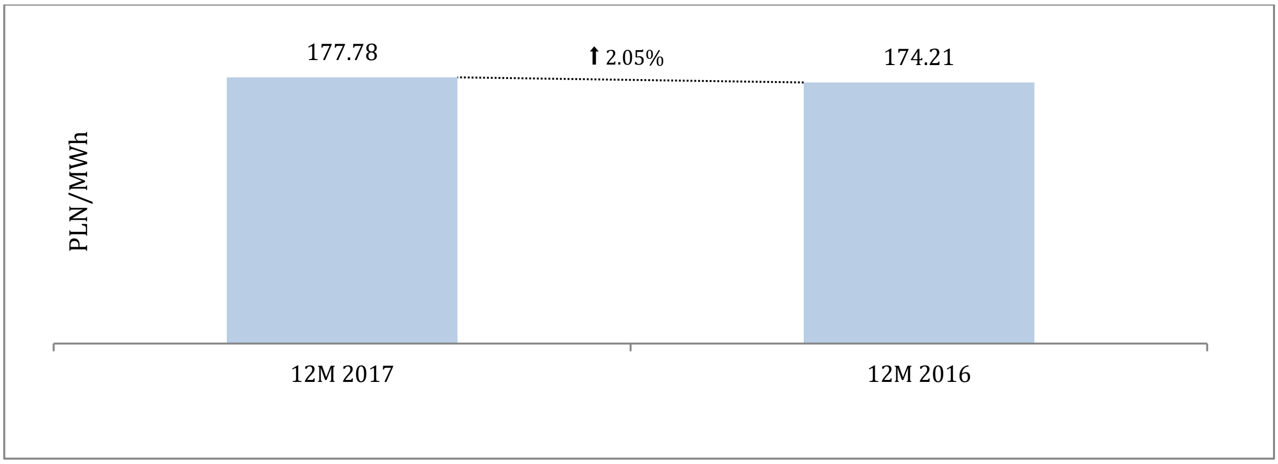
Chart 9: Sale of electricity



* *In addition to the values presented in the chart, in 2016, 0.04 TWh of electricity was sold as part of the production of units 1 and 2 in Pątnów I power plant during the investment period.*

Source: Internal data

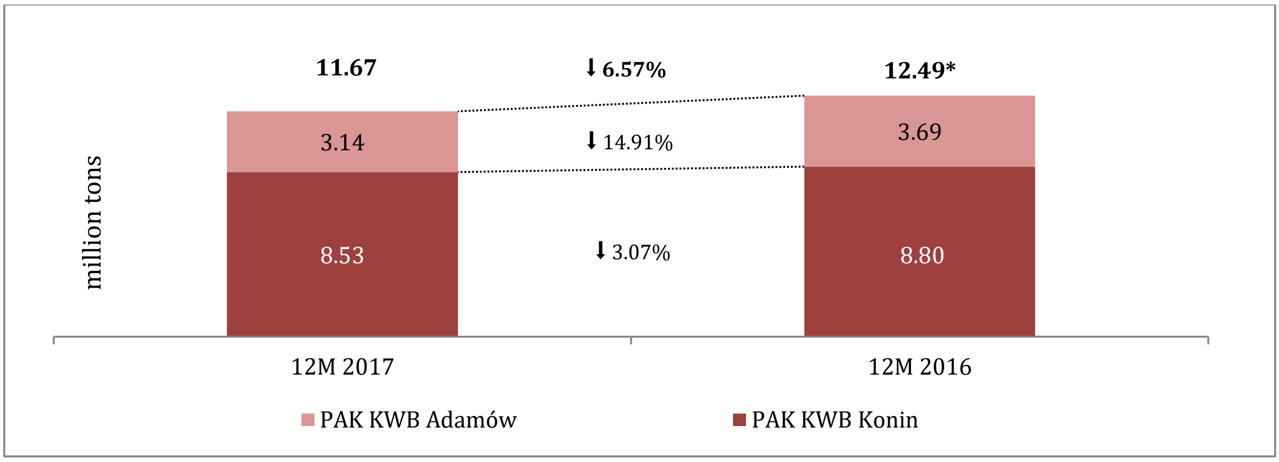
*Chart 10: Average electricity prices**



* *Average price, calculated as electricity sales revenues (own production with system service as from resale) divided by the sales volume.*

Source: Internal data

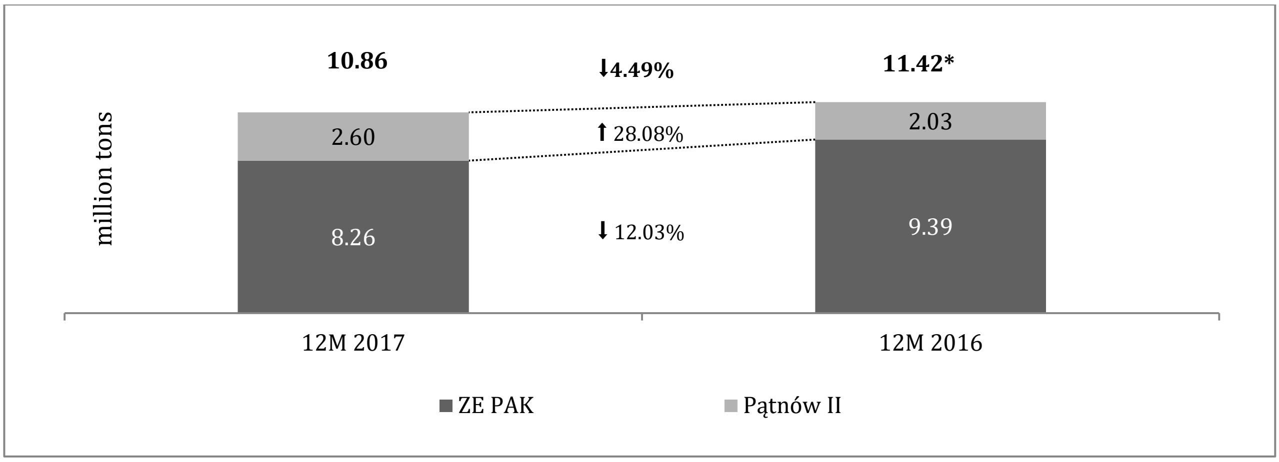
Chart 11: Lignite consumption



* *Apart from the values presented in the chart, additionally 0.05 m tonnes of coal were consumed within 12 months of 2016 for the needs of units 1 and 2 at the Pątnów I Power Plant in the investment period.*

Source: Internal data

Chart 12: CO_2 emissions



* *Apart from the values presented in the chart, additionally 0.04 m tonnes of CO2 were emitted in the course of generation in units 1 and 2 at the Pątnów I Power Plant in the investment period, within 12 months of 2016.*

Source: Internal data

Table 5: Selected items from the consolidated profit and loss account

	zloty thousand *12 months period ended 31 December 2017*	*zloty thousand* *12 months period ended 31 December 2016*	*zloty thousand* *change*	*%* *dynamics*
Sales revenues	**2 443 075**	**2 704 711**	**(261 636)**	**(9.67)**
Cost of goods sold	(2 035 396)	(2 241 353)	205 957	(9.19)
Gross profit (loss) on sales	407 679	463 358	(55 679)	(12.02)
Other operating revenues	11 324	26 461	(15 137)	(57.20)
Selling costs	(4 258)	(4 360)	(102)	(2.34)
Administrative expenses	(119 467)	(108 634)	(10 833)	9.97
Other operating costs	(5 186)	(5 392)	206	(3.82)
Profit (loss) on operating activities	**290 092**	**371 433**	**(81 341)**	**(21.89)**
Financial revenues	16 193	9 117	7 076	77.61
Financial costs	(47 652)	(72 672)	25 020	(34.43)
Gross profit (loss)	**258 633**	**307 878**	**(49 245)**	**(15.99)**
Income tax (tax load)	(75 089)	(57 592)	(17 497)	30.38
Net profit (loss)	**183 544**	**250 286**	**(66 742)**	**(26.66)**
Net other comprehensive income	2 660	8 594	(5 934)	(69.05)
Total income for the period	**186 204**	**258 880**	**(72 676)**	**(28.07)**
EBITDA*	**511 905**	**593 587**	**(81 682)**	**(13.76)**

* *The Company defines and estimates EBITDA as the profit/(loss) on operating activities (estimates as the net profit/(loss) for the accounting year corrected by the (i) income tax (tax load), (ii) financial revenues as well as (iii) financial costs) corrected by the depreciation (shown in the income statement) as well as impairment write-downs against tangible assets, intangible assets as well as mining assets.*

The cost of sales in 2017 amounted to PLN 2 035 396 thousand and, as compared to the previous year, it decreased by PLN 205 957 thousand, i.e. by 9.19%.

The following factors contributed the most to the decrease in own cost: lower value of electricity purchased for trading, lower costs of materials consumption due to lower production (in particular, production from a biomass boiler) and lower employee benefits costs resulting from lower average employment in the period. In 2017, the lack of significant impairment losses on inventories also had a positive effect, which increased the cost base in 2016. The lower amortization value seen in 2017 in relation to the previous year results from the inactivation of one of the outcrops in 2016 and the ending of depreciation of the overburden in one of the mines in March, this effect would be even more visible, but it was partially offset by higher depreciation of the block at Pątnów II Power Plant in 2017 (following the capital renovation in the 4th quarter of 2016). In 2017, a lower cost of mining damage was also recorded in other types of costs. On the other hand, higher external services were influenced by higher external services as a result of greater involvement of one of the service companies in the implementation of contracts for external customers, higher service costs (in 2016 some of these costs were activated in the overhaul component during the capital overhaul at Pątnów II power plant). The costs of CO2 emissions decreased in 2017 as compared to 2016 as a result of both lower volume of energy produced and a slightly lower average unit price of emission allowances. In 2017, in comparison to the previous year, a revaluation write-down was made for fixed assets under construction, a write-down related to one of the machines at PAK KWB Adamów SA and its cause was a change in the economic prospects for mine operation following the end of Adamów power plant operation. Additionally, the amount of the cost of sales in 2017 was adversely affected by the necessity of a one-off increase in the reclamation provision, which was announced by the Company in October. Own cost of sale was charged to the part of the reserve, which related to currently exploited opencasts, while the remaining part of the reserve, concerning the areas where the operation was completed, increased general administrative costs.

The detailed analytical approach to costs by type is provided in Table 6.

Other operating revenues in 2017 amounted to PLN 11 324 thousand and were lower than in 2016 by PLN 15 137 thousand, i.e. 57.20%. In 2017, one of the companies completed the settlement of leaseback transactions, therefore the revenues resulting from the surplus of the contract value over the net value of the leased asset were settled only for a part of the year. Additionally, in 2016, provisions for, among others, coal allowance, which inflated the value of other operating income once.

Other operating expenses in 2017 amounted to PLN 5 186 thousand and their level did not differ significantly from the level from 2016.

Selling costs in 2017 amounted to PLN 4 258 thousand and were lower by PLN 102 thousand, i.e. by 2.34% on sales costs recorded in 2016.

General administrative expenses in 2017 amounted to PLN 119 467 thousand and were higher than in the previous year by PLN 10 833 thousand, i.e. by 9.97%. The increase in general administrative expenses in 2017 is to a large extent the result of classifying to this item part of the costs resulting from the increase in the reclamation provision, about which the Company informed in October. The general administrative expenses related to this part of the increase in the reserve, which refers to unexploited outcrops. The increase in general and administrative expenses also resulted from the lower base effect in 2016 due to the provision for the employee bonus in one of the companies terminated at that time. An additional factor was the inclusion of this part of employee benefits costs, which resulted from agreements concluded with the employees of Adamów power plant, which ended its activities in January 2018.

In 2017, the Group generated operating profit in the amount of PLN 290 092 thousand.

Financial revenues in 2017 amounted to PLN 16 193 thousand and were higher than those recorded in 2016 by PLN 7 076 thousand, i.e. 77.61%. The appreciation of zloty against euro in the previous year had the greatest impact on the increase in financial income due to the impact on the valuation of credit liabilities in the company Elektrownia Pątnów II sp. z o.o.

Financial expenses in 2017 amounted to PLN 47 652 thousand and in comparison to the previous year decreased by PLN 25 020 thousand, i.e. 34.43%. Two reasons have contributed to the decline in financial costs: the first is the lack of exchange-rate expenses in 2017 that were recorded a year earlier, and the second reason is the lower interest expenses related to the decreasing Group debt.

In 2017, the Company generated a gross profit of PLN 258 633 thousand, which means a decrease by 15.99% compared to 2016. At the net level, the profit was PLN 183 544 thousand, by PLN 66,742 thousand, or 26.66% less than a year earlier.

Table 6: Consolidated costs by type

	zloty thousand *12 months period ended 31 December 2017*	*zloty thousand* *12 months period ended 31 December 2016*	*zloty thousand* *change*	*%* *dynamics*
Depreciation	199 648	221 699	(22 051)	(9.95)
Fixed assets – write offs	22 165	455	21 710	-
Inventory – write-offs	(852)	10 188	(11 040)	-
Materials consumption	252 602	336 435	(83 833)	(24.92)

External services	112 451	66 041	46 410	70.27
Taxes and fees excluding excise tax	201 592	204 688	(3 096)	(1.51)
CO_2 allowances costs	289 942	311 328	(21 386)	(6.87)
Employee benefits costs	461 291	488 005	(26 714)	(5.47)
Other costs by type	39 350	48 354	(9 004)	(18.62)
Value of sold goods and materials and of sold energy purchased from trade	555 156	747 216	(192 060)	(25.70)
Total	**2 133 345**	**2 434 409**	**(301 064)**	**(12.37)**

Consolidated statement of financial position

The balance sheet total as at December 31, 2017 amounted to PLN 4 455 712 thousand and, as compared to the balance as at December 31, 2016, it decreased by PLN 345 588 thousand, i.e. by 7.20%.

Fixed assets as at 31 December 2017 amounted to PLN 3 447 776 thousand. In comparison to the last day of 2016, they decreased by PLN 254 282 thousand, i.e. by 6.87%. The biggest decrease concerned:

- the item of intangible assets, which decreased by PLN 112 603 thousand as a result of the settlement in 2017 of CO2 emission allowances, which at the end of 2016 were classified as long-term,
- items of tangible fixed assets which decreased by PLN 110 411 thousand as a result of the difference between the amount of investment outlays and the amortization write-off in the period under consideration. Additionally, at the end of the year, a revaluation write-off was made for the value of fixed assets under construction at PAK KWB Adamów SA.

Current assets as at December 31, 2017 amounted to PLN 1 006 898 thousand. In comparison with the last day of 2016, they decreased by PLN 92 344 thousand, i.e. 8.40%. The largest change took place in the position of other short-term financial assets, which decreased by PLN 40 101 thousand. The decrease was related to changes in one of the loan agreements, which allowed the release of some of the collateral held previously in the form of deposits. The VAT receivables disclosed under other non-financial short-term assets also decreased.

Equity as at December 31, 2017 amounted to PLN 2 264 273 thousand, compared to the end of 2016 increased by PLN 120 615 thousand, i.e. by 5.63%, being the result of an increase by this part of the profit from the previous year, which was not paid in the form of a dividend and earned net profit during the current year.

Liabilities as at 31 December 2017 amounted to PLN 2 191 440 thousand, which means that during the year they decreased by PLN 466 202 thousand, i.e. by 17.54%. The biggest changes took place in the following positions:

- loans and credits, which decreased by PLN 357 771 thousand;
- trade liabilities which decreased by PLN 85 990 thousand and other short-term financial liabilities, which decreased by PLN 70 256 thousand mainly as a result of repayment of the liability of Elektrownia Pątnów II sp. z o.o. related to the settlement of overpayment for compensation for terminating PPAs in previous years.

Table 7: Selected items from consolidated assets

	zloty thousand	*zloty thousand*	*zloty thousand*	*%*
	31 December 2017	*31 December 2016*	*change*	*dynamics*
Fixed assets				
Tangible fixed assets	3 280 835	3 391 246	(110 411)	(3.26)
Investment property	2 365	2 337	28	1.2
Intangible assets	6 679	119 282	(112 603)	(94.40)
Assets concerning stripping and other mining assets (long-term)	72 536	80 524	(7 988)	(9.92)
Other long-term financial assets	10 311	11 945	(1 634)	(13.68)
Other long-term non-financial assets	2 122	5 726	(3 604)	(62.94)
Deferred tax assets	72 928	90 998	(18 070)	(19.86)
Total fixed assets	**3 447 776**	**3 702 058**	**(254 282)**	**(6.87)**
Current assets				
Short-term intangible assets	261 654	273 036	(11 382)	(4.17)
Inventory	97 758	105 296	(7 538)	(7.16)

Deliveries and services receivables and other receivables	253 261	246 025	7 236	2.94
Income tax receivables	17 731	10 227	7 504	73.37
Derivative short-term financial instruments	-	296	(296)	(100.00)
Other short-term financial assets	35 788	77 317	(41 529)	(53.71)
Other short-term non-financial assets	11 425	28 776	(17 351)	(60.30)
Long-term contract receivables due from ordering parties	7 080	8 168	(1 088)	(13.32)
Cash and cash equivalents	322 201	350 101	(27 900)	(7.97)
Total current assets	**1 006 898**	**1 099 242**	**(92 344)**	**(8.4)**
Fixed assets classified as held for sale	1 038	-	1 038	100
TOTAL ASSETS	**4 455 712**	**4 801 300**	**(345 588)**	**(7.20)**

Table 8: Selected items from consolidates equity & liabilities

	zloty thousand	*zloty thousand*	*zloty thousand*	*%*
	31 December 2017	*31 December 2016*	*change*	*dynamics*
Equity				
Issued capital	101 647	101 647	-	-
Supplementary capital	1 094 493	1 028 647	65 846	6.4
Capital from the revaluation of the derivate instrument quotation	(2 678)	(7 084)	4 406	(62.20)
Other reserve capitals	3 472	3 472	-	-
Retained profits / Uncovered losses	884 095	769 302	114 793	14.92
Net profit (loss)	183 243	247 674	(64 431)	(26.01)
Equity of the majority shareholders	2 264 272	2 143 658	120 614	5.62
Total equity	**2 264 273**	**2 143 658**	**120 614**	**5.62**
Long-term liabilities				
Interest credits and loans	302 465	587 851	(285 386)	(48.55)
Long-term employee benefits	48 166	48 587	(421)	(0.87)
Long-term delivery and service liabilities and other financial liabilities	5 146	5 069	77	1.52
Long-term derivative financial instruments (liabilities)	870	4 294	(3 424)	(79.74)
Long-term subsidies	44 509	43 302	1 207	2.79
Other long-term provision as well as prepayments and accruals	364 852	312 253	52 599	16.84
Deferred income tax provision	432 900	388 359	44 541	11.47
Total long-term liabilities	**1 198 908**	**1 389 715**	**(190 807)**	**(13.72)**
Short-term liabilities				
Short-term delivery and service liabilities and other financial liabilities	146 416	302 662	(156 246)	(51.62)
Current part of interest credits and loans	349 573	421 958	(72 385)	(17.15)
Short-term derivative financial instruments (liabilities)	4 139	5 759	(1 620)	(28,13)
Other non-financial liabilities	107 387	116 431	(9 044)	(7.77)
Income tax liabilities	1 092	166	926	557.83
Short-term employee benefits	5 457	6 503	(1 046)	(16.08)
Short-term subsidies	1 507	6 670	(5 163)	(77.41)
Long-term contract receivables due to ordering parties	5 626	3 990	1 636	41.00
Other short-term provisions as well as prepayments and accruals	371 335	403 788	(32 453)	(8.04)
Total short-term liabilities	**992 532**	**1 267 927**	**(275 395)**	**(21.72)**
Total liabilities	**2 191 440**	**2 657 642**	**(466 202)**	**(17.54)**

TOTAL equity & liabilities	**4 455 712**	**4 801 300**	**(345 588)**	**(7.20)**

Consolidated cash flow statement

In 2017, the Group generated a positive balance of cash flows from operating activities in the amount of PLN 478 798 thousand, which was PLN 57 253 thousand lower than in the previous year. The main reasons that affected the lower balance, alongside the lower earnings, were:

- reduction of liabilities (not related to loans and credits) mainly as a result of repayment of the liability of Elektrownia Pątnów II sp. z o.o. related to the settlement of overpayment for compensation for termination of PPAs in previous years,
- a smaller decrease in inventories than in the previous year mainly due to their low level because no green certificates were obtained due to lack of production from the biomass block,
- positive exchange differences as a result of the strengthening of the zloty against the euro.

The balance of cash transactions on investing activities amounted to minus PLN 57 624 thousand and, as compared to the previous year, it decreased by PLN 126 084 thousand. The decrease in the balance was mainly due to lower expenditure on the acquisition of tangible fixed assets and the release of some of the collateral previously held in the form of deposits.

The balance of cash transactions as part of financing activities amounted to minus PLN 447 250 thousand and was higher than the one recorded in the previous year by PLN 60 236 thousand. The difference was determined by the dividend paid in 2017.

Cash in 2017 decreased by PLN 26 077 thousand and at the end of the year amounted to PLN 322 570 thousand.

Table 9: Selected items from the consolidated cash flow statement

	zloty thousand	*zloty thousand*	*zloty thousand*	*%*
	12 months period ended 31 December 2017	*12 months period ended 31 December 2016*	*change*	*dynamics*
Cash flows on operating activities				
Gross profit (loss)	258 633	307 878	(49 245)	(15.99)
Item adjustments	220 165	228 173	(8 008)	(3.51)
Net cash on operating activities	**478 798**	**536 051**	**(57 253)**	**(10.68)**
Cash flows on investment activities				
Sale of tangible and intangible assets	3 478	3 723	(245)	(6.58)
Acquisition of tangible and intangible assets	(98 272)	(195 352)	97 080	(49.69)
Expenses and income related to other financial assets	1 451	7 773	(6 322)	(81.33)
Acquisition of other financial assets	35 630	-	35 630	-
Received dividends	208	60	148	246.67
Received interest	5	6	(1)	(16.67)
Other	(124)	82	(206)	-
Net cash on investment activities	**(57 624)**	**(183 708)**	**126 084**	**(68.63)**
Cash flows on financial activities				
Repayment of financial leasing liabilities	(7 012)	(15 038)	8 026	(53.37)
Credits, loans and debt stocks income	-	12 295	(12 295)	(100.00)
Repayment of credits, loan and debt stocks	(340 837)	(334 211)	(6 626)	1.98
Paid-out dividends	(65 562)	-	(65 562)	-
Paid interest	(33 373)	(48 632)	15 259	(31.38)
Other	(466)	(1 429)	962	(67.37)
Net cash on financial activities	**(447 250)**	**(387 015)**	**(60 236)**	**15.56**
Increase (decrease) in net cash and its equivalents	**(26 076)**	**(34 672)**	**8 596**	**(24.79)**
Cash opening balance	348 646	383 318	(34 672)	(9.05)
Closing cash balance	**322 570**	**348 647**	**(26 077)**	**(7.47)**

Financial indexes

The lower net profit in 2017 had a negative impact on all profitability ratios, which is particularly evident in the case of ROE in relation to the increase in equity during the year, and less in the case of other ratios due to the simultaneous decrease in assets as well as sales revenues.

The total debt ratio reflecting the ratio of liabilities to total assets once again decreased as a result of reducing the level of debt to a greater degree than the reduction in the total assets. The value of the indicator indicates that liabilities constitute 49% of owned assets.

The value of the current liquidity ratio, informing about the degree of coverage of current liabilities with short-term current assets, increased to 1.01, which means that at the end of 2017 the liquidity situation was better than at the end of the previous year.

Table 10: Indexes

		2017	*2016*	*change*	*% dynamics*
ROE	*%*	8.11	11.68	(2.02)	(17.29)
ROA	*%*	4.12	5.21	(0.26)	(4.99)
Net sales profitability	*%*	7.51	9.25	(0.14)	(1.51)
General debt index	*x*	0.49	0.55	(0.06)	(10.91)
Net debt / EBITDA	*x*	0.58	1.00	(0.42)	(42.00)
Current liquidity index	*x*	1.01	0.87	0.14	16.09

5.3. Specification of factors affecting the current and future financial results

The Group's financial results, as an entity focused on the generation and sale of electricity produced on the open wholesale market, are fully dependent on the behaviour of other market participants who, to a greater or lesser extent, depending on their market share, affect the level of shaped prices. Market behaviours of participants in the wholesale energy market are in turn stimulated by legislative actions in the area of broadly understood energy policy, conducted both at the national and EU level as well as at the level of the global economy.

Recently, the energy sector has experienced a number of changes, but also in the near future there is no shortage of announcements that may have a significant impact on the shape and principles of functioning of the broadly understood energy market. In this context, we can mention, for example, the current package of EU regulations, affecting current EU and national legal acts. Energy package known to participants in the energy market under the name "Clean energy for all Europeans" (Winter Package) can fundamentally affect national legislation in the energy sector. The findings related to the shape of these regulations are particularly important from the point of view of the law introducing the power market in Poland, which the Polish parliament adopted in early December 2017. The Polish power market was constructed in such a way that it would be technologically neutral and ensure the participation of domestic generators based on production on every technology, as well as entities offering power demand reduction services, as well as foreign entities. From the point of view of the Group's operations, the power market in its assumptions is a support mechanism primarily for energy companies, designed to stimulate investments in the modernization of existing units and construction of new generation units, because today's energy prices on the wholesale market are low enough that they do not provide return on capital employed in any of the available manufacturing technologies. In addition, the RES support system operating on the market, whose main beneficiary in Poland is primarily wind farms, displaces the oldest coal blocks from the market, which due to the lack of new investments in generation units centrally disposed by the Transmission System Operator ("TSO"), results in the risk of a power shortage in the National Power System ("NPS").

Therefore, when assessing the market and regulatory environment of the producer and seller of electricity, several phenomena that are particularly important in the last year should be taken into account, the effects of which may also affect the Group's results in the future:

- limitation of power increase in NPS in the wind turbines segment;
- intensified work on the project concerning the rules of the power market, concluded with the adoption of the Power Market Act;
- work on the amendment to the Act on renewable energy sources, removing collisions of the currently binding act with European law and establishing such a support system for RES, which will be fully acceptable by the European Commission;

- work on the energy strategy of Poland until 2030, which is to determine the new shape of the target energy mix for Poland, including assumptions for lignite coal mining;
- work on the new support system for Energy production in cogeneration;
- intensified work on adjusting of the wholesale energy market to MIFID II directive;
- issue by the European Commission of a Regulation on BAT conclusions, designating a 4-year adjustment period for the installation, i.e. until August 2021;
- work on the Winter Package, introducing among others new restrictions on CO2 emissions and assuming an increase in the share of renewable energy sources in electricity production;
- intensified work on the reform of the CO2 emission allowance trading system (EU ETS) after 2020;
- Poland's participation in inter-operator projects aimed at building a common European market in the "Price Coupling of Regions" model.

The Group generates the majority of revenues from generation and sale of electricity, therefore the price for which it sells electricity is very important for the results of its operations. Analysing the current market trends in the context of electricity prices on wholesale energy markets, one should take a close look at prices quoted on the Polish Power Exchange ("PPE"), which as the most transparent, form the basis for determining pricing conditions in bilateral agreements concluded on bilateral offer market (OTC market).The factors significantly influencing the level of stock exchange quotations on the SPOT market have remained the same for the past years, the most important of them are: the size of wind generation, the state of the reserve in the PPS system, the volume of transmission capacities available for cross-border exchange, and weather conditions (broader description of trends on the spot and on-time energy market, you can find in point 4 "Basic risk factors of operations - Electricity prices" of this report). A phenomenon characteristic for the past year from the point of view of price transparency is the fact that the volume of trade on TGE fell last year by 11.8% compared to 2016 (the volume of trade in electricity on the PPE in 2017 was 111.65 TWh)[8]. The probable cause can be seen in the prospect of entry into force of the so-called MIFID II package binding on the participants of the wholesale electricity market (January 3, 2018), and the lack of implementation of its provisions into the Polish legal order, which caused a lot of uncertainty to arouse the formal status of futures contracts (classification - commodity or financial instrument), concluded at PPE in 2017 and being the subject of delivery in 2018 that in the light of today's positions of both the Polish Financial Supervision Authority ("PFSA") and PPE, in the year of supply 2018, due to the delayed implementation, remains unchanged. After the entry into force of the Act on Trading in Financial Instruments implementing MIFID II to Polish law, in accordance with the provisions of the currently published bill and positions presented by PPE, it will be able to operate on unchanged terms for 12 months, during which time efforts will be made to obtain the status OTF (organized trading platform). Without the final product qualification, this will be possible only after PPE publishes the trading conditions for these instruments and the change of PPE's trading regulations (in other words after the KNF approves the market model), it is difficult to predict at this time whether and how changes in the functioning of PPE will affect level of quoted prices and liquidity of the electricity market. One of the factors that mostly determines the competitiveness of an energy company producing lignite based on coal, apart from the costs of coal and auxiliary fuels, is the price of CO2 emission rights ("EUA"), which the issuer is obliged to redeem in the amount corresponding to the volume of CO2 emissions to the atmosphere. Currently, the Company receives very small amounts of CO2 emission allowances free of charge, resulting from the allocation for heat production, therefore, virtually all the allowances needed by the Group must be purchased on the primary market (auctions) and secondary (ICE, EEX and bilateral contracts). The level of prices at which the Group acquires CO2 emission rights, was in previous years and will continue to be of great importance for the future financial results of the Group. The Emission Allowances Market is the market which is currently the most exposed to price changes caused by political decisions resulting from the directions of the debate on the shape of the reform of the European Emissions Trading System (EU ETS) lasting for several years. The main assumptions of the EU ETS reform were set by the European Council in the conclusions of October 2014. On this basis, in July 2015 the European Commission proposed a draft directive, and after a series of legislative actions in February 2018, the European Council officially approved the reform of the EU Emissions Trading Scheme for the period after 2020 (more on the approved changes in the European system of trading in allowances for EU ETS issues can be read in point 4 "Basic risk factors of operations - Regulatory environment" of this report). It should be emphasized that any changes that are supposed to affect the increase of the cost of CO2 emissions will also have an impact on raising the cost of energy production. However, not all manufacturers are equally exposed to the impact of this factor. The degree of this impact is determined by the emissivity factor of a given producer and the possible number of free emission rights, which are granted e.g. in the case of investments declared in the National Investment Plan.

[8] PPE statement from www.tge.pl

Another factor that will undoubtedly affect the future financial results of the Group is the final determination of the shape of the Polish power market with the European Commission. The Act of 8 December 2017, adopted after a long time of intense work and expectations, was officially approved by the EC on February 9, 2018, which in its decision confirmed that the assumptions of the Polish power market are in line with EU rules on the rules for granting aid public. Revenues from the capacity market for all its participants will start only with the start of the first year of supply on the capacity market, i.e. in 2021. If the Group's generation units win power auctions, the Group will receive payments resulting from performance of power obligations as a payment for a constant readiness to supply power to the network. If the generating units belonging to the Group do not take part in the auctions or do not win the auctions, the Group still has a share in the secondary power market, where it can buy back power obligations contracted through auction by other entities. However, it should be remembered that the capacity market is not only additional payments for entities participating in it, but also financial penalties, for those who do not perform or do not fully perform contracted obligations. The effectiveness and potential of the capacity market will largely be determined by the parameters of the first auctions, which will cover not only the network demand for power, but also minimum exit prices for individual production technologies, the size of penalties, initial auction price, number of rounds and the price drop step in a particular round. The parameters for the auctions to be carried out in the last quarter of 2018 will be announced by the Ministries of Energy ("ME"), in accordance with the Act, in August 2018. Bearing in mind the above, the Group is currently preparing to participate in the capacity market and is working on the assumptions of the strategy in this respect.

In the context of the capacity market one should also mention the provisions of the Winter Package being processed by the European Commission since 2016, which consists of a number of regulations and directives, whose currently consulted provisions provide for, inter alia, introduction of a strict CO2 emission limit (EPS 550) for publicly funded electricity generators who would operate under capacity markets introduced in individual EU Member States. Conversations, so-called The "trilogue" between the European Commission, the Council of Europe and the European Parliament regarding market documents will probably start in the second half of 2018, so it can legitimately be assumed that the legislative procedure for documents comprising the Winter Package should not end before Poland's 2018 the first power auctions with deliveries for 2021-2023. However, due to the fact that the proposals for the Winter Package assume reviews of existing power mechanisms and the requirement to adapt them to the regulations included in the Winter Package, the final provisions that will be included in the package may affect the rules of the power market in Poland and other EU member states in the near future, and thus may have a large impact on the shape of the Group's operations and its future financial results.

The future shape of Poland's energy mix will be of great significance for the Group's business framework, it should be mentioned that the strategy currently being prepared by the Government is to take into account sectoral assumptions for lignite coal mining. As at the date of publication of this report, there is no official document announced by the ME of a comprehensive program for lignite mining, which is to be one of the foundations of the document for the overall energy policy of Poland until 2030. However, based on the information and statements of ME representatives, it is known that at least 50-60% of electricity will be produced from lignite and black coal and that ME assumes a development scenario and declares the emergence of new lignite opencasts, which is of particular importance for the Group due to its the prolonging process of obtaining a concession for the construction of a new lignite open pit on the Ościsłowo deposit.

5.4. Unusual events affecting the obtained financial results

The results achieved by the Group in 2017 were affected by the following one-off events:

- increase in the reclamation reserve. The provision is related to the exploitation of lignite deposits and concerns the estimated cost of reclamation of areas covered by mining operations after its completion. The basis for increasing the reserve was a report on the costs of reclamation and management of excavations and post-mining areas, prepared by an independent adviser. Preparation of documentation was commissioned due to the need to update the assumptions taken into account when estimating the costs associated with the reclamation of land used. The costs of which the established provisions relate will be borne by PAK KWB Konin SA after the exploitation of the outcrops, i.e. after 2020 and 2030 respectively. The increase in the provision had an impact on the consolidated results of the ZE PAK SA Group, i.e. the net result was reduced by PLN 37 554 thousand

- decrease in deferred tax assets charging the consolidated net result by PLN 19 385 thousand. Change in the balance of deferred tax assets results from the inability to settle them with current financial projections for PAK KWB Adamów SA.

- creation of a write-down of fixed assets under construction in the amount of PLN 22 165 thousand. The write-down results from the update of financial projections for PAK KWB Adamów SA and is related to the change in the economic perspective of the mine's operating efficiency resulting among others, from the closing of Elektrownia Adamów.

6. MANAGEMENT OF FINANCIAL ASSETS

6.1. Evaluation of financial assets management

Companies in the ZE PAK Capital Group have sufficient cash resources to conduct business operations and constantly execute both all their operational liabilities and liabilities resulting from concluded financial and investment agreements. The Group manages its current financial resources in a flexible manner by using cash liquidity analysis models and planning future cash flows on the basis of short-term and long-term financial forecasts developed periodically. By using the aforementioned tools, the Group's Companies execute current monitoring and analyses of the maturity dates of receivables and liabilities as well as adjust the deadlines and bank account balances to the amounts of cash flows. The excess cash is managed by investing in safe instruments of the financial market, which mainly include bank deposits.

6.2. Evaluation of investment plan execution

The Group has its own functioning strategy and an investment plan adjusted to it. The investment plans take into consideration the current conditions in legislation and law, as well as economy and technology. The adopted manner of execution of the planned investments is mainly based on the use of resources obtained from current operations as well as external financing. During financing planning, the Group's Companies take into consideration a series of existing or future factors which can significantly affect the executed program. The projected financing structure of particular investment plans also takes into consideration the levels of a series of financial indexes, such as the debt or liquidity index, in a way which allows obtaining their optimal levels. In the view of the ZE PAK CG, the currently adopted investment plans are possible to execute with the use of the possessed and potential resources. It is however necessary to note that the Group is constantly monitoring the factors which have the biggest impact on the executed investment program and in case of substantial changes in either one of several of them, the Group does not exclude adjustments or significant changed in the executed strategy.

7. SIGNIFICANT FACTORS AND DEVELOPMENT PROSPECTS

Directional activities designated by the Group's strategy

Directions determined by the strategy of ZE PAK SA Capital Group are determined based on a systematic analysis of a wide range of factors, such as: price trends, mechanisms supporting various technologies of electricity and heat generation, etc. and a wider view covering the dominant trends related to the Group's area of operations. The goal is to optimize investment plans in terms of material and work schedules of manufacturing devices. The obtained results allow developing a long-term model of functioning in conditions of visible unfavourable trends for coal-based energy, including threats resulting from more stringent environmental regulations, as well as anticipated changes in the energy mix of Poland.

Ecological requirements determined by EU and Polish law translate directly into the Group's production potential. According to the decisions taken, technically depleted production facilities, for which the analyses will not demonstrate the expediency of modernization, will be gradually withdrawn. The mode of operation during the transitional period must be closely matched to their capabilities by choosing a dedicated derogation.

The company is aware of changes, especially those from the legislative and legal area that occur in the environment. Legal regulations aiming at reducing CO2 emissions, other gases (SO2, NOX) as well as the regulations regarding the renewable energy sector are important challenges for the Group companies. The new environmental regulations, coming from 2021 resulting from the implementation of the BAT (Best Available Technology) conclusions, expand the catalogue of limited pollutants. Conducted, in cooperation with a renowned design office, analyses allow the assessment of the necessity to undertake investment activities to obtain compliance with the requirements and scope of possible exceptions.

1) Elektrownia Adamów

   A power plant covered by the derogation mechanism of a limited derogation (17 500 hours counted from January 1, 2016) on January 1, 2018 ended its operations. Documents required by law were prepared for regulatory authorities and the possibility of auxiliary economies was secured to the extent necessary. In the past year, the Company informed about the potential sale of assets related to Adamów power plant.

Another scenario considered in the context of the Adamów power plant is the return to analyses for the construction of a high-efficiency gas-steam block generating electricity in condensation with a capacity of approximately 400 MWe (block size can be optimized). However, from the current perspective, such a scenario is possible only after 2020. Current forecasts confirm that only after 2025 there may be a significant demand for energy from the designed steam and gas block. In this situation, decisions about the development of this project were suspended. ZE PAK SA investigates on an ongoing basis how far the statutory power market mechanism - approved in 2017 will ensure satisfactory conditions for investors.

2) Elektrownia Konin

At the end of last year, the termination of the contract for the supply of heat for the city of Konin was extended for 2 consecutive years, i.e. until mid-2022. The company also performed the adaptation of the biomass block as the source of the basic heat supply to the city. Currently, used for the production of heat, the carbon part, with restrictions resulting from the profitability of production, may function until mid-2020, as it has been covered by a derogatory mechanism, i.e. the Transitional National Plan. According to the current assumptions, the coal part from June 2020 to June 2022 is to be used as reserve power securing heat production based on the biomass block, in emergency situations and planned repairs with the scope of work up to 500 hours per year.

At Konin power plant, a scenario for the construction of a gas and steam unit with a capacity of approximately 120 MWe was also considered. However, due to the current low economic efficiency of the project, the Company annulled the tender for obtaining a contractor for the investment. The return to analyses is probable after 2020, taking into account other conditions for the operation of the energy industry resulting from the entries, e.g. Winter package.

3) Elektrownia Pątnów

The coal assets in Pątnów I power plant have been partially modernized (units 1 and 2 with a capacity of 222 MW each) and will operate at the current level of production until 2030, under the condition of the adjustment of extraction and securing adequate coal resources by PAK KWB Konin SA. In the context of coal supplies for modernized assets, the most important is the continuation of the procedure for granting a concession for extracting minerals from Ościsłowo open pit. At present, the environmental decision issue is being reconsidered by the Regional Directorate for Environmental Protection in Poznań.

Modernization of units 3 and 4, including replacement or modernization of elements decisive for block efficiency and improvement of operational safety, has been analysed, and a decision was made to withdraw the blocks without modernization. In the event of the successful conclusion of the concession procedure for Ościsłowo open pit, the company is also considering the peak work of block 5 after 2020.

According to the policy and market practice adopted by other companies in the energy sector, more investment projects are analysed and prepared than actually implemented, in the future decisions on the implementation of other projects than those mentioned above, provided for in the documents defining the Group's strategy, may be taken.

Regardless of investment plans, one of the areas of implementation of the Group's strategy is progressive integration in particular segments. Ultimately, the activities assume the existence of two main segments, i.e. the consolidated mining segment and the generation segment. In the case of ancillary activities, the Group aims at the maximum concentration of competences in order to increase the flexibility of the auxiliary segment and to optimize the management structure and cost structure. The Group strives to achieve maximum benefits through the synergy effect in the entire technological chain.

8. SPECIFICATION OF THE SHAREHOLDING STRUCTURE

8.1. Shareholding structure

As of 31 December 2017, the Company's share capital amounted to PLN 101 647 094.00 and consisted of 50 823 547 shares with a face value of zloty 2.00 each.

The below table includes the specification of shareholders holding either directly or indirectly through subsidiaries, at least 5% of the total number of votes at the General Meeting of the Company according to information held by the Company based on the notifications of purchase / sale of the Company's shares, as at December 31, 2017 and as at preparation of this report.

*Table 11: Description of shareholders holding, either directly or indirectly through subsidiaries, at least 5% of the total number of votes at the Company's General Meeting as of 31 December 2017 and as of the day of this statement**

	shares.	*%*
Shareholder	*Number of shares and corresponding number of votes at the General Meeting*	*Share [%] in the total number of shares/votes*
Zygmunt Solorz (indirectly) through:	**26 200 867**	**51.55**
– *Elektrim SA*	*196 560*	*0.39*
– *Embud 2 sp. z o.o. S.K.A.*	*592 533*	*1.16*
– *Trigon XIX Fundusz Inwestycyjny Zamknięty*	*10 004 001*	*19.68*
– *Argumenol Investment Company Limited*	*15 407 773*	*30.32*
Nationale-Nederlanden OFE	**5 068 410**	**9.97**
Towarzystwo Funduszy Inwestycyjnych PZU SA	**3 081 567**	**6.06**
OFE PZU „Złota Jesień"	**2 664 378**	**5.24**

** According to information possessed by the Company based on the delivered notices of purchase / sale of shares.*

The company has no knowledge of any agreements that may result in future changes in the proportions of shares held by the current shareholders.

8.2. Acquisition of own shares

The Company did not acquire own shares in 2017.

8.3. Shares of entities from ZE PAK SA Capital Group in the possession of supervising and managing persons

The below table presents the Company's shareholdings (direct and indirect), as well as shareholdings of the management personnel of its affiliates as of 31 December 2017 and as at the date of this report.

Table 12: The ownership of the Company's shares / stocks in entities related to the Company by the management as at December 31, 2017 and as at the date of the report.

Name and surname	*ZE PAK SA shares.*		*Affiliate shares*	
	quantity	*face value*		*quantity*
Adam Kłapszta	0	0	0	0
Aneta Lato-Żuchowska	0	0	0	0
Zygmunt Artwik	0	0	0	0
Elżbieta Niebisz	0	0	0	0

The below table presents the Company's shareholdings (direct and indirect), as well as shareholdings of the supervising personnel of its affiliates as of 31 December 2015 and as at the date of this report.

Table 13: The ownership of the Company's shares / stocks in entities related to the Company by the supervising personnel as at December 31, 2017 and as at the date of the report.

Name and surname	*ZE PAK SA shares.*		*Affiliate shares*	
	quantity	*face value*		*quantity*
Tomasz Szeląg	0	0	0	0
Henryk Sobierajski	0	0	0	0
Wojciech Piskorz	0	0	0	0
Leszek Wysłocki	0	0	0	0
Wiesław Walendziak	0	0	0	0
Ludwik Sobolewski	0	0	0	0

Lesław Podkański	0	0	0	0
Sławomir Zakrzewski	0	0	0	0

8.4. Control of employee share option plan

The Company does not have an employee share program, therefore there is no control system of the employee share program in the Company.

9. DECLARATION OF COMPLIANCE WITH THE CORPORATE GOVERNANCE RULES

Declaration of compliance with the corporate governance rules is presented in accordance with § 91 paragraph 5 (4) of the Resolution of the Minister of Finances of February, 19, 2009 on the current and periodical information provided by issuers of stocks as well as conditions for recognizing as equivalent information required by the laws of a non-member state.

9.1. Set of corporate governance rules applied

In 2017, the Company was subject to corporate governance principles contained in the „Best Practice for WSE Listed Companies 2016" (Best Practice) adopted by resolution of the WSE Supervisory Council of October 13, 2015. Best Practice came into force on January 1, 2016.

The Management Board of the Company, within the scope of competences conferred upon it by the Statute and generally binding legal regulations, exercises due diligence in order to ensure the Company's compliance with the widest possible range of Best Practices. The number and scope of principles that the Company has not complied with are described in detail in the item below. The Management Board of the Company makes special efforts to ensure that the Company's information policy towards individual as well as institutional investors, being the implementation of the guidelines contained in the Good Practices, was in line with their expectations. Furthermore, for reasons beyond the Company's control, not all rules contained in Good Practices are applied.

The collection of Best Practices is published on the website of the Warsaw Stock Exchange at the following address:

(https://static.gpw.pl/pub/files/PDF/inne/GPW_1015_17_DOBRE_PRAKTYKI_v2.pdf).

According to the Best Practice principles the Company published A statement on the company's compliance with the corporate governance recommendations and principles contained in Best Practice at the following address:

(http://ri.zepak.com.pl/upload/files/PL_GPW_dobre_praktyki_PAK.pdf)

9.2. Set of rules which Company has not complied with

The following are the corporate governance principles that the Company has not applied with as part of its operations in 2017, with an explanation of the position of the Company in each specified derogation.

Principle I.Z.1.20. Best Practice

A Company should operate a corporate website and publish on it, in a legible form and in a separate section, in addition to information required under the legislation: an audio or video recording of a general meeting.

Reasons for non-compliance with the principle I.Z.1.20. of Best Practice:

Taking into consideration the Company's experience, according to which most of the Company's capital share is represented in the deliberations of the general meeting as well as the fact that the recording of the course of the general meeting could be involved with substantial costs and potential difficulties of organizational, technical and legal nature, the company does not record and broadcast the course of the general meeting. In case of notification about a need of recording general meeting announced by bigger group of shareholders, the company will consider such possibility.

Recommendation IV.R.2. Best Practice

If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through:

1) real-life broadcast of the general meeting;

2) real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting;

3) exercise of the right to vote during a general meeting either in person or through a plenipotentiary.

Reasons for non-compliance with the recommendation IV.R.2. Best Practice:

According to the Company's assessment, current shareholders structure does not justify real-life broadcast of the general meeting and real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting. Taking into consideration the Company's experience, according to which most of the company's capital share is represented in the deliberations of the general meeting as well as the fact that the recording and broadcasting of the course of the general meeting could be involved with substantial costs and potential difficulties of organizational, technical and legal nature, the Company does not record and broadcast the course of the general meeting. So far the Company did not receive shareholder's notifications of general meeting broadcasting. In case of such a notification announced by bigger group of shareholders, the Company will consider recording and broadcasting of general meeting. Exercise of the right to vote during a general meeting either in person or through a plenipotentiary is a usual practice on general meeting of the Company. According to the Company's assessment, not in full use of above mentioned recommendation does not adversely affect the achievement of the objective described in the section IV of the code of best practices.

Principle IV.Z.2. Best Practice

If justified by the structure of shareholders, companies should ensure publicly available real-time broadcasts of general meetings.

Reasons for non-compliance with the principle IV.Z.2. Best Practice:

According to the Company's assessment, current shareholders structure does not justify real-life broadcast of the general meeting. Taking into consideration the Company's experience, according to which most of the Company's capital share is represented in the deliberations of the general meeting as well as the fact that the recording and broadcasting of the course of the general meeting could be involved with substantial costs and potential difficulties of organizational, technical and legal nature, the Company does not record and broadcast the course of the general meeting. So far the Company did not receive shareholder's notifications of general meeting broadcasting. In case of such a notification announced by bigger group of shareholders, the Company will consider recording and broadcasting of general meeting.

Recommendation VI.R.1. Best Practice

The remuneration of members of the company's governing bodies and key managers should follow the approved remuneration policy.

Reasons for non-compliance with the recommendation VI.R.1. Best Practice:

There is no comprehensive, formal remuneration policy in the Company. Remuneration of the members of the supervisory board are established by the general meeting, remuneration of the members of the management board are established by the supervisory board and there is a document in the company describing remuneration rules of the key managers. In any case such factors are taken into consideration: competence, experience, and responsibility of the position and work effects.

Recommendation VI.R.2. Best Practice:

The remuneration policy should be closely tied to the company's strategy, its short- and long-term goals, long-term interests and results, taking into account solutions necessary to avoid discrimination on whatever grounds.

Reasons for non-compliance with the recommendation VI.R.2. Best Practice:

There is no comprehensive, formal remuneration policy in the Company. However link with such factors as short- and long-term goals, long-term interests and results are taken into consideration in establishing remuneration of governing bodies and key managers. The company does not discriminate on whatever ground in process of establishing remuneration on any position.

9.3. Description of the main characteristics of internal control and risk management systems in relation to the process of financial statement and consolidated financial statement development

The process of development of the Company's financial statements as well as the Capital Group's consolidated financial statements takes place with the use of internal control and risk management mechanisms, such as: Company's internal procedures, management mechanisms of IT systems used for registration of economic activities and development of financial statements, as well as protection mechanisms of data and systems, principles of supervision over preparation of financial statements, principles of verification and assessment of statements, the internal audit and other control elements.

The development of the Company's financial statements as well as the Group's consolidated financial statements is executed in an orderly manner, pursuant to the organizational structure of the Company and Group. The management accounting tools and IT systems implemented in the Company and Group for the purpose of registration of economic events in books of account provide the basis for the evaluation that the Company's financial statements and the Group's consolidated financial statements reliably and clearly present the Company's and Group's financial and economic situation.

The basic regulations in the scope of development of financial statements include: the Company's accounting policy in accordance with the Accounting Act of 29 September 1994, International Financial Reporting Standards ("IFRS"), approved by the European Union, the procedure of closing the books of account of companies including the Capital Group, as well as the financial statement and consolidated financial statement development requirements imposed by the Warsaw Stock Exchange.

As of the date of development of this statement, the Company did not make a decision on keeping the books of account in the Group according to the International Financial Reporting Standards ("IFRS"). Therefore, the process of development of financial statements in the Group takes place in two stages. Firstly, all the companies of the Group develop their own individual statements pursuant to the Polish accounting standards. These statements are studied if they meet the conditions specified in the Accounting Act. Then, the companies transform the individual statements on the basis of the accounting policy, determined for the Group, in accordance with the International Financial Reporting Standards ("IFRS") using the so-called sheets of transition into financial statements in the IFRS standards. Such prepared individual statements are the basis for development of the Group's consolidated financial statement. Only in case of ZE PAK SA, there is an automatic process of importing data from SAP ERP system to SAP BPC consolidation system.

The Group's consolidated statement is developed with the use of SAP BPC IT system. The separated central unit in the parent company (i.e. ZE PAK SA) merged with accounting departments in individual subsidiaries functions within the framework of the system. The consolidation process is started with the central unit opening access for companies to enter data into the system, the subsidiaries have the possibility of access to its back data at any time, but without the possibility of their adjustment. The central unit constantly monitors the entry of data by the companies, and then, after entering individual data, it starts the consolidation process. This process is based on defined business rules, which determine the content of consolidation adjustments. Furthermore, the consolidation process allows for entering manual adjustments by the central unit. The result of the consolidation process completion includes a complete package of the financial statement together with explanatory notes in Excel files, which is then exported to Word file after verification.

The Management Board is responsible for the Company's internal control system and for its effectiveness in the process of development of financial statements and periodical reports developed and published in accordance with the Regulation of the Minister of Finance dated 19 February 2009 on current and periodic information provided by issuers of securities and conditions for recognizing as equivalent to the information required by the law of a non-member state.

The substantive supervision over the process of development of the Company's and Group's financial statements and periodical reports is executed by a member of the Management Board responsible for financial issues. The organisation of works related to the development of financial statements is the responsibility of the Director of Finance who, together with the Principal Accountant, develops the work schedule including in the development of statements.

The Company's effective internal control and risk management systems related to the process of financial reporting is ensured thanks to the following aspects:

- development of procedures specifying the principles and division of responsibility in the development process of financial statements,
- specification of the scope of reporting pursuant to the mandatory provisions of the Accounting Act and International Financial Reporting Standards,
- implementation and execution of supervision over the use by the Capital Group's companies of coherent accounting principles as well as
- semi-annual inspections and annual audits of the financial statements of ZE PAK SA. and Capital Group by an independent statutory auditor.

The annual and semi-annual financial statements are subject to the independent auditing and inspection by the independent statutory auditor, who gives an opinion on the reliability and clarity of such a statement as well as correctness of books of account comprising the basis for the statement development.

The choice of a statutory auditor is made by the Supervisory Board, from a group of reputable auditing companies, which guarantee high service standards and the required independence.

The audits of financial statements are carried out:

- in accordance with the provisions of Chapter 7 of the Accounting Act of 29 September 1994,
- in accordance with the National Standards of Auditing within the meaning of the International Standards on Auditing, adopted by the resolution of the National Chamber of Statutory Auditors of 10 February 2015 as amended and the resolution of the KRBR of 7 July 2017.

In particular, the audits include verification of correctness of the accounting rules used by the Company and Group, verification of significant estimates, checking – in a random manner – of accounting evidence and records, which the amounts and information included in the financial statement result from, as well as comprehensive assessment of the financial statement.

The Company's and Group's financial results are regularly monitored during the financial year and are subject to periodical evaluation made by the Supervisory Board. During regular sessions of the Supervisory Board, the Company's Management Board provides information regarding the current financial situation of the Company and ZE PAK SA Group.

The Company's and Group's task is to develop a financial statement, including numerical data and wordy clarifications, which:

- reliably and clearly presents all information which are significant for the evaluation of the financial and economic situation for a given day, as well as the financial result for a given period,
- was properly developed in all the significant aspects, that is, in accordance with the accounting rules resulting from the International Financial Reporting Standards, as well as the related interpretations published in the form of the European Commission regulations, and according to the requirements of the Accounting Act and executive regulations issued on its basis, as well as on the basis of correctly kept books of account,
- is compliant with the regulations and provisions of the Company's Articles of Association, which affect the financial statement content.

The Company has the documentation, which describes its adopted accounting principles, specified in Article 10 of the Accounting Act. The applied principles of cost accounting, quotation of assets and liabilities as well as determination of the financial result are pursuant to the Accounting Act and the International Financial Reporting Standards.

The Management Board is responsible for the correct keeping of the Company's and Group's accounting. The Company keeps the books of account within the integrated SAP ERP IT system. This system, like the above SAP BPC consolidation system of statements, provides the division of competence, coherence of activity entries in the books, as well as control between the main book of account and the auxiliary books. The conducted registration allows determining the financial result, VAT tax, and other budget liabilities. The account registration ensures correctness and completeness of entries. The chronology of economic events is kept. Entries in the books of account reflect the actual state, and data are entered in a complete and correct manner, on the basis of accounting records qualified for entry. The continuity of entries and correctness of the applied procedures are ensured. The accounting records meet the requirements of the Accounting Act. The books of account are kept in the Company's registered office. There is a possibility to modify the system operation in order to ensure the adequacy of technical solutions to the changing accounting principles and legal standards. The system includes the documentation both in the part related to end users as well as in the technical part. The system's documentation is subject to periodical verification and updating. The Company implemented organisational and system solutions in the scope of ensuring proper use and protection of data access protection systems as well as hardware. The access to the financial registration system resources is limited with proper entitlements, which are provided to authorized employees only in the scope of their responsibilities and activities.

The internal audit, the aim of which is to carry out independent and objective assessment of the risk management and internal control systems, functions in the Company. The internal audit is conducted on the basis of the auditing regulations. The audit executes planned and temporary auditing tasks both in the parent company as well as in the Group's companies. The audit plans are developed on the basis of the risk analyses. The audit results are reported to the Company's Management Board. Information on the internal audit activity also constitutes the subject of analyses of the Audit Committee.

As part of the control activity, the periodical management reporting is subject to evaluation in terms of presented information, especially, in the context of the analysis of deviations from the assumptions adopted in the financial plans.

9.4. Shareholders with significant blocks of shares

The below table presents the shareholders with significant blocks of shares, in accordance with the Company's knowledge, based on the notifications submitted to the Company.

*Table 14: Shareholders owning directly or indirectly significant blocks of shares in accordance with the information available to the Company based on the notifications of purchase / sale of the Company's shares, as at December 31, 2017 and as at the date of this report.**

Shareholder	*Number of shares*	*Percentage share in the share capital*	*Number of votes*	*Percentage share in the share capital*
Zygmunt Solorz (indirectly) through: Elektrim SA, Embud 2 sp. z o.o. S.K.A., Trigon XIX Fundusz Inwestycyjny Zamknięty, Argumenol Investment Company Limited.	26 200 867	51.55%	26 200 867	51.55%
Nationale-Nederlanden Otwarty Fundusz Emerytalny	5 068 410	9.97%	5 068 410	9.97%
Towarzystwo Funduszy Inwestycyjnych PZU SA	3 081 567	6.06%	3 081 567	6.06%
OFE PZU „Złota Jesień"	2 664 378	5.24%	2 664 378	5.24%

** according to the Company's knowledge on the basis of notifications submitted by the shareholders.*

9.5. Holders of stock giving special control rights

As of 31 December 2017 and as of the date of development of this statement, the Company has not issued stocks giving special control rights.

9.6. Limitations in the execution of the right of ballot

According to the Company's Articles of Association and other internal documents of the Company as of 31 December 2017 and as of the date of development of this report, there are no limitations regarding the execution of the right of ballot.

9.7. Limitations regarding the transfer of right of ownership of stock

As of 31 December 2017 and as of the date of development of this statement, the Company does not include any limitations regarding the transfer of right of ownership to Company's stocks.

9.8. Principles for the appointment and dismissal of management and supervisory personnel

Management Board

The Management Board is comprised of 3 to 6 members appointed for joint term. The composition of the Management Board includes: President of the Board, Vice-Presidents, as well as other members of the Board. The number of Board members and their functions are specified by the Supervisory Council. The Management Board's term is five years. The Board's President, Vice-Presidents, as well as other members are appointed and dismissed by the Supervisory Council during a secret ballot. The Board's President, Vice-Presidents, as well as other members can also be dismissed or suspended in duties during the General Meeting.

The Board administers the Company's cases and represents the Company. The Board acts pursuant to the Board's Regulations which specifically determine the Board's action mode. The Regulations are established by the Board and approved by the Supervisory Council by way of a resolution.

The Board's resolutions are required for cases exceeding common management, which especially include:

1) resolution and changes in the organisational regulations which specify the organisation of the Company's entrepreneurship,
2) contracting credits and loans,
3) proxy establishment,
4) granting credit guarantees and sureties,
5) acquisition and disposal of property, right of perpetual usufruct or share in property or perpetual usufruct.
6) decisions in cases, the value of which exceeds zloty 500 000.00. The value of transactions expressed in foreign currencies is subject to conversion according to the average exchange rate of the National Bank of Poland (NBP) of the date of resolution passing.

The Board's resolutions are also required for cases in which the Board addresses the General Meeting and the Supervisory Board.

Supervisory Board

The Supervisory Board is comprised of 5 to 14 members appointed for joint term. The Board's term is five years. The members of the Supervisory Board are appointed and dismissed during the General Meeting. The General Meeting, prior to the appointment of the Board's members for a new term, specifies the number of members of the Board. The Board appoints the President, Secretary, Vice-President or, if deemed reasonable, two Vice-Presidents, among its members in a secret ballot.

The composition of the Board should include two members who fulfil the independence criteria projected for an independent Board member within the meaning of the Commission's Recommendation of 15 February 2005 regarding the role of non-executive directors or directors acting as members of supervisory Boards in stock exchange listed companies and the (supervisory) Board's committee (2005/16/EC) with consideration of Good Practices of the Warsaw Stock Exchange Listed Companies ("Independent Supervisory Board Members"). A candidate for the Independent Supervisory Board Members provides the Company, prior to his/her appointment as a Board member, with a written declaration on the fulfilment of the independence criteria.

In accordance with the Act of 11 May 2017 on statutory auditors, audit firms and public supervision (Journal of Laws, item 1089), the Company has the status of a public interest entity within the meaning of this Act, and therefore it should have an Audit Committee. The audit committee consists of at least 3 members. At least one member of the audit committee has the knowledge and skills in the field of accounting or auditing of financial statements. According to the said Act, the majority of the audit committee members, including its chairman, must meet the criteria of independence from a given public interest entity.

The Board supervises the Company's activities in all areas of its operation.

The Board's rights especially include:

1) approval of the Board's Regulations and giving opinion on the organisational regulations, which specify the organisation of the Company's entrepreneurship,
2) conclusion, termination, and amending agreements with the Board members, as well as establishment of the Board's remuneration principles and the remuneration amounts for the Company's Board members,

3) appointment and dismissal of the Board's President, Vice-Presidents, as well as other Board members in a secret ballot,
4) suspension in duties due to significant reasons, in a secret ballot, of the Board's President, Vice-Presidents, as well as other Board members, or the entire Management Board,
5) delegation of a Board member or members for temporary execution of Board member activities in case of suspension of Board members or the entire Management Board,
6) selection of the entity authorised to audit the Company's financial statements,
7) evaluation of the Board's report from the Company's activities or financial statement for the previous accounting year,
8) evaluation of the Board's conclusion regarding the division of profit or loss coverage,
9) submission to the General Meeting of the written annual report on the results of evaluations specified in paragraph 7 and 8,
10) submission to the General Meeting of the annual brief evaluation of the Company's situation, as well as the annual report on the Board's work,
11) giving opinion on cases submitted by the Board and comprising the subject of the General Meeting's resolutions,
12) approval of the Company's and ZE PAK Capital Group's perennial activity programs, including the Company's and ZE PAK Capital Group's activity strategies, developed by the Board, and
13) approval of the Company's annual activity programs, as well as the Capital Group's annual activity programs, especially including production plans and revenues, type cost plans, unit cost plans, remuneration plans, investment plans, as well as renovation and maintenance service plans.

The Board's competencies also include giving the Board an approval:

1) to participate in other companies and disposal of shares in other companies,
2) to establish foreign branches,
3) to make advanced payments for dividends,
4) for the Company to execute activities which result in incurring liabilities, except for:
    a. activities provided in the Company's annual activity program approved by the Board,
    b. activities resulting in incurring liabilities with a value of up to zloty 1 000 000, including granting sureties or guarantees as well as suretyship,
5) acquisition and disposal of property, right of perpetual usufruct or share in property or perpetual usufruct with a value exceeding zloty 1 000 000,
6) conclusion by the Company and an affiliate of a major agreement within the meaning of the regulations regarding the current and periodical information provided by issuers of stocks accepted for trade in a regulated market, excluding typical agreements concluded by the Company pursuant to market conditions, within the conducted operational activities,
7) designation by the Board of personnel acting in the bodies of companies or other entities in which the Company has a direct or indirect share, as well as
8) establishment by the Board of the manner of ballot execution during the General Meeting or the Meeting of Partners in companies, in relation to which the Company is a parent company or an affiliate within the meaning of the Code of Commercial Companies, in the following cases:
    a. disposition and lease of the company's entrepreneurship or its organised part, establishment of a limited property right for them, as well as execution of other activities related to the acquisition or administration of the company's asset components which comprise the subject of the General Meeting's or Meeting of Partners' deliberations,
    b. company's termination or liquidation,
    c. amendment of the company's articles of association or deed
    d. company's merger, division or transformation, as well as
    e. increase or decrease in the company's share capital.

Pursuant to the Board's application, the Supervisory Board grants Board members the approval to take positions in the bodies of companies, in which the Company holds shares, as well as for the collection of remuneration for acting in these positions.

9.9. Composition, its changes as well as description of the management and supervisory bodies

Management Board

The 2017 financial year began in the following composition:
1) Adam Kłapszta – Vice-President of the Board, acting President of the Board,
2) Aneta Lato-Żuchowska – Vice-President of the Board,
3) Zygmunt Artwik – Vice-President of the Board,
4) Katarzyna Sobierajska – Vice-President of the Board,
5) Tomasz Zadroga – Vice-President of the Board.

On 3 March 2017, by the resolution of the Company's Supervisory Board, the function of the President of the Management Board was entrusted to Mr. Adam Kłapszta. Simultaneously, at the same Supervisory Board meeting, Ms. Katarzyna Sobierajska and Mr. Tomasz Zadroga submitted their resignation from the positions of the Vice-Presidents of the Company's Management Board on March 3, 2017. The Supervisory Board of the Company also appointed Ms. Elżbieta Niebisz as the Vice-President of the Management Board.

Since 3 March 2017, the Management Board of the Company has been operating in the following composition:
1) Adam Kłapszta – President of the Board,
2) Aneta Lato-Żuchowska – Vice-President of the Board,
3) Zygmunt Artwik – Vice-President of the Board,
4) Elżbieta Niebisz – Vice-President of the Board.

Supervisory Board

There were the following changes in the composition of the Supervisory Board in the reported period:

The 2017 financial year the Supervisory Board of ZE PAK SA started in the following composition:
1) Tomasz Szeląg – Chairman,
2) Henryk Sobierajski – Deputy of the Chairman,
3) Wojciech Piskorz – Secretary,
4) Leszek Wysłocki,
5) Lesław Podkański,
6) Ludwik Sobolewski,
7) Wiesław Walendziak.

On June 28, 2017, the Ordinary General Meeting of the Company appointed the Supervisory Board for a new, i.e.7th term of office. 7 members were appointed to the Supervisory Board of the 7th term, i.e.:
1) Tomasz Szeląg,
2) Wojciech Piskorz,
3) Henryk Sobierajski,
4) Leszek Wysłocki,
5) Wiesław Walendziak,
6) Lesław Podkański,
7) Sławomir Sykucki.

At the meeting on June 29, 2017, the Supervisory Board of the Company chose:
1) Wiesław Walendziak as the Chairman of the Supervisory Board,
2) Tomasz Szeląg as the Deputy of the Chairman of the Supervisory Board,
3) Wojciech Piskorz as the Secretary of the Supervisory Board.

On October 21, 2017, the Extraordinary General Meeting of the Company appointed Mr. Sławomir Zakrzewski to the Supervisory Board. Since October 21, 2017, the Supervisory Board has been working in the following composition:
1) Wiesław Walendziak – Chairman,
2) Tomasz Szeląg – Deputy of the Chairman,

3) Wojciech Piskorz – Secretary,
4) Henryk Sobierajski,
5) Leszek Wysłocki,
6) Sławomir Zakrzewski,
7) Lesław Podkański,
8) Sławomir Sykucki.

The members of the Supervisory Board meeting the criteria of the independence are Mr. Lesław Podkański and Mr. Sławomir Zakrzewski.

In performing its code and statutory duties, the Supervisory Board held 12 meetings in 2017, adopting a total of 64 resolutions. The Supervisory Board performed the statutory duty to hold a meeting in each quarter.

In the reporting period, the Supervisory Board collectively supervised the Company's activity in all areas of its operation. The Supervisory Board focused on the following issues:

1) evaluation of statements developed for the financial year of 2015,
2) giving an opinion on the Company's new organisational structure,
3) appointing the Audit Committee within the new, i.e. 7th term of the Supervisory Board,
4) giving consent for the Company to perform actions resulting in incurring liabilities with a value of over PLN 1 million,
5) giving opinions on applications submitted by the Management Board regarding matters related to the current operations of the Company,
6) changes in the Management Board of ZE PAK SA,
7) supervising activities related to heat supply to Miejskie Przedsiębiorstwo Energetyki Cieplnej – Konin Sp. z o.o.,
8) supervising works related to the end of coal blocks operation at Elektrownia Adamów,
9) approval of activities related to the ongoing restructuring process in ZE PAK SA Capital Group,
10) current discussion of the situation related to the course of the construction project of the open-pit construction of Ościsłowo, in particular obtaining a decision on environmental conditions for this investment.

On October 21, 2017, the Supervisory Board of the 7th term of office appointed the Audit Committee in the following composition:

1) Sławomir Zakrzewski,
2) Lesław Podkański,
3) Tomasz Szeląg.

In the financial year 2017, the Audit Committee of the Supervisory Board of ZE PAK SA held 5 meetings. At the meeting on October 23, 2017, the Audit Committee of the Supervisory Board of ZE PAK SA, functioning within the 7th term of the Council, proceeded to elect the Chairman of the Committee. Members of the Committee elected Mr. Lesław Podkański as the Chairman. Additionally, during the meetings held, the Audit Committee of the Supervisory Board of ZE PAK SA discussed with the auditor, among others, results of audits of financial statements for 2016 and review of interim financial statements for 2017. As part of the work carried out in 2017, the Audit Committee adopted such documents as: "Policy of providing Zespół Elektrowni Pątnów-Adamów-Konin SA by the auditing company conducting the research, by entities related to this auditing company and by a member of the auditing company's network of permitted non-audit services", "The procedure for selecting an audit firm for the purpose of carrying out a statutory audit of Zespół Elektrowni Pątnów-Adamów-Konin SA" and "The policy of selecting an audit firm for the purpose of carrying out a statutory audit of Zespół Elektrowni Pątnów-Adamów-Konin SA". The Audit Committee also dealt with the matter of indicating the Person Being responsible for the implementation of the selection procedure for the audit company for the purposes of conducting the statutory audit ZE PAK SA for the years 2018-2019.

9.10. Procedure and basic powers of the General Meeting as well as description of shareholders' rights and their exercise

General Meeting

The General Meeting is held in cases specified in the Code of Commercial Companies and in the Company's Articles of Association. The General Meeting is held in principle by the Company's Board and deliberates, and an ordinary or extraordinary meeting. In case of summoning the General Meeting by an entity or body other than the Company's Board, the Board is obligated to cooperate with the entity or body in order to execute any activities specified by the law as necessary to summon, organise, and execute the General Meeting. Since the first day of listing of the Company's shares in the regulated market of the Warsaw Stock Exchange Joint-stock Company, the General Meetings can take place with the use of electronic communication resources. The decision on arranging the General Meeting using electronic communication devices is made by the Company's Supervisory Council.

The General Meeting takes place in Warsaw or in the Company's registered office.

The ZE PAK SA's General Meeting is summoned by notification placed on the Company's website and in a manner specified for provision of current information in accordance with the regulations on public bidding and conditions for introducing financial instruments to the organised trade system and on public companies.

The materials made available to shareholders in relation to the General Meeting, including drafts of resolutions proposed for passing, as well as other important materials are made available by the Company on the http://ri.zepak.com.pl/ website.

The basic competencies of the General Meeting include:

1) examination and approval of the Board's report on the Company's activities, as well as the financial statement for the previous accounting year, as well as acknowledgement of the fulfilment of duties by the Company's body members,
2) division of profit and loss coverage,
3) change in the subject of the Company's activities,
4) amendments to the Company's Articles of Association,
5) increase or decrease in the share capital,
6) authorisation of the Board to acquire own shares for the purpose of redemption,
7) appointment and dismissal of Council members,
8) establishment of the remuneration of Council members,
9) Company merging, division and transformation,
10) Company termination and liquidation,
11) emission of convertible bonds or bonds with right of priority and subscription warrants,
12) sale or lease of the company or its organised part as well as establishment of a limited property right for them,
13) establishment and cancellation of the Company's capitals and funds,
14) conclusion by the Company of a credit, loan, surety agreement, or a similar agreement with a member of the Company's Board, Supervisory Council, proxy or liquidator, or for any of this personnel,
15) conclusion by an affiliate of a credit, loan, surety agreement or a similar agreement with a member of the Company's Board, Supervisory Council, proxy or liquidator, or for any of this personnel,
16) any provisions regarding claims the remedy of damage done during the Company's establishment or executing management or supervision, and
17) use of the share capital.

The active right to participate in the General Meeting is available to persons being the shareholders, 16 days prior to the General Meeting. The condition of admitting a shareholder to participate in the General Meeting is the submission of a registered certificate regarding the right to participate in the General Meeting, which is issued by the entity that keeps the stocks account.

The shareholder participates in the General Meeting's deliberations and executes the right of ballot in person or via an authorised representative.

The shareholder who represents at least 1/20 of the Company's share capital is entitled to request specific cases to be included in the Company's General Meeting agenda. The request should be reported to the Company's Board no later than 21 days prior to the Company's General Meeting.

The shareholder, who requests to include specific cases in the General Meeting's agenda, should demonstrate the possession of the proper number of shares at the date of request submission, including a deposit certificate to the request, issued by the entity keeping the stocks account.

The shareholder representing at least 1/20 of the Company's share capital can submit resolution drafts regarding the cases introduced into the General Meeting's agenda, or cases, which are to be introduced into the agenda in a written or electronic form prior to the date of the General Meeting.

Each of the shareholders authorised to participate in a general meeting can provide the resolution drafts regarding the cases introduced into the agenda during the Company's General Meeting.

The General Meeting's resolutions are passed with a majority of 75% votes, provided that the Code of Commercial Companies does not specify otherwise. Each Company's share entitles to a single vote at the General Meeting.

9.11. Description of principles of changes in the Company's statute

Changes to the Company's statute, in accordance with the Code of Commercial Companies and provisions of the Company's Statute, require the General Meeting to pass a suitable resolution and an entry into the register of entrepreneurs. The General Meeting can authorise the Company's Supervisory Council to develop a uniform text of the amended statute, or to introduce editorial changes specified in the General Meeting's resolution. Amendments to the Statute are binding since the moment of entry into the register of entrepreneurs.

9.12. Information on the remuneration system and the amount of management and supervisory staff's remuneration

In Zespół Elektrowni Pątnów-Adamów-Konin SA. company, the remuneration system is based on the Corporate Collective Labour Agreement for ZE PAK SA employees as of 24 September 1993 (CCLA). Only members of the Management Board, the principal accountant and key managers are not subject to the CCLA's provisions.

The basic components of remuneration for the employees contained in the CCLA include an individual monthly basic salary, a monthly statutory bonus, an annual bonus, a post-employment benefit and allowances. The employees are also entitled to receive awards from the president's fund and social benefits.

The Management Board determines the principles of remuneration of key managers in individual agreements. The basic component of remuneration is the basic salary. The key managers can receive a discretionary award granted by the Management Board's decision. The key managers are also entitled to some components of the CCLA.

The members of the ZE PAK SA Management Board are paid on the basis of the provisions of individual management agreements, the content of which is formed by the Supervisory Board of the Company. There are no other additional regulations or other documents creating the rules of the Management Board's remuneration. The members of the Management Board are entitled to a monthly salary. They can also be granted a discretionary award. In case of dismissal from the Management Board composition, the payment of a severance pay in the amount of a six-month salary is provided. The severance pay is not entitled if the dismissal occurs for reasons concerning the dismissed member of the Management Board, particularly for the reasons set forth in Article 52 of the Labour Code.

The Company does not have a motivational or bonus program based on the Company's capital.

Table 15: Information on the amount of remuneration paid in 2017 by the Company and its subsidiaries to all Management Board members performing their functions in 2017

The Board's member name and surname	*zloty thousand* Value of (gross) remuneration paid by the Company	*zloty thousand* Value of (gross) remuneration paid by the Company's subsidiaries	*zloty thousand* In total:	*zloty thousand* including variable elements of remuneration*
Adam Kłapszta	550.00	63.60	613.60	200.00
Aneta Lato-Żuchowska	493.00	94.10	587.10	140.40
Zygmunt Artwik	736.00	1.20	737.20	100.40
Elżbieta Niebisz	114.00	394.70	508.70	30.40
Katarzyna Sobierajska	86.40	270.90	357.30	20.00
Tomasz Zadroga	340.90	0.40	341.30	200.00
Total	2 320.30	824.90	2 591.80	691.20

* *The variable remuneration components include: awards and bonuses, severance pay for dismissals from the Management Board, holiday equivalents, retirement benefits and remuneration for participation in meetings of supervisory boards.*

Table 16: Information on the amount of non-cash benefits in 2017 granted by the Company and its subsidiaries to all Management Board members performing functions in 2017

The Board's member name and surname	*zloty thousand* Total estimated value of non-cash benefits granted by the Company	*zloty thousand* Total estimated value of non-cash benefits granted by the Company's subsidiaries	*zloty thousand* In total:
Adam Kłapszta	0.80	-	0.80
Aneta Lato-Żuchowska	0.70	-	0.70
Zygmunt Artwik	1.10	-	1.10
Elżbieta Niebisz	1.60	2.00	3.60
Katarzyna Sobierajska	0.20	0.60	0.80
Tomasz Zadroga	0.03	-	0.03
Total	4.43	2.60	7.03

The total amount of remuneration, understood as the value of remuneration, bonuses and benefits received in cash, in kind or in any other form, paid by the Company and subsidiaries of the Company to the Management Board members in 2017 amounted to PLN 3 152.23 thousand. The given amount should be treated as the gross value of remuneration paid or due in the period from 1 January to 31 December 2017.

Members of the Supervisory Board of ZE PAK SA are remunerated on the basis of Resolution No. 32 of the Ordinary General Meeting of June 28, 2017, which fixed the monthly remuneration for the chairman of the Supervisory Board in the amount of PLN 15 000 and for other members in the amount of PLN 10 000.

Table 17: Information on the amount of remuneration paid and the value of non-cash benefits in 2017 by the Company and its subsidiaries, as a member of the Supervisory Board, all members of the Supervisory Board performing their functions in 2017

	zloty thousand	*zloty thousand*	*zloty thousand*
Name and surname of Supervisory Board member	*Value of (gross) remuneration paid by the Company and the Company's subsidiaries*	*Total estimated value of non-cash benefits granted by the Company and the Company's subsidiaries*	*In total:*
Wiesław Walendziak	145.50	0.00	145.50
Tomasz Szeląg	154.50	0.00	154.50
Wojciech Piskorz	121.10	1.10	122.20
Henryk Sobierajski	120.00	0.00	120.00
Leszek Wysłocki	120.00	3.30	123.30
Lesław Podkański	120.00	0.00	120.00
Ludwik Sobolewski	71.50	0.00	71.50
Sławomir Sykucki	240,00	0.00	240,00
Sławomir Zakrzewski	13.20	0.00	13.20
Total	1 105.80	4.40	1 110.20

The total amount of remuneration, understood as the value of remuneration, bonuses and benefits received in cash, in kind or in any other form, paid out by the Company and subsidiaries of the Company to the members of the Supervisory Board in 2017 amounted to PLN 1 110.20. The given amount should be treated as the gross value of remuneration paid or due in the period from 1 January to 31 December 2017.

10. STATEMENT ON THE DIVERSITY POLICY

With reference to §91 paragraph 5 point 4 lit. 1 of the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information the Company declares that in ZE PAK SA Group and in ZE PAK SA no separate document describing the diversity policy has been adopted. At the same time, management solutions related to the issue of diversity management were adopted.

The objectives related to diversity management, in particular with regard to the age structure of employees, were adopted in the Group together with the Corporate Social Responsibility Strategy of ZE PAK SA Capital Group for the years 2017-2020. The restructuring process, lasting for years, meant that most vacancies were filled on the basis of internal recruitment (as part of transfers between departments and companies). A side effect of actions aimed at reducing redundancies and concentrating in the recruitment process on persons already employed in the Group's companies was the lack of a significant inflow of young employees, and as a result, the average age of employees increased. At some point, this may result in significant retirements and staff shortages. Therefore, ZE PAK SA Group actively monitors changes in the age structure of employees in order not to allow the adverse consequences of losing a large part of experienced employees without proper preparation of their successors.

Simultaneously, the Code of Ethics adopted at the end of 2017 in ZE PAK SA includes diversity policy, guaranteeing equal treatment regardless of gender, age, worldview, religion, political views, etc. The document is a tool for reporting potential incidents related to discrimination on any background. It is planned to implement analogous solutions in the subsequent companies of the Group.

As of today, in the Company's opinion such solutions are sufficient.

Numerical data referring to diversity can be found in the Statement on non-financial information for 2017 in the subsection "Employee issues", page 57 of this report.

11. STATEMENT OF ZESPÓŁ ELEKTROWNI PĄTNÓW-ADAMÓW-KONIN SA CAPITAL GROUP ON NON-FINANCIAL INFORMATION FOR 2017

In the process of preparing an approach to non-financial reporting, including preparation of this statement, ZE PAK SA Group has worked on the basis of the best global practices in this field, for instance using the approach for defining the significant contents, information as well as the indicators suggested, among others, by:

- PN-ISO 26000 standard,
- GRI G4 guidelines / GRI Standards,
- RI G4 Sectoral Supplements in the field corresponding to the mining and power engineering

Nevertheless, this statement might not be considered as the one developed in accordance with GRI G4, GRI Standards or any other comprehensive standard.

The reporting process itself was preceded by the development of strategy for Corporate Social Responsibility of ZE PAK SA Group, where the approach suggested by PN-ISO 26000 was maintained, i.e. in the first step of works, during the internal conferences, in which the members of interdisciplinary team appointed by ZE PAK SA Management took part, the significant areas of responsibility and crucial groups of stakeholders were defined. The defined significant areas became appropriately a starting point to determine the crucial aspects to which particular emphasis has been placed in the statement, in the fields of social, employee, environmental protection, human rights and counteracting corruption issues.

11.1. Description of business model

ZE PAK SA Capital Group („ZE PAK SA Group", „Group") is a significant producer of energy on the polish market and an important element of national power engineering system. The vast majority of its revenues are generated from the sale of produced electricity. The Group is operating on the basis of the integrated business model. With its own coal lignite mines, it extracts it and using mainly this fuel it is generating electricity and heat in nearby power plants. Simultaneously, there are entities functioning within the group, in the form of separated companies responsible for the support functions (e.g. sale, renovation, maintenance, etc.).

The companies of the greatest importance to the ZE PAK SA Group due to their scale of operations are: Zespół Elektrowni Pątnów-Adamów-Konin SA ("ZE PAK SA") - dealing with the production of electricity and heat, Elektrownia Pątnów II sp. z o.o. - dealing with the production of electricity, and PAK KWB Adamów SA and PAK KWB Konin SA dealing with lignite mining. Beside the companies from the main areas of activity, there are also other companies that, among others, are dealing with implementation of construction and assembly works, maintenance, service, production and trade activities aimed at satisfying the needs and comprehensive industry service. In 2017 generation assets of the Group included four lignite-fired power plants located in the centre of Poland, in Wielkopolska voivodship. There are: Pątnów II - equipped with the power unit of supercritical parameters, Pątnów I and Konin – equipped with the biomass-fired boiler unit, and Adamów (Elektrownia Adamów was closed in January 2018). The Group's basic production assets are concentrated mainly in two companies: PAK KWB Konin SA, which currently operates in Jóźwin, Tomisławice and Drzewce opencast mines, and PAK KWB Adamów SA exploiting Adamów opencast mine.

11.2. Social issues

Management approach

The policy and management approach of the ZE PAK SA Group to social issues were set out in the Strategy for Corporate Social Responsibility of the ZE PAK SA Capital Group for 2017-2020 adopted in 2017. Simultaneously, the approach presented in the Strategy is reflected in other internal regulations. The management approach is also determined in administrative decisions that allow conducting the mining and generating operations in the units that belong to ZE PAK SA Group and dependent on the specifics of the particular object. Each time, the Group is trying to work out the optimal solutions in this respect, based on social consultations as well as in accordance with the applicable law.

The Group's management approach to social issues is conditioned by the nature of its companies' influence on the environment. Particularly in the areas where the influence is or might be negative and can be associated with specific burdens for people, the management approach aims at eliminating, limiting or compensating for these burdens, and consequently limiting the exposure of the Group to the risk.

The Group's influence on the environment is multidimensional. From the point of view of general public, ZE PAK SA Group is an important supplier of energy for the Polish economy and Polish society. Nevertheless, the final customers are not the main clients of the Group but the trading companies operating on the wholesale electricity market. For this reason, the ZE PAK SA Group aims at ensuring stable electricity supply at a competitive price to other technologies. The ZE PAK SA Group has a much wider range of impact on the environment from the point of view of the local community, i.e. understood as a community living in the immediate neighbourhood of the Group's plants, where the production of electricity and heat and lignite coal mining is conducted. The exploitation of lignite deposit and production of energy have the great impact on the natural environment (see: Environmental issues), and consequently social environment too. Dealing with the negative influence on the natural as well as social environment, it is necessary to mention, first of all, about the danger and burdens associated with:

- an influence on the land surface (opencast mining of minerals results from the transformation of the land surface; in the place of the originally used land, spatial field forms (excavation, heap) and accompanying infrastructure are created (conveyors, transport routes, facilities),
- an influence on the surface water (inter alia reducing the flow in watercourses under the influence of the mine and increasing the flow in the watercourses due to discharging water from underground drainage and surface pits),
- an influence on the groundwater (formation of the so-called depression funnel due to the drainage of open-cast mines),
- noise emission (basic machines related to the operation of the overburden and its dumping, basic machines mining coal, coal and overburden conveyors, road transport),
- an impact of mine objects on atmospheric air (dust emission: technological (mechanical), i.e. associated with mechanical mining and transport of the raw material with conveyor belts; climatological, i.e. related to wind erosion of vegetation-free areas; organized emissions of pollutants into the air from the boiler room providing heat for social facilities mine),
- an influence on valuable natural area (in case when the valuable natural area is located in the zone of influence),
- hazards associated with electromagnetic fields.

It is worth mentioning here, that the above mentioned influence is not only negative. Konin energy basin has a unique, cooling system, based on water cycle. A common name of "jeziora ślesińskie" includes the following lakes: Gosławskie, Pątnowskie, Wąsowsko-Mikorzyńskie, Licheńskie and Ślesińskie, which are included in the cooling circulation of Pątnów, Pątnów II and Konin power plants. All the lakes are connected by a channel system of total length of about 26 km and they are forming a closed circulation where the water flow is regulated by culverts and pumping stations. The discharge of waste heat to nearby lakes obviously influenced their ecosystems, but also made these reservoirs especially valuable for fishing and fish farming. Higher temperature of water and its large flow in the channels and lakes caused that in the area of cooling system the breeding fish ponds were located there. Fishing farms operating here are not only the largest producers of sturgeon fish in Poland (Siberian sturgeon, Russian sturgeon, sterlet), but also other species of fish such as European catfish, rainbow trout, amur, silver carp, catfish, carp or ornamental fish. By the use of waters with increased thermic for reproduction, breeding and breeding of thermophilic fish, they are an important producer of fry in the domestic market. The cooperation with ZE PAK SA Group makes the warm water to flow directly through the ponds providing optimal conditions for development of fry and adult fish. One of the farms is taking the water for breeding from Elektrownia Konin precooling water tank and the production is strictly dependent on the conditions made by the power plant, water temperature and its cleanliness, etc. For this reason there is a constant communication and information flow between the fish farms and the power plants. In addition to some of the largest fishing farms in Poland, these areas are known among anglers. Supporting such economic activities, as well as all other forms of social involvement allows compensating partially to social environment the burdens related to the activities of ZE PAK SA Group.

ZE PAK SA Group may also be a welcome member of the community, due to significant direct and indirect economic impact. Money transfers in the form of taxes and para-taxes (license fees, concessions, etc.) to a large extent feed budgets of local governments. For example, in 2017, the Group's companies paid over PLN 247.9 million (PLN 264.1 million in 2016), of which PLN 170.6 million (in 2016 it was over PLN 158.1 million) increased budgets of local governments. These means allow the communities to realize investment projects, finance health care and education, etc. Simultaneously, thanks to the salaries of employees who are mostly recruited from local communities, the so-called multiplier effects are started and the local economy is stimulated, including sectors not directly related to lignite mining and energy (the Group's companies allocated employee benefits to PLN 461 million in 2017 and PLN 488 million in 2016).

The management approach of ZE PAK SA Group concentrates mainly on ensuring production continuity and stability while ensuring at the same time the safety for natural and consequently social environment. Such management approach was set out in the Strategy for Corporate Social Responsibility for 2017-2020 adopted in 2017 and it assumes providing effective mechanisms reducing to minimum the threat of anomalies and gaps occurring resulting in over-normative impact on the environment in the mining or manufacturing process. Consequently, it assumes providing mechanisms guaranteeing the stable operation of the plants, which is not disturbed by interruption in production or mining that would be caused by social factors. These aspects also relate to policies accompanying management systems and internal regulations that ensure compliance with laws and administrative permits related to specific manufacturing facilities and installations.

The other dimension of impact on social environment is connected with the economical use of waste heat, which accompanies the electricity production. A part of heat has been used for years for heating purposes, inter alia by Miejskie Przedsiębiorstwo Energetyki Cieplnej in Konin. Such approach is extremely rational from the social as well as environmental point of view. Nevertheless, due to restructuring of power plants, the heat production from the current source based on the lignite from Konin power plant, after June 30, 2020 will not be possible because of the environmental requirements. However, the Group, wishing to remain a supplier of heat for the local community, conducts analytical and formal-legal work for this purpose to develop an optimal project for starting a new source of heat based on a biomass block that could form the basis for a new heat supply contract. The Group is interested in constructive dialogue, giving a chance to develop the solutions satisfying for the parties and economically viable, that would ensure safe heat supply for Konin residents. Nevertheless, as noted, the solutions must be profitable at the same time, in order to protect the obvious interest of the residents, as well as the shareholders'.

The management approach and, consequently, the implemented activities directly or indirectly address the risks associated with the loss of favour of the local community, and thus contribute to the prevention of events that could disrupt the stable operation of mining and manufacturing plants, and consequently negatively affect the Group's financial results. When it comes to aspects of influence on the natural environment, which at the same time are the source of potential burdens for the local society, they were widely described in the further part of the report (see: Social issues). They constitute the element of environmental management, having parallel consequences for local society. The approach to them was also described in other internal regulations as well as in the administrative decisions regulating the environmental issues. This description is limited to the characteristic of the Group's approach to these aspects which concerns only the human beings. Though, all of them focus on the activities which aim at monitoring and reducing the negative influence.

For instance, in the areas that are to be under extraction, as well as directly adjacent with the area designed for extraction, real estate buyouts are made. Most often they are agricultural lands but also the buildings or constructions. Assessments of the influence, i.e. whether the real estate adjacent to the opencast mine is going to be the subject to buyout, are set individually. The individual approach is justified by the fact that in such aspect the significant roles are played by emotional factors, for instance, associated with getting used to this place. In addition to those who may be reluctant to resell the property, there are also those who would like to sell it, although in the opinion of the investor's experts, the scale of impact will not be sufficient to justify the necessity of buying. In extreme cases, there may be disputes that eventually find their final in the court. Nevertheless, the Group's intention is to carry out the described processes in a way reducing the negative emotions, because it may influence subsequent projects of this type.

Lignite deposits in the operation area of the Group have their specific characteristics and wealth. The company does not use one deposit, but over the years it is forced to launch further opencast mines. Therefore, at the same time a process of reclamation of previously exploited pits, exploitation of current outcrops and preparatory processes for the next ones take place. Currently, PAK KWB Konin SA is applying for a mining concession for Ościsłowo open pit. The coal supplied from this outcrop is to secure supplies for the modernized blocks at Pątnów I and Pątnów II power plants. These are the most efficient generation assets of the Group for modernization of which, significant expenditures have already been incurred. The process of launching a new lignite mine is a multi-stage process and its implementation requires special care. It should be borne in mind that in processes related to obtaining formal consents before public administration authorities, there are usually various associations and organizations that aim to fight specific types of activities (e.g. they deny the use of lignite as a rule, and thus, the operation of opencast mining). In the current pending proceedings concerning the determination of environmental conditions for the project entitled: "Extraction of lignite coal and accompanying minerals from Ościsłowo open-pit" (more detailed description in the Management Board's report on pages 11 and 12) the parties also have several organizations opposed to the location of new lignite opencast mine. It is worth mentioning that, on the other hand, the trade unions or some local opinion leaders pay a lot of attention to the supporters.

As mentioned earlier, as a result of mining operations, socially annoying phenomena may occur. In case of occurrence of such situations the Group tries to compensate by paying out appropriate damages in justified cases. Damage can be divided into direct and indirect. Direct damage is usually associated with mining plant operations and the progress of exploitation fronts. They include reconstruction and construction of new roads, power lines, water supply networks and other technical infrastructure as well as road repairs, on which the mine transport moves and in particular cases the transfer of sacral culture objects, e.g. chapels, churches, cemeteries. Due to direct damage, the companies from the Group's mining segment in 2017 paid PLN 8 855 thousand, while in 2016 it was PLN 16 927 thousand, respectively. It is worth noting that in each case the payment of compensation for direct damages occurred by way of a settlement or agreement. Apart from direct damage, there are also indirect damages connected, for example, with the lowering of the groundwater level in the areas adjacent to the mines. However, drainage of water from the outcrop to watercourses can lead, for example, to raising their level. Water shortage as well as its excess can mean adverse effects, for example, on agricultural production, which the Group tries to compensate by paying reasonable compensation in justified cases. Owners of compensated land receive written notifications with a proposal for the amount of compensation due to the mine's impact. In the case of acceptance, an out-of-court settlement is signed with the owner, with a waiver of claims after payment of compensation. Only a few cases of mining damage are subject to resolution by ordinary courts. Practice indicates that in the vast majority (about 80-90%) of compensation cases, out-of-court settlements are made, in the remaining part by way of court settlement or court ruling. In 2017, only PLN 52.37 thousand out of PLN 2,189 thousand - the total amount of indirect damages was paid as a result of a court judgment, and in the case of the remaining part, a settlement was reached. In 2016, the whole of 1,994 thousand PLN was paid as part of the settlement.

In case of other periodical burdens, for example intensified noise associated with the renovation or modernization works on the generating objects (such works give rise to the necessity of blowing the boiler's installation under very high pressure, in order to remove even the filings from the installation, which could damage it, and that is quite loud), the Group informs local society, through mass media, about such burdens by giving the information to local media or local offices. The same happens with any other burdens (e.g. in road traffic connected with the transport of oversized equipment, the intensification of dusting or dew from chimneys. Consequently, they do not arouse controversy, and the plant can count on the forbearance of the inhabitants of the immediate area. Within the education activities directed to external society, the Group's PR department performs press articles explaining the rules of exploitation of lignite open mines and reclamation of post-mining sites. As mentioned earlier, the inhabitants of the nearest neighbourhood of the plant are often the Group's employees. Thus, although the external communication is described here, the appropriate internal communication is significant and the employees themselves are the ambassadors of ZE PAK SA Group. In case of communication activities, in situations like those described above, an equally important role can be played here by internal communication. Here, however, a wider spectrum of information transfer is possible: some activities can be better and more precisely explained, using e.g. "Kontakt" - a monthly e-magazine of the Capital Group.

The Group also declares its support for local initiatives, although due to the savings program it has been less recently than in previous years. ZE PAK SA Group aims at supporting local society by social commitment, so as to compensate the burdens associated with the operation of the plant, in a part which cannot be eliminated or limited.

The Group's involvement in spectacular projects is not meant to get publicity but to reach the nearest communities and non-governmental organizations from the region. PAK KWB Konin, for instance gave a number of donations last year, largely factual, e.g. in the form of earth or sand for Ślesin and Wierzbinek community and for Roman Catholic parish in Połajewo in the amount of ca. PLN 80 thousand gross; in the form of 7000 bottles of "Licheńska" water (produced by one of Group's subsidiaries) for communal harvest festivals in Kobylanki, Zakrzewek, Rudzica and Osiek Mały; for organization of the First Running Festival of Skulsk Commune on "Szlak Wielkiej Pętli Wielkopolski"; in the form of Christmas packages for the Special Educational Centre of Janusz Korczak in Konin and Sociotherapy Centre No. 4 in Konin. PAK KWB Konin also gave, along with the loading, a 42-ton boulder for "LEDNICA 2000" Association for the monument on the grave of Father Jan Góra and a 6-ton erratic boulder for the municipality of Świnice Warckie for placement of a plaque commemorating the air battle between Polish and German aircraft. For the Deep Diving Dive Centre, two excavator digger shovels were donated and for the commune of Osiek Mały a service was performed in the form of sludge and silt loading by wheel loader and transport carried out by dump trucks - the works were related to the clean-up of the lake shoreline in Łuczywno. On the occasion of Barbórka, the mine donates every year to Sailing Club operating at PAK KWB Konin for the organization of the Winter Regatta of Barbórka and the Runner Club "Aktywni Konin", organizer of the Run for the Miners' Lamp. There are the meetings organized in educational institutions, the miners meet children in schools and kindergartens, the company's employees perform presentations about mine work, mining traditions. Also the brass bands operating at both mines organize musical meetings with children from schools and kindergartens - the prepared program concerns the history of the mine, mining traditions and work of the orchestra, and it is combined with the presentation of musical instruments and a short concert. Such meetings are free and they are very popular within educational institutions. The bands participate in state and church celebrations. Simultaneously, thanks to the support of the mines, PAK KWB Konin teams took part in: X National Volleyball Tournament for the Cup of the Mayor of Miasto i Gmina Kleczew, volleyball tournament organized as part of the Great Orchestra of Christmas Charity in Konin, volleyball tournament in Kazimierz Biskupi, Polish National Football Tournament of Non-attached Members for the Cup of Director PGE GiEK S.A. in Bełchatów, "Runmageddon" training in Lubstów (organized on the reclaimed area of Lubstów open-cast mine) in Sompolno commune, Runmageddon in Poznań and the Polish National Darts Masters Tournament. PAK KWB Adamów takes part in the event called "All of Poland Reads to Kids" prepared by the centre's educators in Stemplew – text is reading by a miner in gala uniform. Every year before Christmas the mines' employees take part in Christmas Eve in orphanage in Nowy Świat, the company gives the children gifts and sweets. Throughout the year the company is visited by the tour groups from the various regions of Poland: from schools, workplaces and associations. Sightseeing of the mine is free of charge. In 2017, within prosocial activities, ZE PAK SA supported financially the 38th International Kids Song and Dance Festival in Konin, organization of the Sailing Regatta for the Cup of the President of ZE PAK SA and celebrations of the 40th anniversary of the Association of Polish Electrical Engineers in Konin. A donation was also made to the Camaldolese Hermit Congregation of the Crown Mountain - the Five Martyrs hermitage in Bieniszew. Traditionally, ZE PAK SA supports Polsat Foundation activities, one of the biggest non-governmental organizations operating in the area of Poland, which for over twenty years has been directing its help to sick children and their parents.

The significant role in the life of local society is played by Konin lakes mentioned earlier, which are on one hand the source of revenue for unique (on national scale) fish farms, and on the other hand they attract a number of amateur anglers. For this reason, the contribution of ZE PAK SA employees who are privately engaged in the life of the fishing community is worth mentioning here. In addition to other fishing clubs of Polish Angling Associations operating in this area, there are two in ZE PAK power plants associating their employees. The members of one of them are taking care of the mentioned earlier precooling tank of Elektrownia Konin - they organize annual spring action of cleaning the edge of the water reservoir and restocking with various fish species. There are also season fishing competitions with youths' participation organized by the anglers from PAA clubs. It aims at promoting fishing sport among young residents of the region and it helps acquiring new members to fishing clubs, as well as it builds a positive attitude among the participants of mentioned sport, cultural and social events towards the activity of the Group.

Associated business risk

Business risk that may have negative influence on the Group's results and development, and being associated with the area of social influence, results directly from the character of its influence (e.g. disturbing the hydrology balance or noise mentioned earlier). They constitute inconvenience and may also be a source of material damage of the third parties. This can lead to disputes with the society and thus loss of its positive attitude for present and further projects, including so-called social licence to operate. It can cause the increase of complaints directed by the society to administration bodies, initiating the proceedings against the plants and legal and financial sanctions, in case of confirming the allegations. Ineffective dialogue, for example on damages or land purchase, may also mean civil proceedings for damages. A particular threat is the loss of public trust and a negative opinion about the plant as an unreliable investor, which can definitely hinder the acquisition of further permits and concessions (e.g. for lignite mining in new areas). This, in turn, may cause a greater risk associated with the new investment and less favour of investors and lenders, and thus difficulties in raising capital.

It is worth mentioning here that the employees of the plants are recruiting from local communities. As a consequence, these groups are not separate and any possible animosities with the local community related to, for example, inconvenience, will indirectly affect the culture of the organization and the work atmosphere, and vice versa: all important incidents on the employer-employee line may result and are resulting in specific consequences in relations with local community. The same person may appear in several roles, i.e. an employee, a resident of a local community adjacent to a plant, which is exposed to nuisance related to noise for example, as well as being the owner of a real estate that is seeking compensation or redemption.

Key indicators

	2017	*2016*
Number of environmental failures resulting in serious contamination	0	0
Amount of indemnities paid as a result of court verdict in relation to the amount of damages paid out by the Group as a result of a settlement or agreement	0.5%	0%
Total amount of taxes and para-taxes paid - altogether	PLN 247.9 m	PLN 264.1 m
Total amount of taxes and para-taxes paid – for local administration	PLN 170.6 m	PLN 158.1 m

11.3. Employee issues

Management approach

In the area of human resources management, the ZE PAK SA Group has formal solutions defining the relationships between the employer and employees, resulting from the polish law, inter alia work regulation resulting from the

Labour Code, corporate collective labour agreement resulting from the Labour Code, Company Social Benefits Fund resulting from the act of Social Benefits Funds, in the companies not covered by the provisions of CSBF the remuneration regulations are obligatory. The companies meeting the statutory criteria have their own Staff Councils. The Unions are also operating in ZE PAK SA Group. In the matters specified by the law the management of ZE PAK SA and other companies inform and consult the decisions with the employee representatives.

Simultaneously, apart from formalized solutions resulting from specific legal provisions or adopted voluntarily (e.g. recruitment procedure), current operational activity is based on a series of solutions and customary forms of behaviour that do not require rigid formalization in the managers' opinion, and at the same time they guarantee the management that is effective and consistent with legal norms and standards of social coexistence. The Group's companies comply with the labour law and they require proper behaviour in relations between the employees as well as between the employees and their superiors.

Corporate collective labour agreements, obligatory in ZE PAK SA Groups in the reporting period, contain the principles of employment and remuneration of the employees. On the other hand, the regulations of the Company Social Benefits Fund define the rules of using and financing of social activity and housing for the benefits of the employees and their family members. The records in both documents are implemented by the managing units although at the same time there are collective disputes concerning the employee remuneration.

Meanwhile, in companies such as PAK –Volt SA (trading in electricity, office work) significant from the point of view of the generated revenues, but with very little employment and work specificity without any significant health and safety risk, formalization of labour relations and related procedures are minimal and limited to legal requirements.

Basic aspects associated with the human resources management have been determined in the Strategy for Corporate Social Responsibility of the ZE PAK SA Capital Group for 2017-2020.

Health and Safety at Work

Similarly to earlier areas, the most significant ways of activities associated with the health and safety risk management have been described in the Strategy for Corporate Social Responsibility of ZE PAK SA Capital Group for 2017-2020. Simultaneously, it is important to remember about the obligatory certified management systems covering the issues of security management, including:

- the process of electricity and heat production with all the auxiliaries, identified environmental aspects, threats, legal and other requirements (ZE PAK SA – according to PN-N 18001, OHSAS 18001),
- works in scope of installations, renovations and service of power engineering and industry equipment, industry construction services, management of investments in power engineering and industry, as well as modernization and maintenance of automation and electrical systems in power engineering (Przedsiębiorstwo Remontowe PAK Serwis Sp. z o.o. – according to PN-N 18001, OHSAS 18001).

Their goal and the objective of the Corporate Social Responsibility Strategy of ZE PAK SA Capital Group for the years 2017-2020 is to minimize the level of accidents, with particular emphasis on the elimination of events with severe and fatal consequences and undertaking organizational and technical measures aimed at eliminating or reducing the exposure of workers to harmful factors occurring in the work environment like noise and pollination to a level compliant with the standard. Simultaneously, selected management aspects, falling within a broader scope of environmental management, are regulated by internal principles and ordinances.

Mining

The mining part is the only one from three main areas where certified management system according with PN-N 18001 and OHSAS 18001 was not implemented. The management of health and safety risk works on the basis of Ordinances of the President and Ordinances of Manager of mining plant. For example, for PAK KWB Konin SA there are the following ordinances:

- 15/2001 on providing the employees of the Company by the employer with eyeglasses that correct the eyesight,
- 4/2002 on informing employees of occupational risk related to the work performed,
- 16/2003 regarding the index of works which should be performer by at least two employees,
- 20/2003 regarding the index of works requiring the particular employees' psychophysical predispositions, organization and conducting of psychological tests,
- 4/2004 regarding establishment of Health and Safety Work Commission,
- 7/2005 regarding minimum requirements concerning health and safety work in scope of using the machinery and equipment by the employees,

- 29/2007 regarding a list of works particularly hazardous or high physical or mental effort, which may not exceed 8 hours a day by a night worker,
- 27/2009 on nuclear safety, radiological protection, employee health protection and quality assurance program,
- 29/2010 regarding safety exploitations of scaffolding ,
- 28/2012 on the list of harmful, burdensome and dangerous works and the rules of granting cash and preventive meals on this account,
- 24/2013 on defining the type of particularly hazardous works in PAK KWB Konin SA,
- 36/2013 on determining places and workplaces and works requiring wearing protective helmets and the rules for their use in accordance with the company standard ZN-003: 2007,
- 29/2014 on determining places and workplaces requiring wearing appropriate personal protective equipment,
- 30/2014 on the organization of medical assistance in PAK KWB Konin SA.
- 31/2014 regarding the supply the employees with water and soft drinks,
- 49/2014 regarding the proceedings in case of accidents at work and dangerous events in PAK KWB Konin SA,
- 5/2015 regarding the form and principles of in-house training in the area of health and safety at work in PAK KWB Konin SA,
- 18/2015 on the principles of clothing, work and protective footwear as well as personal protection and hygiene,
- 7/2016 on introducing an updated „PAK KWB Konin SA Safety Document",
- 4/2017 on the prohibition of smoking cigarettes, including smoking of innovative tobacco products and smoking of electric cigarettes in rooms, facilities and means of transport of PAK KWB Konin SA,
- 8/2017 on initial, periodic and control medical examinations.

Typical threats accompanying opencast lignite coal mining should be divided into natural and traumatic hazards. The last ones, potentially connected with the machines work, particularly their rotating elements, dangerous in consequences but they happen very rarely, mostly due to the activities of health and safety service and the employees' awareness. In recent years, in practice, if there were accidents, these were light accidents: dislocations, sprains and occasional fractures. As for the natural hazards, they can be divided into landslide (scarp escaping), methane (emergence of gas in drainage wells), fire and water (associated with: atmospheric precipitation, neighbourhood of natural reservoirs and watercourses or watercourses in the excavation).

Regarding the activities carried out in 2017 to improve the health and safety conditions in the area of extraction, in accordance with the adopted annual plan in PAK KWB Konin SA, cabin operators of basic machines (excavators, stackers) were repaired, which allowed reducing the noise level in the cabins. The change of seats for basic machine operators allowed reducing the level of exposure to vibrations. The platform for filling the excavator poles on Drzewce opencast contributed to the improvement of safety while performing welding works in the polygon chamber. The safety was also improved by the assembly of the entrance to one of the tapes from the platform of the operator's cabin.

Simultaneously, the renovations carried out in 2017 including replacement of shower cabins in the bath, painting of office and social rooms and renovation of shelters (windows, heaters, insulation, partial replacement of external sheet, chairs) improved sanitary and hygienic conditions in PAK KWB Konin.

Comfort of work was also improved by purchase of rain clothes, shoe protectors, replacement of flashlights, as well as purchase of new equipment and power tools.

Generation

In the generation area of ZE PAK SA, as mentioned earlier, the management of health and safety work is based on the integrated management system compliant with PN-N 18001 and OHSAS 18001. Simultaneously, the activities in the area of health and safety are regulated by the President's Ordinances, referring to wider aspects but covering health and safety matters as well, including:

- 42/2000 regarding eyeglasses correcting sight while working on screen monitors,
- 50/2000 on medical examination and psychological tests and preventive health care for ZE PAK SA employees,
- 47/2001 on carrying to risk assessment of identified threats at all workplaces in ZE PAK SA,
- 30/2002 regarding implementation of pre-medic rescue system in The Capital Group of ZE PAK SA,
- 47/2002 on accidents on the way to and from work,
- 51/2003 on the register of suspected occupational diseases and the register of occupational diseases,
- 5/2005 regarding occupational accidents and accidents treated equally as occupational accidents,
- 12/2005 on the workplaces and the rules of issuing supportive meals and drinks,

- 19/2005 on the training in the area of health and safety at work,
- 5/2006 on the inspection of machines in terms of compliance with the minimum health and safety requirements for the use of machines by workers at work,
- 11/2010 regarding the establishment of the Safety and Health at Work Committee, hereinafter referred to as the "Health and Safety Commission" at the Management Board of ZE "PAK" SA, hereinafter referred to as the "Employer",
- 29/2011 on the rules for determining the qualifications of persons dealing with the operation of equipment, installations and networks by qualification commissions appointed by ZE PAK,
- 5/2014 on the implementation of the "Instruction for the organization of operating works at energy devices in ZE PAK SA that pose a potential threat to human health or life", including the "Instruction for the safe conduct of fire hazardous work in rooms at risk of fire or explosion and the management of technical gases in the area Pątnów Power Plant" and "Document for securing workstations against explosion",
- 22/2016 on the list of particularly dangerous works, related to high physical or mental effort, which, due to the necessity to ensure work safety and health protection of employees, may be performed by a working person not more than 8 hours a day, hereinafter referred to as the "list of works",
- 21/2017 on the rules and standards for the allocation of clothing and footwear, personal protective equipment and personal hygiene measures for employees of ZE PAK SA.

Significant documents and procedures are here: Exploitation Manuals of Power Devices (they are the elementary documents on the basis of which the safe operation of devices is carried out), business order of the power plant's director, including e.g. No. 5/2017 regarding application at the Pątnów Power Plant "Instruction on the organization of operating works at power units at ZE PAK SA that pose a potential threat to health and human life".

Identification of threats at workplaces is the element of ZE PAK SA operation in reference to products and services that may affect the working environment. The threats identification results are included in the process of planning by establishing the particular purposes with reference to health and safety at work. In order to define the ZE PAK SA affection to working environment the following activities are carried out at workplaces: initial health and safety review, recognition of the source of the threat, identification of threat, controlling of defined workplaces. Occupational risk that includes typical operating conditions, retention and start-up, as well as potential and significant influences accompanying justified emergency situations is assessed. The scope of tests and measurements at workplaces is determined and the measurement results are analysed.

Annual analysis show that repairs and renovations carried out over the years, and most of all decommissioning of old and construction of new devices and installation, including generation units, in addition to improvement of production efficiency and reduction of negative influence on natural environment, undoubtedly contribute improvement of employees working conditions and technical safety at work through elimination or reduction of danger to health and life of the employees.

Regarding the occupational risk assessment, the factor causing noise pollution above the maximum permissible intensities are the elements such as gears, motors, clutches, etc. The maximum permissible dust concentrations, on the other hand, are exceeded in the case of lignite transporting devices. Another group of threats are dangerous factors, and their influence on the employee may cause injuries or even death. The most important factors of this group are: high temperature, high pressure, electric current, explosive atmosphere and machines' movable components. The factors related to the nuisance of work include excessive physical load, insufficient lighting and night employment.

The controls of working conditions as well as compliance with health and safety rules and regulations are carried out systematically by Health and safety service, and the recommendations are issued for these controls.

In 2017 minor works increasing health and safety level in the power plants were carried out, and they related, among others to the inspection and supplementation of the markings in the pipeline of heavy oil as well as acid and lye, repair of the insulation of the hot air duct of one of the boilers and repair of the stretch of the pavement on the roof at Pątnów Power Plant. On the other hand, in Konin Power Plant, the planned works were related to the construction of the demolished sound absorbing cover of one of the pumps, the adjustment of safety barriers to the source of ionizing radiation on the boiler biomass tank and the replacement of the sheet covering the brine tank at the Demineralization Station. At Adamów Power Plant, it was decided to replace and repair seats in the cabins of silence, replace the air conditioner, light up selected points of water readings and adjust the markings.

Service

In the service area (PAK Serwis Sp. z o.o.) the risk assessment includes all the workplaces, stationary as well as extramural ones. The risk assessment is carried out once for three years and each time, in case of any changes, reported at workplaces or after an accident. Health and safety department keeps a register of all the workplaces being the subject to occupational risk assessment.

The so-called last minute risk analysis is carried out as well - before the work starts the employees identify the potential threats at their workplaces and assess the degree of risk. In this way the works and areas of operation associated with the significant threats are being identified. For each and every significant threat the way of procedure and supervising is determined, providing compatibility with legal and other regulations of health and safety.

Due to the current health and safety management the following procedures are of the special importance:

- „Training in scope of health and safety and environment protection",
- „Identification of threats and occupational risk assessment",
- „Health and safety and environment monitoring",
- „Serious failures",
- „Organization of works of significant threats",
- „Accidents and occupational disease investigation".

Annual analyses show that most of the accidents in service work result from the improper behaviour of the employees, i.e. by failure to exercise due caution and concentration on the performed activity. The most common cause of potentially accidental events, on the other hand, is the failure to carry out the risk assessment before the task starts (LMRA – last minute risk analysis). The noise and industrial dust are the basic factors associated with the work environment, and the factor related to the nuisance of work is a forced body position. Within post-accidental prophylaxis the employees are acknowledged with the circumstances and reasons of the accidents, additional instructions are given, and the information on accidents are provided to the services of ZE PAK SA (in these cases where the cause related to energy devices was found). Sometimes, it is also possible to impose administrative fines on the person supervised, in relation to whom non-compliance with health and safety regulations was proven, in connection with the accident. The employees of the Health and safety Office carry out inspections in the scope of compliance with health and safety rules and regulations, as a result of which, in the most common cases, the so-called non-compliance card and applications for imposing a penalty are given out. In the prepared business notes or protocols after the inspections carried out, the most common recommendations regarding disorder at the workplace and improper technical condition of the work means are registered.

Ancillary activity

In PAK Górnictwo Sp. z o.o. due to consolidation in the course of the reporting period under one company's activities previously covered by several entities and the related extension of the scope of activity, the majority of formal documents related to management, including occupational safety and health management, were developed and adopted in 2017 (the company has been operating since August 1, 2017 and has acquired the following companies: Energoinwest SERWIS Sp. Z o. o., Aquakon Sp. z o.o., Eko Surowce Sp. z.o.o and EL PAK Serwis Sp. z o.o.). In order to systemise the formal approach to health and safety due to the changed scale and scope of activities, the following, among others, were adopted:

- Manual of supervision over measurement of factors in the work environment
- Regulation No. 33/2017 on the handling of chemical substances in work processes
- Regulation No. 24/2017 on preventive health care
- Regulation No. 25/2017 regarding the acceptance of the control regulations carried out by the Health and Safety Service
- Regulation No. 26/2017 regarding the adoption of the risk assessment and documentation procedure
- Regulation No 28/2017 on industrial accidents, accidents treated on an equal footing with accidents at work and accidents on the way to and from work
- Regulation No. 31/2017 on the allocation of work and protective clothing, personal protective equipment and personal hygiene
- Regulation No. 36_2017 regarding the appointment of the Safety and Hygiene Work Commission at PAK Górnictwo Sp. z o.o.
- Regulation No. 38/2017 regarding the acceptance of the Instruction for Supervision of Measurement of Factors in PAK Górnictwo Sp. z o.o. Work Environment
- Regulation No. 43/2017 on the rules of issuing supportive meals and drinks

- Regulation No. 27/2017 on the prohibition of smoking cigarettes, smoking of innovative tobacco products and electronic cigarettes within premises and means of transport in PAK Górnictwo Sp. z o.o.
- Regulation No. 52/2017 on detailed training rules in the field of health and safety
- Regulation No. 39/2017 on the rules for the allocation of work and protective clothing, personal protective equipment and personal hygiene for "PAK Górnictwo" Sp. z o.o. employees

Associated business risk

Among the risks associated with the employee issues there are several categories to be distinguished. In all the areas of functioning of ZE PAK SA Group it is necessary to guarantee the employment at an appropriate level, by positioning the Group's companies as attractive employers in the region. An attractive remuneration level compared to those offered by other local employers has allowed, on the one hand acquiring new people, and on the other, to connect them with the company, preventing the outflow of qualified employees. Simultaneously, the restructuring process that has been going on for many years caused that most vacancies were filled on the basis of the internal recruitment (shifts between departments and subsidiaries). However, such solutions have some disadvantages, i.e. no significant inflow of young employees from outside. Concentration on the people employed in the Group's companies, in the restructuring process, causes that the age average of the employees is increasing. Aging of the crew will then lead to an increase the number of people retiring. The prolonged collective disputes regarding the principles of remunerating employees may consequently cause social unrest and strengthened relations with trade unions, which is another risk factor.

Another dimension of risk associated with the employees is the one of health and safety aspect. It is strongly dependent on the threats on particular workplaces and all the activities in the area of health and safety management concentrate on eliminating and reducing the threats and minimisation of accidents' consequences, if there are any.

Key indicators

a. Employment structure at the end of the year by type of contract (in persons at the end of subsequent periods)

	2017			*2016*		
	women	*men*	*total*	*women*	*men*	*total*
By type of contract						
Work contract for an indefinite period	495	4640	5135	545	5087	5632
Work contract for an definite period	25	472	497	46	505	551
Work contract for a trial period	0	15	15	1	13	14
Civil-law agreement	12	117	129	13	135	148

b. Employment structure at the end of the year by type of position, education and age (in persons at the end of subsequent periods). The structure does not include the civil law agreement employees.

	2017			*2016*		
	women	*men*	*total*	*women*	*men*	*total*
By type of position						
Managerial position	53	244	297	63	287	350
Non-managerial position	467	4 883	5 350	529	5 319	5 848
By education						
Higher (bachelor, master, postgraduate, doctorate, professor)	298	1 129	1 427	328	1 203	1 531
Medium (high school, technical college, college, post-secondary)	186	1 919	2 105	216	2 180	2 396
Professional (basic, learning a profession)	26	1 756	1 782	36	1 897	1 933
Basic (elementary, junior high)	10	323	333	12	326	338

By age						
Up to 30 years old	31	521	552	46	653	699
31 to 40 years old	73	851	924	97	908	1 005
41 to 50 years old	146	2 242	2 388	151	2 483	2 634
Over 50 years old	270	1 513	1 783	298	1 562	1 860
Total	520	5 127	5 647	592	5 606	6 198

c. Newly employed during the year (in persons in the given period)

	2017			*2016*		
	women	*men*	*total*	*women*	*men*	*total*
Up to 30 years old	1	36	37	11	101	112
31 to 40 years old	2	32	34	5	49	54
41 to 50 years old	2	38	40	9	50	59
Over 50 years old	5	9	14	2	29	31
Total	10	115	125	27	229	256

d. Leaving work during the year (in persons in the given period)

	2017			*2016*		
	women	*men*	*total*	*women*	*men*	*total*
Up to 30 years old	3	73	76	6	124	130
31 to 40 years old	7	80	87	7	135	142
41 to 50 years old	6	145	151	7	205	212
Over 50 years old	40	154	194	27	260	287
Total	56	452	508	47	724	771

e. Diversity in the boards of the Company (in persons at the end of subsequent periods)

Amount	*2017*	*2016*
Management of ZE PAK SA:		
– Total	4	5
– Women	2	2
– Men	2	3
Supervisory Board of ZE PAK SA:		
– Total	8	7
– Women	0	0
– Men	8	7

f. Accidents at work

	2017	*2016*
Total number of accidents (injured), including:	62	54
– Light	62	53
– Serious	-	-

– fatal	-	1
Number of lost days	4 573	3 321
Frequency ratio of injured in total accidents (per 1000 insured)	9.6	7.5
Frequency ratio of injured in serious and fatal accidents (per 1000 insured)	-	0.138

g. Number of employees exposed to health harmful factors and those connected with the work burdens (in persons at the end of subsequent periods)

	2017	*2016*
Noise	286	286
Dust	67	106
Insufficient lighting	324	350
Energy expenditure	1 358	1 097
Nuisance at work – night shift work	3 387	3 057

11.4. Environmental issues

Management approach

Similarly to other areas, the foundation of policies and ZE PAK SA management's approach to environmental issues were defined in the Strategy for Corporate Social Responsibility of ZE PAK SA Capital Group for 2017-2020. Simultaneously, it is important to remember about the obligatory certified management systems covering the environmental issues, including:

- the process of electricity and heat production with all the auxiliaries, identified environmental aspects, threats, legal and other requirements (ZE PAK SA),
- works in scope of installations, renovations and service of power engineering and industry equipment, industry construction services, management of investments in power engineering and industry, as well as modernization and maintenance of automation and electrical systems in power engineering (Przedsiębiorstwo Remontowe PAK Serwis Sp. z o.o.).

They contain the environmental policies of selected companies with particular procedures periodically reviewed and optimized. Their goal and the objective of the Corporate Social Responsibility Strategy of ZE PAK SA Capital Group for the years 2017-2020 is to provide stable and safe lignite mining, energy production and service and modernization work for the environment.

Simultaneously, selected management aspects, falling within a broader scope of environmental management, are regulated by internal principles and ordinances. They often reflect the legal provisions obligatory not only in the country, but also relating to a specific project, object or installation. The latter, i.e. environmental impact reports, and their detailed description of the foreseen activities of the planned project on the environment, constitute in itself an obligatory reference point for the managers of particular facilities and installations. This approach is extremely important. It should be realized that not universal management systems, but environmental impact reports, on the one hand refer to the specificity of the conditions of a given investment, and on the other, unlike many other procedural solutions, they are created through dialogue and open consultations with the environment. Therefore, solutions minimizing the impact on the natural environment are developed with the participation of stakeholders (local government, administration, local community, environmental organizations). They also recognize the unique specificity of each place, which is important, for example, in the case of opencast mines because even if they are located close to each other, the prevailing conditions (e.g. geological, hydrological, location of human settlements) will be at most similar but not identical. Therefore, the approach to environmental management and limiting the negative impact on the natural environment may also be similar, but not identical.

The starting point for policy and procedures based on it is the nature of the impact of business operations on the natural environment. It is associated with identified risks, to which specific and constantly improved procedures and technological solutions correspond. Defining briefly the nature of the impact on the environment, they should be divided into the impact associated with mining (lignite mining) and energy production.

In case of open pit mines, basic aspects of influence on natural environment are the following:

- impact on the surface area (opencast mining of minerals consists in the transformation of the land surface, instead of the land that was originally used, spatial terrain forms (excavation, heap) and accompanying infrastructure (conveyors, transport routes, facilities),
- impact on surface waters (including reduction of flow in watercourses under the influence of the mine's operation and increase of flow in watercourses due to discharge of water coming from underground drainage and surface opencast),
- impact on groundwater (formation of the so-called depression funnel due to the drainage of open-cast mines),
- noise emission (basic machines related to the operation of the overburden and its dumping, basic machines mining coal, coal and overburden conveyors, road transport),
- influence of mining objects on the atmospheric air:
    - dust emission: technological (mechanical), i.e. associated with mechanical mining and transport of the raw material with conveyor belts; climatological, i.e. related to wind erosion of vegetation-free areas;
    - organized emissions of pollutants into the air from the boiler room providing heat for social facilities mine,
- an influence on valuable natural area (in case when the valuable natural area is located in the zone of influence),
- hazards associated with electromagnetic fields.

In case of producing energy in conventional lignite power plants the following aspects of influence on the environment are to be distinguished:

- emissions of compounds accompanying coal combustion, e.g. CO_2, SO_2, NO_X
- dust emissions,
- noise generation (e.g. due to the operation of power unit turbines),
- waste generation (in the process of lignite combustion and flue gas cleaning),
- possible oil leaks, mazout and acids spills, resulting in local contamination of the ground and water environment,
- heating of surface waters, lakes (due to the use of lake surface waters in the cooling process),
- leakage of ash pulp or supernatant water to the soil and water environment,
- emission of industrial wastewater,
- emission of electromagnetic fields,
- terrorist threat that may result in environmental contamination.

In the mining area, the majority of the key activities, aiming at preventing, limiting or compensating nature of negative environmental impact, are initially planned at the stage of environmental analyses and creating a report of influence on the environment. In addition to technical and engineering solutions (appropriate formation of the dump, planning solutions to minimize the effects of disruption of water relations due to the drainage of opencasts, etc.), impact norms are defined in specific environmental aspects and environmental monitoring is carried out throughout the entire life cycle of the opencast mine. The monitoring of the level of water in wells, watercourses and water reservoirs, the quantity and quality of water discharged to receivers (water and ground), the extent of the depression funnel, dust emissions, noise level etc., is carried out as well.
From the procedural side, the situation in the manufacturing area looks quite similar. On the one hand, the existing production installations, which have been in operation for many years, have been modernized and retrofitted with technological solutions connected, above all, with adjusting them to the increasingly tightening environmental standards. As a result of the modernization of two blocks at Pątnów power plant and the construction of the third one (Pątnów II power plant) in recent years, the efficiency of generation (and thus the efficiency of fuel use) increased on those plants, and on the other hand, the emissivity decreased, including CO2 mass per unit of electricity produced. Such approach also allowed reducing radically the emission of harmful nitrogen, sulphur oxides and dust to the atmosphere. At the beginning of 2018, Adamów power plant finished its work. The power plant has previously used derogation from the IED Environmental Directive in the scope of 17.5 thousand working hours, i.e. during the derogation period it was applicable to the size of the permissible emission of pollutants to the air, which were defined in the integrated permit as binding on 31 December 2015. In practice, this should result in a decrease in the average level of emissions per unit of electricity produced by the Group.

Similarly to the mining area, key environmental impact parameters during electricity production are monitored, often in a continuous mode. The cases of reports about potential irregularities are checked in a similar manner.

Mining area

In the last year, opencast mines managed by PAK KWB Adamów SA and PAK KWB Konin SA carried out:

- quantity and quality monitoring of groundwater and surface water,

- nature monitoring, particularly valuable areas,
- technical and biological reclamation,
- investments, primarily related to hydro-technical constructions, in accordance with the administrative decisions obtained.

At PAK KWB Adamów SA in 2017, the following were made, among others: groundwater monitoring (in piezometers, farm and drainage wells), surface water monitoring (flow tests in river channels in the area of impact) and monitoring of vegetation in Warta River interval (determining the impact of Koźmin opencast on the variability of water conditions and vegetation of "Natura 2000" area), as part of natural compensation, the area of the" island "was mowed in the fork of Warta and Ner rivers. In PAK KWB Konin SA there were made, among others: monitoring of birds, natural habitats and plant species in the vicinity of Tomisławice open pit, monitoring of the impact of Drzewce open-pit on water-marsh birds being the subject of a special bird protection area in Central Warta Valley. The water environment of PAK KWB Konin SA open pit was monitored for the outlets of Tomisławice, Jóźwin, Drzewce and open pit areas where the exploitation was already completed, i.e. Kazimierz and Lubstów. In the past year, as part of the natural compensation and care for creating the friendliest conditions, among other things 15 artificial floating platforms for the black tern on the old river bed in the Central Warta Valley (Drzewce open pit) have been installed.

In the areas where the exploitation of the fields has already been completed, technical and biological reclamation are carried out in the water, forest, agricultural, recreational and other areas. For instance, in 2017 a technical reclamation was carried out on 223 hectares, biological reclamation on 750 hectares. As part of the biological reclamation over 373.5 thousand trees and shrubs were planted. At PAK KWB Adamów SA, among others, there were completed the works on sacking "Głowa" reservoir and technical reclamation of areas adjacent to the reservoir. In PAK KWB Konin SA, among other things, a decision was made to complete the water reclamation of Lubstów reservoir on the former grounds of Lubstów with an area of 33 ha, and flooded part of Kleczew water reservoir in the excavation pit of Kazimierz Północ with an area of 177 ha was reported for acceptance.

The mines were also inspected by the Voivodship Inspectorate for Environmental Protection (environmental compliance control regarding Adamów and Tomisławice open pits), Regional Water Management Board in Poznań (control of Tomisławice open water drainage system), District Mining Office in Poznań (control of Noteć river flows, control of reclamation performance) and the Poviat Eldership in Konin and Turek (control of the obligation to reclaim). The inspection bodies did not identify any deficiencies, therefore no post-inspection orders were issued and no fines were imposed.

<u>Generation area</u>

In the generation area in 2017 the activities were concentrated traditionally on the aspects associated with air protection (emissions, nuisance), water and wastewater management (lakes monitoring, sewage and groundwater management), waste management, noise emission to the environment.

Air protection: emissions and nuisance

During the year the quantities of pollution emissions in particular power plants were monitored in terms of meeting obligatory emission standards. The correct operation of continuous measurement systems were supervised, functioning of procedures was coordinated (QAL3 – quality assurance procedures during the exploitation of exhaust emission monitoring system in ZE PAK SA in accordance with PN-EN 14181). Emission limits of particular contamination such as SO2, NOx and dust for Pątnów I and Konin power plants covered by TNK (Transitional National Plan) derogation were monitored, calculated and reported. The conditions determined in natural derogation of 17 500h for Elektrownia Adamów were monitored. The correct operations of protective devices reducing emission of pollutants into the air were supervised. The production process in aspect of meeting air pollution emissions' standards and limits was coordinated (optimization of combustion process in Pątnów II Power Plant). The tasks were realized under PRTR (National Register of Pollution Release and Transfer) by pollution measurements and reporting as well as by paying the fees. Financial commitments were made for the emission of pollutants into the air as part of its operations, i.e. environmental and penalty fees as well as in the scope of reporting pollutant emissions to the air.

Due to the emission influence on the immediate surroundings, the purity of the atmospheric air in the area of operations of the Groups power plants is also monitored. In 2017 no significant differences between the levels of substances tested and those measured by the stations of Voivode Inspectorate of Environment Protection were found. In 2017, measurement data collection system of air monitoring was renovated and adjusted to the current standards.

Lakes monitoring

Anthropogenic activities contributed to the creation of an aquatic ecosystem characteristic only for heated lakes in the area of Konin (Gosławskie, Pątnowskie, Ślesińskie, Licheńskie, Wąsowsko - Mikorzyńskie). However, Konin power plants do not treat lakes only as an available source of water intake for cooling and a receiver of heated water, but they take measures to improve their purity and therefore carry out continuous monitoring.

Cooling system of Pątnów I, Pątnów II and Konin power plants works in the conditions changing during the year. The following parameters are changeable:

- the amount of circulating water,
- the temperature of drop water,
- the levels of water in the lakes,
- use the lakes for cooling (only „close" or "distant" circulation).

All the above mentioned parameters are covered by a constant monitoring. Systematic control of thermic conditions in the lakes and in the channels of cooling circuit of Pątnów I, Pątnów II and Konin power plants is run by ZE PAK SA on the principles determined in the integrated permit. This control includes:

- temperature measurements of Surface water in 24 points important for protection of lakes and operation of cooling circuit; the measurements are taken at least once a month (in the cold period) and more often (even every day) in the summer period (depending on the temperature of the air),
- continuous, automatic temperature measurement on the lakes' shots – Pątnowskie and Gosławskie,
- continuous, automatic temperature measurement of water on power plant discharges.

All the objects of cooling system are equipped with the network of control and measurement benchmarks. Measurements of water levels and flows are carried out in order to control the proper functioning of the entire cooling circuit. They are, among others, water level gauges, mounted on water intake and discharge ditches and on lakes. Fluctuations in water levels in lakes depend on a number of factors, mainly of natural character. However, the possibility of using water to cool the working blocks depends on its quantity and temperature. In all the lakes and channels included in the cooling circuit, physicochemical monitoring of water is also performed once a month.

Sewage management

Wastewater generated in power plants is treated in factory sewage treatment plants and after obtaining parameters compliant with applicable regulations, it is discharged to the receivers. However, for many years, in order to prevent lake water pollution, the power plants have been taking actions aiming at using the sewage in internal systems. Thus, wastewater from exhaust gas treatment installations, oily sewage from cleaning industrial floor and filter wastewater from a drinking water treatment plant are used for the production of ash and slag pulp, and therefore there is no need to use lake water as a transport medium for this purpose. Additionally, the lakes are not polluted with chemical substances. In 2017 there were performed some renovations, concerning the management of wastewater form Pątnów II power plant water demineralization station in flue gas desulphurization station. Wastewater was directed both to top up process water in absorbers as well as to sorbent preparation tanks (lime milk). The quality of sewage (their physical composition) does not have a negative influence either on the processes taking place in absorbers or on the sorbent quality, perfectly replacing water from Gosławskie lake. Wastewater management in the independent directions brings the possibility of their continuous and comprehensive collection. The above described solution allowed reducing the surface water intake from Gosławskie lake and caused no discharge of industrial wastewater to the environment. It causes financial as well as environmental savings.

Economical groundwater management

Technologies used to build the Group's power plants allowed for the use of deep water for technological purposes. On the basis of such technology, the station of demineralization water production in Pątnów I power plant was operating for many years. The plant was taking huge amounts of groundwater in order to produce demineralization water necessary for production of electricity. The current environmental regulations require such practices to be stopped in order not to diminish the aquifer. Therefore, Pątnów I power plant undertook to bring and use demineralised water produced in a modern, membrane-based treatment station. This station is supplied with surface water from Gosławskie Lake. This contributed to significant savings in groundwater intakes. Sewage from this station does not go into the environment, but is used in the internal system.

Wastes

In ZE PAK SA, the main stream of generated waste is furnace waste (ashes) and solid waste from calcium methods of flue gas desulphurization (gypsum). Waste generated in the first place is managed by external companies as part of waste recovery. On the basis of the volatile ash produced, mixtures for road foundations and road binders are mainly made. On the other hand, waste from flue gas desulfurization is directed mainly to the production of gypsum products, drywall and cement plants. In 2017, over 325.5 thousand tons of furnace waste and 268 thousand tons of waste from calcium flue gas desulphurisation were sold. The remaining quantities of waste generated are directed to landfills belonging to the Company. The furnace waste and waste from flue gas desulphurisation produced in ZE PAK SA meet the requirements of environmental protection and do not threaten human life and health, which was confirmed by research in the field of physicochemical, toxicological and Eco toxicological properties performed for the registration of substances in accordance with REACH requirements.

At landfills managed by ZE PAK SA in 2017, monitoring of the quality of groundwater and surface water as well as supernatant water was carried out, with the frequency specified in the integrated permits and instructions for running landfills, i.e. once a quarter. Currently, ZE PAK SA has 4 landfills and all of them were exploited in 2017 on the following:

- solid waste landfill, Pątnów opencast (landfill for inert waste),
- landfill site for Zachodnia opencast with a vaporizer - so-called Wschodnia outcrop and landfill site (landfill for non-hazardous and inert waste),
- northern landfill site for Pątnów open pit (landfill for non-hazardous and inert waste),
- landfill of furnace waste in Gosławice open pit along with Linowiec vaporizer (landfill for non-hazardous and inert waste).

Monitoring was carried out in the primary and supplementary monitoring networks. Monitoring of groundwater quality is performed in a network of piezo metric wells located in the vicinity of landfills. In the last 3 years, new hydrogeological documentations have been developed for all landfills describing the hydrogeological conditions around landfills along with recommendations for groundwater monitoring. For some facilities it was necessary to make new openings, liquidate old ones, which required changes in existing permits and instructions for running the landfills. In 2017, this process was completed and currently the monitoring is already being carried out in the updated monitoring network. The quality of the groundwater tested in piezometers and deep wells in 2017 fluctuated in classes from I to V. Supernatant waters occurring in landfills (used for hydro transport of furnace wastes) were characterized by high mineralization, high electrolytic conductivity, high pH and total hardness. In addition, as a part of the monitoring of landfills, an annual assessment of slope stability and subsidence is also carried out. Most of the monitored slopes surveyed in 2017 proved to be stable.

ZE PAK SA also conducts reclamation of unused parts of landfills on an ongoing basis. In 2017, the reclamation of the closed part of the furnace waste yard of the Gosławice open pit was continued. The total area in which reclamation works were carried out last year amounted to over 30.8 ha.

As part of the protection of the earth's surface, ground and soil studies were also carried out. In 2017, samples were taken from various depth intervals and the content of heavy and petroleum metals was determined at Pątnów I power plant. Sampling sites were selected in locations where there is the highest risk of soil and water contamination, i.e. near storage and use of environmental hazardous substances.

Noise

As part of the obligation to monitor noise emitted to the environment, imposed by integrated permits for the fuel combustion installations in ZE PAK SA and Elektrownia Pątnów II Sp. z o.o., in 2017, noise measurements were taken from the area of Konin and Pątnów II power plants. No measurements were taken from Adamów and Pątnów I power plant because the measurements from 2015 and 2016 are valid.

Measurements made in the past year showed that there was no exceeding of the permissible values of noise in the environment, imposed by the integrated permit for Konin and Pątnów II Power Plant both at daytime and at night.

Inspections

In 2017 the Voivodship Inspectorate for Environment Protection in Poznań, Delegacy in Konin, inspected Elektrownia Pątnów I, Elektrownia Pątnów II and Elektrownia Konin:

- Elektrownia Pątnów I – inspection of sources covered by the Transitional National Plan at the request of GIEP (General Inspection of Environment Protection).
- Elektrownia Pątnów II – inspection of compliance with environmental protection requirements by operators of installations requiring an integrated permit.
- Elektrownia Konin – inspection of sources covered by the Transitional National Plan at the request of GIEP.

As a result of the activities carried out, no necessity to order any post-inspection activities was found.

Programs for the prevention of major industrial accidents

In 2017, programs for the prevention of major industrial accidents were updated in terms of type, amount and hazardous substances location as well as description of technological installations in the power plants. On the base of performed update of hazardous substances quantity, only Elektrownia Pątnów I is in the group of plants where increased risk of major industrial accidents may occur.

Other

In PAK Górnictwo Sp. z o.o. due to the consolidation of activities carried out in the past year (within one company) previously covered by several entities, the majority of formal documents related to management, including environmental management, were formally developed and adopted in 2017. The following were adopted, among others:

- Regulation No. 34/2017 of the President of the Management Board - Chief Executive Officer of PAK Górnictwo Sp. z o.o. on determining the amount of fees for using the environment in PAK Górnictwo Sp. z o.o.
- Regulation No. 37/2017 of the President of the Management Board – Chief Executive Officer of PAK Górnictwo Sp. z o.o. on waste management and related Instruction on waste management and disposal.

Administrative decisions issued in connection with taking over the functions of other business entities of the Group (including water abstraction, collection and waste production) are also of key importance. The issue of water abstraction is connected with the takeover of the activity previously carried out by Aquakon Sp. z o.o. and the collection of groundwater from chalk deposits from two deep wells (production of mineral water). Another important aspect of the environmental impact is the collection and production of waste. It is mainly about waste generated in service and repair workshops and maintenance workshops, a conveyor belt regeneration hall, a repairs hall, and a bottling plant.

On the other hand, **PAK - Volt SA** (electricity trading, office work) a company significant in terms of generated revenues, should be considered irrelevant as regards the impact of the entire Group on the natural environment.

Associated business risk

The particular aspects of influence on the natural environment, described above, give rise to specific threats to business, reducing environmental resources at the same time. Each of the aspect described above, in certain situations (e.g. breakdown resulting in contamination or over-normative emissions), can cause image losses, social conflicts and loss of social allowance for operation, legal sanctions, imposing of penalty or other decisions resulting in reducing the profits, or finally incurring additional costs for environment protection. As a consequence, it may cause, for example, the disturbance in production stability (the need to temporarily shut down some part of the production installation), decrease of revenues (decrease in production) or increase of costs (e.g. the need to remove the consequences of a failure, but also additional fees and penalties related to emissions to the environment, including greenhouse gas emissions).

For this reason, as it was adopted in the Strategy for Corporate Social Responsibility of the ZE PAK SA Capital Group for 2017-2020, the policy and the procedures accepted by the Group, focus on:

- providing effective mechanisms reducing to minimum the threat of anomalies and gaps occurring resulting in over-normative impact on the environment in the mining or manufacturing process.
- reducing the emission to atmosphere to minimum by optimal shaping of the use of generation capacities existing in ZE PAK and ensuring the minimization of the risk of exceeding emissions of gaseous pollutants into the atmosphere.

Key indicators

Due to the fact that at the beginning of 2018 Adamów power plant ceased its operations, apart from cumulative data for the Group, data excluding the impact of Adamów power plant are also presented (columns marked '*'). Due to the fact that the termination of Adamów power plant operation does not significantly affect the ratios in other areas described in this statement, only in the case of indicators related to the issue, this solution was used for purposes of maintaining comparability in subsequent periods.

a. *CO_2 emission (thousands of tons/TWh)*

	2017	*2017**	*2016*	*2016**
CO_2 emission in ZE PAK SA Group per production unit	1.16	1.12	1.11	1.06

**excluding elektrownia Adamów*

b. SO_2, NO_X and dust emission to the atmosphere (thousands of tons /TWh)

	2017	*2017**	*2016*	*2016**
SO_2 emission in ZE PAK SA Group per production unit	2.03	0.86	2.00	0.93
NO_X emission in ZE PAK SA Group per production unit	1.53	1.22	1.58	1.24
Dust emission in ZE PAK SA Group per production unit	0.27	0.09	0.29	0.10

** excluding elektrownia Adamów*

c. Violation of environmental standards (%)

Emitted amount resulting from exceeding the standards in relation to the total amount of emissions

	2017	*2017**	*2016*	*2016**
SO_2	5.41	0.06	0.00	0.00
NO_X	0.00	0.00	0.00	0.00
Dust	15.59	0.00	13.52	0.00

** excluding elektrownia Adamów*

d. Summary of the data on the size of the areas where the technical reclamation was carried out and areas where biological reclamation and seeding are still being carried out, as well as the areas for which the decision on the properly completed reclamation have been made (hectares)

	2017	*2016*
Technical reclamation	223	220
Biological reclamation (in progress)	750	651
Biological reclamation (completed)	90	173

e. Share of land for which decisions on completion of reclamation were made for land excluded from agricultural and forestry production in mines (%)

	2017	*2016*
	148	81

11.5. Issues of respect for human rights

Management approach

While analysing the issues associated with the respect for human rights, there are two significant aspects that are to be distinguished: the right to associate and strike as well as the respect for the inalienable rights of the individual.

As already mentioned earlier, in the Group's companies meeting the statutory criteria, there are operating the Employees' Councils selected on the basis of applicable regulations. There are also a number of trade union organizations operating under the Trade Unions Act. The Management Boards of the Group's companies inform and consult all the decisions in matters specified by the law with employees' representatives (Employees' Council, trade unions). In the opinion of managers, freedom of association in trade unions and related rights are assured.

In the aspect referring to an individual and ensuring its respect, which means the respect for variety and simultaneous lack of any form of discrimination, beside the respect and enforcement of legal regulations that guarantee such a respect (e.g. Labour Code), in 2017 ZE PAK[9] adopted The Code of Ethics. Not only does it guarantee the aforementioned rights of an individual, but it is also a tool in itself that allows for the resolution of potential conflicts of interest. It contains a mechanism for both resolving doubts as well as reporting suspicions about potential behaviour that violates the provisions of the Code. It is worth mentioning that the Code of Ethics also condemns other behaviours that violate human rights, such as child labour, forced labour or slave labour.

Associated business risk

The disrespect for human rights, including aforementioned right to associate and strike, would mean not only the breach of national law (and sanctions in consequence), but also could lead to unnecessary escalation of conflicts on the employer-employees line. Despite the existing differences of opinion, manifesting, for example, with a collective dispute, the managers of ZE PAK SA Group appreciate the role of trade unions. Theoretical tightening of disputes, while not having a dialogue, can lead to strike actions and threaten the stability of production. Trade unions and the management, despite disputes and different assessment of the situation (e.g. in terms of short and long-term approach), are constructively oriented and aware of the economic consequences of a possible imbalance in the stability of energy supplies. Such consequences could concern not only the Group but also the national energy system.

Regarding the risk of disrespect for individual rights, such cases can not only expose ZE PAK SA Group to litigations and necessity to pay compensations, but they are primarily a real threat for organisation culture, work atmosphere and the same its effectiveness. They are also associated with the risk of losing valuable employees or, through discrimination, the impossibility of making full use of their potential (e.g. promotion of people with lower competences, while inhibiting the promotion of discriminated people).

All the cases of disrespect for human rights in ZE PAK SA Group also mean a measurable reputational risk, and then, with the escalation of this type of phenomena it can affect the loss of social consent for acting.

Key indicators

	2017	*2016*
the number of cases of reporting suspicion of unethical behaviour under the mechanisms provided for by the Code of Ethics for violation of individual rights	2	n/a
Unionization ratio	47.74%	47.92%
Number of collective disputes	4	4
Number of work days lost due to strike actions	0	0

11.6. Issues related to counteracting corruption

Management approach

One of the purposes of ZE PAK SA Capital Group Strategy for Corporate Social Responsibility adopted in 2017 is providing high quality and constantly improved management system that in the process of taking decisions would include the social and environmental aspects. One of many solutions of such management system is counteracting potential corruption and other unacceptable unethical phenomena. The threat of such phenomena depends, among others, on the exposure to the risk of corruption behaviour (e.g. a range of realized investments and projects), organizational culture and ethical values as well as the effectiveness of inspecting system.

The range of contracts concluded and investments undertaken depends on the factors other than the threat of corruption phenomena. It is frequently a consequence of adopted strategy of development, and therefore from the managing point of view in terms of counteracting corruption, it should be treated as an independent factor. The other thing is the way of realizing contracts, including for instance the way of choice, evaluation and selection of suppliers and subcontractors. Regarding the choice, this issue is regulated in ZE PAK SA Groups by the procedures of management systems.

The factor influencing the degree of danger of such type phenomena is a proper organizational culture, i.e. the culture based on ethical values and such institutional solutions that provide the employees with the implements enabling them to determine and distinguish the behaviours within the company that are right and the ones that are not. The promotion of ethical values allows resolving potential conflicts of interest or doubts in this regard, as well as reporting suspicions

[9] It is planned to implement analogous solutions in subsequent companies of the Capital Group.

about potential unaccepted behaviours, including those of bearing the signs of corruption. For this reason, while implementing the provisions of the Strategy for Corporate Social Responsibility for years 2017-2020, the Management of ZE PAK SA decided to adopt the Code of Ethics in 2017.

Another aspect, worth attention while analysing the system of counteracting corruption is the internal system of inspection. "Rules of Internal Audit of Zespół Elektrowni Pątnów-Adamów-Konin SA" and "Rules of Internal Supervision of PAK KWB Konin SA" determine the rules of organizing and functioning of internal audit that provides the systematic and methodological approach to evaluation and improvement of the effectiveness of supervision as well as management of risk and organization processes. They include the research and evaluation of activities of organizational units and the Group's subsidiaries in terms of thriftiness, legality, advisability, reliability and transparency of documentation (processes). The inspection activities aim at disclosure of unused business provisions, detection of irregularities and abuse in the operations of organizational units, determination of causes and effects of irregularities found and persons responsible for them, as well as elaboration of conclusions and post-audit recommendations. Among the irregularities and abuse there are also all activities that may be characterized by bribery and corruption.

The internal inspection system includes: self-control of the correctness of work performance, functional and institutional control (implemented by the internal audit unit). As part of the institutional control, the internal audit unit checks the activity of the organization as a whole, responding to the needs reported by the Management Board and the Supervisory Board in accordance with the audit regulations (among others, evaluates the coordination of activities between workstations and organizational units, evaluation of the creation system and documentation flow and information, etc.) with a frequency depending on the identified risk areas and the level of risk significance, as well as the role of control in its reduction. In this context, the activities of the internal control unit supplement the basic control and ongoing supervision and are aimed at revealing weaknesses or gaps in the organization and functioning of the internal control system. Controls are planned (in accordance with the annual plan approved by the Management Board), ad hoc (at the request of the Management Board or the Supervisory Board) and the one of checking nature.

The purchasing procedures described in the management systems applicable in the companies of the ZE PAK SA Group also regulate the issues of supplier selection. In the case of generation area, ZE PAK SA has implemented the Integrated Management System, under which in Sector 5.3 "Product / service support" applies, among others two procedures 5.3 - 01 "Supplier assessment" and 5.3 - 02 "Identification and traceability". The basic condition in the selection of suppliers is that they should be specialist suppliers, meeting agreed technical and commercial conditions and guaranteeing 100% reliability of deliveries. In addition, suppliers whose products decide directly on the quality of electricity and heat are subject to qualifications based on ongoing cooperation with suppliers, delivery control and periodic evaluation, among others, through their auditing as well as updates of the list of qualified suppliers. The management system also introduces "Supplier assessment sheets". In addition to the obvious factors such as the quality of deliveries, the level and stability of prices and payment conditions, for example, timeliness, or the fact that suppliers have certified management systems are taken into account.

Simultaneously, the purchase process itself has been defined in ZE PAK SA by the "Rules of Supplier Selection". The process is supported by the electronic purchase platform which eliminates some of the threats, for instance, it prevents from getting acquainted with offers submitted before the deadline. Thus, it eliminates the risk that dishonest employee could provide the information of competitive bids to the supplier who is still working on the offer. It is worth mentioning here, that the purchase process is based on the electronic auction option, which is carried out in real time, and this limits the possibility of unethical contact with a potential supplier. Moreover, until the auction closes, employees are not able to observe its progress, i.e. offers submitted by individual tenderers. They can read them only after the auction process is closed. ZE PAK SA makes purchases in the area of generating electricity.

The purchase for mining area are made by PAK KWB Konin (including the purchase for PAK Górnictwo Sp. z o.o.) and by PAK Serwis Sp. z o.o. for service area. Nevertheless, although each of the areas makes purchases on the basis of their own regulations, they are very similar to each other as to the shape of the process itself. They use the same tools, including the same electronic purchase platform. Approximately, the purchase procedure is initiated by a substantive unit that reports a specific purchase need. After obtaining relevant approvals justifying the future purchase, a commission which defines the purchase criteria is appointed[10]. The commission makes an assessment of the collected offers and points out the recommended supplier. In the next step, negotiations are conducted, and finally the accepted offer is directed to implementation. From the perspective of transparency, the important thing is that the information on planned purchases (i.e. request for quotations and tender inquiries) is published on the electronic purchase platform as well as on the website, and the purchases themselves are usually open tenders. Simultaneously, all areas, including the aforementioned purchasing area, are subject to be controlled by internal audit staff, also in terms of the potential occurrence of corruption-related phenomena. Controls may be planned as well as ad hoc inspections. The employees of

[10] In case of mining area the members of commission are appointed right after the collection of the bids.

the internal audit unit have an access to all information and reports necessary to perform the control activities in a reliable and objective way. Auditors are therefore obliged to inform the auditing manager on an ongoing basis about the course of the audit and the difficulties encountered in the implementation of the audit tasks. Auditing manager presents an assessment of the implementation of the audit's objective to the Management or the Supervisory Board. The auditors are authorized to: enter all the objects and rooms of the audited unit; inspect all recording devices, plans, reports, protocols and business memos or correspondence as well as other documents and materials associated with the controlled unit operation; periodical assisting at all activities of controlled unit; request for clarification and any information (oral or written) related to the subject of the control, from the manager and other employees of the controlled unit; requesting the head of the audited entity to perform partial or complete inventory of certain assets at the indicated date and to commission calculations, draw up lists, analytical statements, copies, extracts, etc.; receiving declarations from employees and other persons in matters related to the activity of the controlled entity; determine the real states by means of measurements, situational sketches as well as photo and recordings etc.; take necessary actions to secure evidence and property in case of irregularities; request the management of the audit with an application for the appointment of experts, in case of a justified need to make an expert report; ask the head of the controlled entity to provide all means necessary for a smooth inspection and for the effective implementation of conclusions resulting from the audit findings; performing control activities at the time selected by the inspector and extending the subject of controls in justified cases without obtaining additional consent of the manager of the control. The manager of the controlled unit is obliged to provide the auditor with the appropriate working conditions and technical assistance necessary for the efficient control.

If there are any circumstances threatening for human health or life, or any other resulting in the loss of goods due to the mismanagement, negligence, prodigality or an offense found during the inspection, the auditor makes a written request to a manager of the controlled unit, obliging him to take immediate action in order to eliminate such incidents. The auditor informs immediately audit management unit and secures the evidence documents and items of mismanagement or an offense. Then, after receiving the legal advice, a person managing the audit takes a decision to inform law enforcement authorities.

Simultaneously, each employee of ZE PAK SA Group, in the case of suspicion of any unethical behaviour, including those of bearing the marks of corruption, has not only the possibility but obligation as well to report information using the mechanisms provided by the Code of Ethics. For this purpose, the employee can contact the superior or the person indicated by the Management and acting as Ethics Spokesman. Such a notification is analysed, and an employee who has reported the information cannot be in danger of any consequences and will be protected from any retaliation, even if the information was not confirmed but was reported in good faith.

Associated business risk

The risk of corruption behaviours accompanies every enterprise, and the cases of making decisions by corrupt employees lead, among others, to suboptimal choices in purchasing processes, in terms of price increase, as well as, for example, improper quality of products or services, untimely delivery or performance of services, or the consent of a corrupt employee to other, inappropriate contractor behaviour (e.g. breaking regulations, failure to carry out warranty repairs, etc.). Undoubtedly, the corruption and bribery can take a number of other forms, and may be connected with giving benefits by the employees to officials for issuing favourable decisions, etc. As a consequence, the organization may be exposed to threats related to unjustified increase of costs as well as, for example, huge image losses.

Simultaneously, in terms of assessing the exposure of ZE PAK SA Group to the risk of corruption, a relatively small scale of high-value orders is important. Unlike many other electricity generators, the business model of the ZE PAK SA Group is based on a strongly integrated value chain, i.e. energy production is based on its own raw material resources. Thus, the supply of raw materials takes place inside the organization (understood as a capital group), and not from external entities. Service work is also performed in many cases by entities from the ZE PAK SA Group. As a consequence, purchases of products and services from the outside are limited to minimum, and that contributes to the reduction of risk, although it does not eliminate it. The risk of corruption may increase in the case of significant investments (e.g. construction or modernization of power units or opencast mines). However, in 2017 no large investments or upgrades were made.

Key indicators

	2017	*2016*
Number of suspicions of corrupt behaviour reported to law enforcement authorities	0	0
Number of people convicted by a valid sentence for a corruption offense	0	0

12. OTHER INFORMATION

12.1. Significant court proceedings

In 2017 Zespół Elektrowni Pątnów - Adamów - Konin SA and companies consolidated within the Group were not a party in proceedings pending before court, competent arbitration authority or public administration authority, whose single or total value would exceed 10% of the equity of ZE PAK SA except as described below.

Proceedings on refund of excise duty overpayment

In light of the regulations mandatory within the European Union, especially regulations of Article 21 paragraph 5 of the Energy Directive, in relation to Article 6 paragraph 1 of the Horizontal Directive, after 1 January 2006, the object of excise tax is sale of energy at the last stage of trade, i.e. sale by the distributor to the final recipient (consumer). Taxation with this tax does not cover an earlier stage of trade, e.g. between the producer of electricity and its distributor. In this case, the tax obligation arises at the time of supply of electricity to the consumer.

As at 1 March 2009, the Act of 6 December 2008 on excise duty entered into force, according to which the sale of electricity to an entity which is not its final customer is not subject to excise duty.

Due to the above fact, pursuant to Article 75 § 1, in relation to Article 75 § 2 of the Act of 29 August 1997 – Tax Ordinance, ZE PAK SA submitted applications for stating overpayment of the excise tax for 2006, 2007, 2008, as well as January and February 2009 for the total amount of PLN 626 million, with the justification that pursuant to the regulations of the EU law and the judicial decisions of the Provincial Administrative Courts, the activities executed by ZE PAK SA are not subject to the excise tax. Particular applications were recognised at the following levels: the Customs Office in Kalisz, the Customs Chamber in Poznań, and, currently, the Provincial Administrative Court in Poznań („PAC"), as well as the Supreme Administrative Court. Due to the position of judicature presented in the course of court proceedings, the amount of overpayment, the repayment of which the Company submits, has been reduced to the amount of damages caused by economic analyses, i.e. currently up to the amount of approximately PLN 108 million.

Moreover, in association with the rulings of the Administrative Courts regarding other power companies, in the subject of overpaid excise duty and the resolution I GPS 1/11 of the National Administrative Court ("NSA") of 22 June 2011 (where the NSA ruled that transferring the tax load in price, excludes the possibility to return the overpayment), notwithstanding the ongoing administrative proceedings, on 10 February 2012, the Company initiated a civil-law proceedings, filling an application to summon the State Treasury to a conciliation hearing regarding the amount of PLN 626 406 thousand, to the District Court Warszawa Śródmieście. A conciliatory settlement was not reached since during the hearing of 16 April 2012, the representatives of the Treasury did not agree to settle. Simultaneously, the Company, waiting for the results of the tax proceedings regarding the previously submitted application for overpayment, submitted in writing, on 14 September 2012, in the Customs Chamber in Poznań, additional explanations in the form of results of a detailed economic analysis, the purpose of which was to demonstrate whether the Company suffered loss related to the payment of excise tax to which it was not obliged. The Company's opinion is that the submitted document also applies to other overpayment applications from the entire period embraced by the proceedings, i.e. between January 2006 and February 2009. Ultimately, all applications were included in the cause lists of the Provincial Administrative Court (WSA) and the Supreme Administrative Court (NSA). As of the date of development of this statement, the status of the proceeding is as follows:

- Twenty two cases for the period of January 2006 – November 2007 (excluding November 2006) were conducted again from the start by the Head of the Customs Office, after the cases returned from the Supreme Administrative Court. The Company submitted monthly economic analyses of suffering the prejudice. After the negative decisions of the Head of the Customs Office and then of the Head of Customs Chamber, complaints were submitted to the Provincial Administrative Court in Poznań, Hearings before the Provincial Administrative Court in Poznań took place on 4 and 18 November 2015. In all cases, negative judgements for the Company were issued. In February 2016, the Company submitted cassation appeals to the Supreme Administrative Court. Currently, the Company is expecting the determination of hearing dates before the Supreme Administrative Court, The Supreme Administrative Court dismissed the Company's cassation appeals in the abovementioned 22 cases at the hearings held on April 10 and 11, 2018.
- 14 proceedings for the period of December 2007 – February 2009 (excluding July 2008) on 26 January 2017, hearings took place before the Provincial Administrative Court in Poznań. In all the cases, the Company's appeals against the Customs Chamber in Poznań were dismissed. The Company submitted applications for a written justification of the judgement, which were obtained on 7 March 2017, to the Provincial

Administrative Court. Currently, the Company analyses justifications and prepares the applications of cassation appeals to the Supreme Administrative Court,

- the proceeding for November 2006 was concluded with a negative judgement of the Supreme Administrative Court of 8 December 2011,
- the proceeding for July 2008 reached the recognition of our cassation appeal by the Supreme Administrative Court. On the hearing on 29 April 2015, the Supreme Administrative Court dismissed the Company's cassation appeal and pointed out that it fully agrees with the Provincial Administrative Court in Poznań in the judgement, against which the cassation appeal was submitted.

Notwithstanding the foregoing proceedings, ZE PAK SA lodged a complaint against the actions of the Polish authorities to the European Commission ("EC"), pursuant to art. 258 of the Treaty on the Functioning of the European Union. The opinion issued by the EC may oblige the Polish tax authorities to pass a ruling beneficial to ZE PAK SA. On 21 March 2017, ZE PAK SA received a "pre-closure letter" from the EC, which initially denied the relevance of ZE PAK SA's position, however, at the same time giving the right to a second comment on the subject, which ZE PAK SA exercised. On 9 June 2017, a letter summarising the reasoning of ZE PAK SA, in terms of the overpaid excise tax. Currently, ZE PAK SA is awaiting the EC to take the final position on the case in question.

In case of the Elektrownia Pątnów II sp. z o.o., the proceedings for all periods (one case) were included in the cause lists of the Provincial Administrative Court after a negative decision of the Head of Customs Chamber. The aforementioned company does not have access to comparative analyses of suffering the prejudice. On 4 November 2015, a hearing in the Provincial Administrative Court in Poznań took place. On 18 November 2015, a negative ruling was given. On 8 February 2016, the company filed a cassation appeal to the Supreme Administrative Court. Currently, Elektrownia Pątnów II sp. z o.o. is awaiting the setting of a hearing before the Supreme Administrative Court. The Supreme Administrative Court dismissed the Company's cassation complaint at the hearing held on April 11, 2018.

Proceedings on an environmental decision issued to PAK KWB Konin SA concerning lignite deposit in Tomisławice

PAK KWB Konin SA is a party in the administrative proceedings related to the environmental decision regarding the lignite deposit in Tomisławice. On 7 August 2007, the Head of Wierzbinek Commune issued an environmental decision regarding the lignite open cast. On 5 December 2008, this decision was contested by nine physical persons supported by the Greenpeace organisation due to alleged major infringement of the regulations of the law. On 25 March 2009, the Self-government Appeal Court dismissed the application to reverse the environmental decision. The plaintiffs applied for the judicial review. On 4 May 2009, after the judicial review, the Self-government Appeal Court sustained its previous decision. The plaintiffs again appealed against the environmental decision. On 5 May 2010, the Provincial Administrative Court in Poznań ruled that the environmental decision, pursuant to which the license for the extraction of lignite at the Tomisławice deposit was granted, infringes the regulations of the law in a major manner. PAK KWBK SA and the Self-government Appeal Court submitted an appeal against this judgement. On 21 March 2012, the Supreme Administrative Court overturned the contested decision of the Provincial Administrative Court in Poznań and referred the matter for reconsideration. On 6 November 2012, the Provincial Administrative Court in Poznań announced the decision repealing the decision of the Self-government Appeal Court of 25 March 2009 refusing to declare the invalidity of the environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune, related to the extraction of lignite from the Tomisławice open pit by PAK KWBK SA On 7 January 2013, PAK KWBK Konin SA submitted a cassation appeal from the described decision.

After the review on the hearing on 7 October 2014, the Supreme Administrative Court dismissed the cassation appeal of PAK Kopalnia Węgla Brunatnego Konin SA from the judgement of the Provincial Administrative Court in Poznań of 6 November 2012 repealing the decision of the Self-government Appeal Court in Konin of 25 March 2009 refusing the annulment of the environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune related to the extraction of lignite from Tomisławice open pit.

Dismissal of the cassation appeal of PAK Kopalnia Węgla Brunatnego Konin SA means that the judgement of the Provincial Administrative Court in Poznań of 6 November 2012 became legally binding and the case regarding the statement of invalidity of the environmental decision will be examined again by the Self-government Appeal Court. On 1 October 2015, the Self-government Appeal Court issued a decision to suspend the proceedings on the statement of invalidity of the environmental decision issued by the Head of Wierzbinek Commune in connection with the unfinished European Commission proceedings against the Polish government on breach of the provisions concerning the environment protection in connection with the lignite deposit in Tomisławice. In the case of a ruling on suspending the proceedings, a separate proceeding is under way.

The decision of the Supreme Administrative Court in Warsaw of 7 October 2014 does not invalidate the environmental decision issued by the Head of Wierzbinek Commune and does not halt the extraction and utilisation works at

Tomisławice open pit. The environmental decision issued on 7 August 2007 by the Head of Wierzbinek Commune is still in legal transactions, and until the issue of a final judgement by the Self-government Appeal Court, it exerts legal effects.

Proceedings on an environmental decision on lignite deposit in Ościsłowo

On 13 March 2017, PAK KWB Konin SA received the decision of the Regional Director for Environmental Protection in Poznań ("RDOŚ in Poznań") of 10 March 2017, refusing the establishment of the environmental conditions for the investment titled: "Extraction of lignite and associated minerals from the Ościsłowo Open Pit." The decision of RDOŚ in Poznań is not final. PAK KWB Konin SA appealed accordingly to the General Directorate for Environmental Protection in Warsaw. The appeal included a request to revoke the appealed ruling in its entirety and determine the environmental conditions for the execution of the above-mentioned project. On 30 November 2017, General Director of Environmental Protection in Warsaw has decided to repeal a decision in its entirety (contested by PAK KWB Konin SA - a subsidiary of the Company) of the Regional Director for Environmental Protection in Poznań ("RDOŚ in Poznań") dated March 10, 2017, refusing to specify environmental conditions for the project entitled: " Extraction of lignite and associated minerals from Ościsłowo Open Pit" and forward the case for reconsideration by RDOŚ in Poznań.

PAK KWB Konin SA, by letter of December 18, 2017 filed an objection against the abovementioned decision of GDOŚ in Warsaw to the Provincial Administrative Court in Warsaw (WSA). In the opinion of PAK KWB Konin S.A. there were grounds for issuing a reformatory decision by GDOŚ in Warsaw, i.e. amending the contested decision of RDOŚ in Poznań and substantive decision in this matter, not referring the matter for reconsideration. The other party also opposed the WSA. Both objections were dismissed by the WSA. The verdict was passed on March 1, 2018.

At present, the case is being reconsidered by RDOŚ in Poznań, which informed about June 5, 2018 as the new date of settling the matter.

The proceedings for issuing the environmental decision were initiated on 16 September 2015.

Other court cases are described in the consolidated financial statements of the Group in point 34.1.

12.2. Significant achievements in the field of research and development

As at the date of this report, the companies from the ZE PAK SA Capital Group do not conduct research and development works that would be of significant importance to the Group. In addition, during the past year, the Group did not make any significant financial outlays for research and development.

12.3. Information on the auditing of the financial statement

The Agreement on the Company's financial statement audit and the Group's consolidated financial statement with the entity entitled to audit financial statements, i.e. Ernst & Young Audyt Polska, a limited liability company, a limited partnership, with its registered office in Warsaw, Rondo ONZ 1, was concluded on 19 June2017.

The information regarding the remuneration of the entity authorised to the audit of financial statements was presented in section 38 of the Group's consolidated financial statement for 2017.

12.4. Financial forecasts

The Capital Group did not publish financial forecasts for 2017 and it will not present the forecast for 2018.

Konin, 19 April 2018

Adam Kłapszta *President of the Board*	*Aneta Lato-Żuchowska* *Vice President of the Board*	*Zygmunt Artwik* *Vice President of the Board*	*Elżbieta Niebisz* *Vice President of the Board*