



ENERGA SA Group

Independent Auditor's Report

Financial Year ended

31 December 2017

This document is a free translation of the Polish original. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to aid understanding. The binding Polish original should be referred to in matters of interpretation.

INDEPENDENT AUDITOR'S REPORT

To the General Shareholders' Meeting of ENERGA SA

Report on the Audit of the Annual Consolidated Financial Statements

We have audited the accompanying annual consolidated financial statements of the Group, whose parent entity is ENERGA SA with its registered office in Gdańsk, al. Grunwaldzka 472, which comprise the consolidated statement of financial position as at 31 December 2017 the consolidated statement of profit or loss, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended and notes comprising a summary of significant accounting policies and other explanatory information (the "consolidated financial statements").

Responsibility of the Management Board and Supervisory Board of the Parent Entity for the consolidated financial statements

The Management Board of the Parent Entity is responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards, as adopted by the European Union ("IFRS EU") and other applicable laws. The Management Board of the Parent Entity is also responsible for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

According to the accounting act dated 29 September 1994 (Official Journal from 2018, item 395) (the "Accounting Act"), the Management Board and members of the Supervisory Board of the Parent Entity are required to ensure that the consolidated financial statements are in compliance with the requirements set forth in the Accounting Act.

Auditor's Responsibility for the audit of the consolidated financial statements

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with:

- the act on certified auditors, audit firms and public oversight dated 11 May 2017 (Official Journal from 2017, item 1089) (the „Act on certified auditors”);
- International Standards on Auditing as adopted by the resolution dated 10 February 2015 of the National Council of Certified Auditors as National Standards on Assurance; and

- 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-listed entities and repealing Commission Decision 2005/909/EC (Official Journal of the European Union L 158 from 27.05.2014, page 77 and Official Journal of the European Union L 170 from 11.06.2014, page 66) (the "EU Regulation").

Those regulations require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the regulations mentioned above will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of 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 detecting a material misstatement resulting from error because fraud may involve collusion, forgery, deliberate omission, intentional misrepresentations or override of internal controls.

The scope of audit does not include assurance on the future viability of the Group or on the efficiency or effectiveness with which the Management Board has conducted or will conduct the affairs of the Group.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our 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, we consider internal control relevant to the Group's preparation of the consolidated financial statements that give a true and fair view 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 Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of the Parent Entity, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The most significant assessed risks of material misstatements

During our audit we identified the most significant assessed risks of material misstatements (the "key audit matters"), including those due to fraud, described below and we performed appropriate audit procedures to address these matters. Key audit matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We have determined the following key audit matters:

Key audit matters**Our procedures****Impairment of property, plant and equipment**

Net book value of property, plant and equipment as at 31 December 2017 amounts to PLN 13.371 million, while recognized impairment loss on tangible fixed assets as at 31 December 2017 amounts to PLN 660 million.

Reference to the consolidated financial statements: Note 6 "Material items subject to judgment and estimates", Note 9.6 "Property, plant and equipment", Note 9.9 "Impairment of non-financial non-current assets", Note 11.2 "Costs by nature", Note 11.3 "Cost of depreciation and impairment losses recognized on non-financial non-current assets in the statement of profit or loss", Note 13 "Property, plant and equipment"

As described in the note 13 of the consolidated financial statements, in relation with the identified indications of possible impairment of property, plant and equipment, the Group decided to perform impairment tests for property, plant and equipment of the energy production sector, in particular, power generation assets belonging to ENERGA Wytwarzanie SA, ENERGA Elektrownie Ostrołęka SA and ENERGA Kogeneracja Sp.z o.o.

The Group has performed an estimation of the recoverable amount of property, plant and equipment of the power generation sector based on the corresponding value in use of cash generating units using the discounted cash flow model.

Impairment of property, plant and equipment has been recognized as a key audit matter due to the fact that the estimation of their recoverable amount is based on a range on assumptions and estimates, most notably in relation to the future cash flows and the adopted discount rate.

The projected cash flows are highly sensitive on the assumptions based on the electrical energy prices, coal prices, prices of energy certificates of origin and CO2 emission rights. The validity of the assumptions made in this regard is considered to be burdened with a significant risk taking into consideration the potential regulatory variability and uncertainty of their effect on economy of functioning of the energy production sector.

Our procedures included:

- Assessment of compliance of the accounting policies adopted by the Group with regard to identification and recognition of impairment of property, plant and equipment dependent on the corresponding financial reporting standards;
- Assessment of the internal controls system in regard to identification of indicators of impairment and testing for impairment of property, plant and equipment;
- Assessment of Group's judgements in regard to grouping assets into cash generating units;
- Critical assessment of rationality of judgements and assumptions made by the Group, and the estimations of recoverable amount of property, plant and equipment in the power generation sector, and as a consequence, the value of identified impairment loss, with the ongoing support of our internal valuation specialists, including:
 - assessment of the discounted cash flow model prepared by the Group with regard to its compliance with the correspondent financial reporting standards, compliance with the commonly used impairment tests models, and the internal integrity of the used methodology,
 - assessment of the rationality of the key macroeconomic and discount rate assumptions made by the Group and comparing them to external sources,
 - critical assessment of the rationality of projections of future cash flows, including the assumed levels of revenues, costs,

investment expenditures by comparing the adopted assumptions to the historical financial information, and by analyzing actions taken by the Group and its subsidiaries until the audit,

- assessment of whether the Group's assumptions regarding future regulatory conditions were based on a rational model of power sector and renewable energy sources support system;
 - assessment of the correctness of the assumptions regarding the prices of electricity by comparing them to the results of analyzes of external experts ordered by the Group, whose competences, experience and objectivity we assessed.
 - Assessment of correctness and completeness of disclosures in the consolidated financial statements with regard to impairment tests, including the assessment of the sensitivity of cash flow model prepared by the Group to changes in its key assumptions, such as discount rate, inflation rate, prices of electric energy, revenues of the power market.
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Revenue recognition

Sales revenues for the financial year ended 31 December 2017 amount to PLN 10.534 million, trade receivables as at 31 December 2017 amount to PLN 1.834 million.

Reference to the consolidated financial statements: Note 6 "Material items subject to judgment and estimates", Note 9.22.1. "Financial assets", Note 9.24 "Revenue", Note 11.1 "Sales revenues", Note 28 "Financial instruments"

In the year ended 31 December 2017, the Group generated revenues primarily from the sale of electricity to the end users and on the wholesale market, electricity distribution services and gas sales.

The issue of recognition of sales revenues was the subject of our special attention due to the fact that the application of appropriate financial reporting standards is complex and requires the Management to make accounting estimates and judgments about the value of supplied electricity and

Our procedures included:

- Updating our understanding and assessment of the process of recognizing sales revenues and conducting internal control tests in this area, in particular regarding the correctness of invoicing customers for energy consumption based on reading from the meter;
- Evaluation of the accounting policy regarding the recognition of revenues in terms of their compliance with the relevant requirements of the financial reporting standards;

distribution service where no bill has been issued at the balance sheet date. Meter readings regarding the value of electricity sold to end users are made mostly in periods different from the reporting period.

In connection with the above, the entities belonging to the ENERGA Group make estimates of electricity sales and distribution services for each day ending the reporting period, for the period not covered by the reading.

The recognition of sales revenues is also based on the use of complex IT systems for data processing (in particular billing systems) that process large volumes of data with a combination of different tariffs and periods of reading the actual value of electricity sold.

For these reasons, this area has been recognized by us as a key audit matter.

- With the support of our internal Information Risk Management specialists, assessment of selected IT systems used by the Group in relation to automated controls in the area of program changes and access to the above systems, including billing systems used in the process of revenue recognition;
- Comparison the amount of revenues included in the books to billing data and revenues recognized on the basis of estimates made by the Group regarding the value of electricity and the realized non-billed distribution service at the balance sheet date with actual data available after the end of the reporting period;
- Evaluation of the reasonableness of the amount of sales revenues by building independent expectations regarding these revenues:
 - for distribution services - based on the analysis of revenues from the previous year, updated with the effect of changing the distribution tariff;
 - for electricity sales services based on the analysis of revenues from the previous year, updated with the effect of changes in volume and price in individual tariff groups. Comparison of our expectations to sales revenues recognized by the Group for the sales business line;
- For a selected sample of the Group's clients, obtaining receipts of receivables balances as at October 30, 2017; Reconciliation of changes in the balance of receivables from October 30, 2017 until the balance sheet date.
- Reconciliation of data on the amount of electricity consumed for a selected sample of invoices for customers with information in billing systems based on reading from meters, including checking the receipt of payment for selected items from each billing system.

Claims for cessation of performance of long-term contracts for purchase of property rights resulting from certificates of origin of energy from renewable sources

The value of disclosed contingent liabilities due to the cessation of long-term agreements for the purchase of property rights as at December 31, 2017 amounts to PLN 26.5 million;

Reference to the consolidated financial statements: Note 35.1 "Contingent liabilities"

As described in Note 35.1 to the consolidated financial statements, the subsidiary ENERGA-OBRÓT SA (the "Subsidiary") has come to the conviction of non-existence of the legal relationship related to multi-annual framework agreements for the purchase of property rights arising from certificates of origin ("CPAs"). In the opinion of the Subsidiary, the reason for the non-existence of the CPA Agreements is their inconsistency with the Act of 29 January 2004 - Public Procurement Law (Dz.U.2017.1579).

Because of the above, as of September 11, 2017, the Company ceased to perform the CPA Agreements and initiated a court and arbitration proceedings which subject-matter is to be determination of the non-existence of CPAs. Litigation regarding invalidity of CPA contracts are pending. Disputes were initiated in September 2017 and they are currently at the initial stage of the proceedings.

There is significant uncertainty as to the outcome of the final settlement of court disputes regarding the legal grounds for recognition of their non-existence and reported claims, which requires a detailed analysis and a number of assumptions and judgments. The value of claims may be significant, and the determination of any amount that should be recognized or disclosed in the financial statements is subjective in nature, therefore the reported and potential claims for cessation of contracts for the purchase of property rights arising from certificates of origin have been recognized by us as the key audit matter.

Our procedures included:

- Assessment of compliance of the Group's accounting policy regarding the disclosure of contingent liabilities as a result of cessation of the performance of the CPAs with appropriate financial reporting standards;
- Analysis of the content of selected contracts for the purchase of green certificates, including in particular in the context of the legal basis set out by the Entity invalidity, and collected up to the date of audit court trial documentation, in order to assess the risk for the Entity in resolving disputes related to the cessation of these contracts;
- Analysis of legal opinions obtained by the Entity and letters independently received by us from lawyers servicing the Entity regarding reported claims and court proceedings pending in this respect, discussion of selected issues with the Entity's Management Board;
- Analysis of the legal opinion prepared at our request by an independent law firm not previously involved in the proceedings assessing the most probable outcome of the dispute as well as possible further consequences for the Entity, both acceptance and rejection by the court of applications for absolute termination of contracts;
- An analysis of the facts and arguments of the parties prepared by our internal law specialist;
- Critical assessment of the Entity's assumptions and estimates (including the probability of negative settlement of court disputes) based on the above analyzes;
- Critical evaluation of the reasonableness of cost calculation due to cessation of contracts in the event of unfavorable settlement of disputes, by building expectations based on the estimated volume of unrealized purchase of green certificates and average contract prices for the purchase of green certificates

- and their comparison to the amount determined by the Company;
- Assessment of the correctness and completeness of disclosures in the consolidated financial statements regarding contingent liabilities from ceasing to carry out contracts for the purchase of green certificates.

Opinion

In our opinion the accompanying consolidated financial statements of ENERGA SA Group:

- give a true and fair view of the consolidated financial position of the Group as at 31 December 2017 and of its consolidated financial performance and its consolidated cash flows for the year then in accordance with IFRS EU and the adopted accounting policy;
- comply, in all material respects, with regard to form and content, with applicable laws and the provisions of the Parent Entity's articles of association.

Other Matters

The consolidated financial statements of the Group as at and for the year ended 31 December 2016 were audited by another audit firm who expressed an unmodified opinion as at 29 March 2017

Report on other legal and regulatory requirements

Report on the Group activities

Our opinion on the consolidated financial statements does not cover the report on the Group's activities (the "report on activities").

The Management Board of the Parent Entity is responsible for the preparation of the report on activities in accordance with the requirements of the Accounting Act and other applicable laws. Furthermore, the Management Board and members of the Supervisory Board of the Parent Entity are also required to ensure that the report on activities is in compliance with the requirements set forth in the Accounting Act.

In accordance with Act on certified auditors our responsibility was to determine if the report on activities was prepared in accordance with applicable laws and the information given in the report on activities is consistent with the consolidated financial statements. Our responsibility was also to state, if based on our knowledge about the Group and its environment obtained in the audit, we have identified material misstatements in the report on the activities and describe the nature of each material misstatement.

Based on the work undertaken in the course of our audit of the consolidated financial statements, in our opinion, the accompanying report on activities, in all material respects:

- has been prepared in accordance with applicable laws, and

- is consistent with the consolidated financial statements.

Furthermore, based on our knowledge about the Group and its environment obtained in the audit, we have not identified material misstatements in the report on activities.

Opinion on corporate governance statement

The Management Board and members of the Supervisory of the Parent Entity are responsible for preparation of the corporate governance statement in accordance with the applicable laws.

In connection with the audit of the consolidated financial statements, our responsibility in accordance with the requirements of the Act on certified auditors was to report whether the issuer of securities obliged to prepare a corporate governance statement, constituting a separate part of the report on activities, included information required by the applicable laws and regulations, and in relation to specific information indicated in these laws or regulations, to determine whether it complies with the applicable laws and whether it is consistent with the consolidated financial statements.

In our opinion the corporate governance statement, which is a separate part of the report on the the Group's activities, includes the information required by paragraph 91 subparagraph 5 point 4 letter a, b, j, k and letter l of the Decree of the Ministry of Finance dated 19 February 2009 on current and periodic information provided by issuers of securities and the conditions for recognition as equivalent of information required by the laws of a non-member state (Official Journal from 2014, item 133 with amendments) (the "decree"). Furthermore, in our opinion the information identified in paragraph 91 subparagraph 5 point 4 letter c-f, h and letter i of the decree of the regulations, included in the corporate governance statement, in all material respects:

- has been prepared in accordance with the applicable laws; and
- is consistent with the consolidated financial statements.

Information about non-financial statement

In accordance with the requirements of the Act on certified auditors, we report that the Parent Entity has prepared a statement on non-financial information referred to in art. 49b paragraph 9 of the Accounting Act.

We have not performed any assurance procedures in relation to the non-financial statement of the Group and, accordingly, we do not express any assurance conclusion thereon.

Independence and the appointment of the audit firm

Our opinion on the audit of consolidated financial statements is consistent with our report to the audit committee.

During our audit the key certified auditors and the audit firm remained independent of the Group in accordance with requirements of the Act on certified auditors, the EU Regulation and the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants' (IFAC) as adopted by the resolutions of National Council of Certified Auditors.

We declare that, to the best of our knowledge and belief, we did not provide prohibited non-audit services referred to in art. 5 paragraph 1 second subparagraph of the EU Regulation and art. 136 including transitional provisions in art. 285 of the act on certified auditors.

The key statutory auditors or the audit firm did not provide any other services to the Group that were not statutory audits of the financial statements, except those disclosed in the report on operations.

The audit of the consolidated financial statements was carried out on the basis of a resolution of the Supervisory Board of December 20, 2016.

Our total uninterrupted period of engagement is 1 year, beginning from the periods ending at 31 December 2017.

On behalf of audit firm
KPMG Audyt Spółka z ograniczoną
odpowiedzialnością sp.k.
Registration No. 3546
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Signed on the Polish original

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Zbigniew Libera
Key Certified Auditor
Registration No. 90047
Limited partner

14 March 2018

Signed on the Polish original

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