



**Report of Grupa LOTOS S.A. on Application of the Corporate Governance
Principles in 2007**

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INTRODUCTION

The Report of Grupa LOTOS S.A. on Application of the Corporate Governance Principles in 2007 was prepared in accordance with "Best Practices at WSE-Listed Companies". The structure of this document is compliant with Resolution No. 1013/2007 of the Management Board of the Warsaw Stock Exchange, dated December 11th 2007, concerning the scope and structure of reports on application of the corporate governance principles at listed companies.

Pursuant to Resolution No. 13/1171/2007 of the Supervisory Board of the WSE, dated July 4th 2007, concerning amendment to the WSE Rules, the report contains a summary of application of the corporate governance principles defined in the document "Best Practices in Public Companies 2005" by Grupa LOTOS S.A. in 2007.

1. CORPORATE GOVERNANCE PRINCIPLES WHICH WERE NOT APPLIED BY GRUPA LOTOS S.A. IN 2007

In accordance with the Statement of the Management Board of Grupa LOTOS S.A., the Company declared to observe the corporate governance principles defined in the document "Best Practices in Public Companies 2005" with the exception of Principles No. 14, 20, 27, 28, 38 and 43. In 2007, the Company fully complied with the corporate governance principles which the Company's Management Board undertook to apply in its statement of May 15th 2006.

Below are presented the principles whose observance was not declared in 2007, along with the Company's commentary on the reasons for non-compliance.

Principle No. 14

A resolution not to consider an item on the agenda may be adopted only if it is supported by sound reasons. Any motion in this respect should be accompanied by a detailed justification.

A decision to remove an item from the agenda or not to consider an item put on the agenda at a shareholder's request requires a General Shareholders Meeting resolution, once all the shareholders present who put the item on the agenda have given their consent, supported by 75% of the votes present at the meeting.

Commentary

Pursuant to § 6 item 5 of the Rules of Procedure of the General Shareholders Meeting, the resolution on not considering an item on the agenda of the General Shareholders Meeting can be taken only if it is supported by sound and material reasons and the relevant motion should be accompanied by detailed explanation. Removal of an item from the agenda or not considering it upon a motion of the shareholders, requires a consent of the shareholder or shareholders who requested that item be put on the agenda and the resolution of the General Shareholders Meeting adopted with an absolute majority of votes.

The aforementioned limitation to absolute majority of votes is related to the Company's role in the Polish oil sector and the need to retain the strategic shareholder's influence on the Company operations in line with the guidelines of the Strategy for the Oil Industry in Poland.

Principle No. 20

- a) At least half of the Members of the Supervisory Board should be independent members, subject to point (d) below. Independent Members of the Supervisory Board should not have relations with the company and its shareholders or employees which could significantly affect the independent Member's ability to make impartial decisions;
- b) Detailed independence criteria should be laid down in the company's articles of association,
- c) Without the consent of the majority of independent Supervisory Board Members, no resolutions should be adopted on the following issues:
- performances of any kind by the company and any entities associated with the company in favour of Management Board Members;
 - consent to the execution by the company or a subsidiary of a key agreement with an entity associated with the company, a Member of the Supervisory Board or Management Board, or with their associated entities; and
 - appointment of an auditor to audit the company's financial statements.
- d) In companies where one shareholder holds a block of shares carrying over 50% of all voting rights, the Supervisory Board should consist of at least two independent Members, including an independent chairman of the audit committee, should such a committee be set up.

Commentary

There are no "independent Members" at the Company due to the Company's present shareholding structure and its role in the Polish fuel sector. However, the Company does not rule out making relevant changes in the future. However, the Supervisory Board has appointed the following standing committees: Remuneration Committee, Audit Committee, and Strategy and Development Committee.

Principle No. 27

Supervisory Board Members' remuneration should be set on the basis of a set of transparent procedures and rules. The remuneration should be fair but should not constitute a significant cost item in the company's business or have a material impact on its financial results. It should also be in reasonable relation to the remuneration of Members of the Management Board. The total amount of all Supervisory Board Members' remuneration, as well as the remuneration of individual Members, with a breakdown of its various elements should be disclosed in the annual report together with information on the procedures and rules applied to determine it.

Commentary

The Supervisory Board Members' remuneration is subject to limitations and rules defined in the Act on Remunerating Persons Managing Certain Legal Entities of March 3rd 2000 (Dz. U. no. 26 of 2000, item 306, as amended) and in secondary legislation adopted on the basis of the Act.

Principle No. 28

The Supervisory Board should operate in accordance with its rules of procedure, which should be publicly available.

The Rules of Procedure of the Supervisory Board should stipulate that at least two committees should be set up:

-audit, and
-remuneration.

The remuneration committee should consist of at least two independent Members and at least one person possessing the relevant qualifications and experience in accounting and finance. The committee's tasks should be specified in the Rules of Procedure of the Supervisory Board. The committees should present reports on their activities to the Supervisory Board every year. The company should then make these reports available to its shareholders.

Commentary

The Company has Rules of Procedure of the Supervisory Board in place, and they are available at www.lotos.pl. Presently, there are no Supervisory Board Members with an "independent" status. The absence of independent Members stems from the current shareholding structure of the Company and its role in the Polish fuel sector. However, the Company does not rule out that it will make relevant changes in the future. The provisions of § 9 of the Rules of Procedure of the Supervisory Board provide, however, for appointment of three standing committees: Remuneration Committee, Audit Committee, and Strategy and Development Committee. Additionally, in line with § 9 item 1 of the Rules of Procedure of the Supervisory Board, the Supervisory Board may appoint working teams from among its Members in order to investigate various matters.

Principle No. 38

The remuneration of Management Board Members should be set on the basis of transparent procedures and principles, taking into account its incentive nature and ensuring effective and smooth management of the company. The remuneration should correspond to the size of the company's business enterprise, should be in reasonable relation to business results, and be related to the scope of liability in a given function, taking into account the level of remuneration of Members of Management Boards in similar companies on a similar market.

Commentary

The Management Board Members' remuneration is subject to limitations and rules defined in the Act on Remunerating Persons Managing Certain Legal Entities of March 3rd 2000 (Dz. U. no. 26 of 2000, item 306, as amended) and in secondary legislation adopted on the basis of the Act.

Principle No. 43

The auditor should be selected by the Supervisory Board on the recommendation of the audit committee, or by the General Shareholders Meeting on the recommendation of the Supervisory Board containing the audit committee recommendation. If an auditor other than the one recommended by the audit committee is chosen by either the board or the General Shareholders Meeting, detailed reasons should be given. Information on the selection of an auditing entity together with the relevant justification should be disclosed in the annual report.

Commentary

The auditor is selected by the Supervisory Board on the recommendation of the Audit Committee. The recommendation is prepared based on transparent rules and market criteria. Since there are no Supervisory Board Members with the independent status, the Audit Committee does not meet the corporate governance criteria. (see commentary to Principles No. 20 and 28)

2. DESCRIPTION OF THE MODE OF OPERATION OF THE GENERAL SHAREHOLDERS MEETING, ITS BASIC POWERS AND THE SHAREHOLDERS' RIGHTS ALONG WITH THE PROCEDURE OF THEIR EXERCISE

The General Shareholders Meeting of Grupa LOTOS S.A. operates in accordance with:

- the Company's Articles of Association – consolidated text, incorporating amendments introduced by the General Shareholders Meeting (including the most recent one of February 22nd 2008), adopted by virtue of the Supervisory Board's resolution of March 5th 2008 (Resolution No. 130/VI/2008);
- Rules of Procedure for the General Shareholders Meeting of Grupa LOTOS S.A. – Resolution No. 18 of the Extraordinary General Shareholders Meeting of Grupa LOTOS S.A., dated January 30th 2006.

A General Shareholders Meeting is convened by the Management Board in the circumstances provided for in the Articles of Association or in the Commercial Companies Code.

An Annual General Shareholders Meeting is held no later than within six months after the end of the financial year, i.e. by the end of June. In 2007, the Annual General Shareholders Meeting of Grupa LOTOS S.A. was held on **May 28th**. The right to convene an Annual General Shareholders Meeting rests also with the Supervisory Board in the event that the Management Board fails to convene it within the specified timeframe.

An Extraordinary General Shareholders Meeting is convened by the Management Board on its own initiative, at the request of the Supervisory Board or at the request of a shareholder(s) representing no less than one tenth of the Company's share capital, within two weeks from submission of such a request. A request to convene a General Shareholders Meeting should specify the issues to be addressed at the meeting.

A shareholder representing at least one fifth of the Company's share capital has the right to convene an Annual General Shareholders Meeting – if the Management Board fails to convene it within the specified timeframe and an Extraordinary General Shareholders Meeting – if the shareholder deems it appropriate and the Management Board fails to convene such a Meeting within two weeks from the date of the shareholder's request.

A General Shareholders Meeting is convened by publishing an announcement in *Monitor Sądowy i Gospodarczy*, no later than three weeks before the date of the Meeting.

Persons entitled to participate in the General Shareholders Meeting are holders of registered shares entered into the share register at least a week prior to the date of the Meeting, and holders of bearer shares on the condition that a deposit certificate, issued to their name by the entity keeping the securities account in accordance with the laws governing public trade in securities, is submitted at the Company's registered office at least a week prior to the date of the Meeting; the deposit certificate should provide in particular that it has been issued to be submitted with the Company in connection with the Meeting and that the shares will remain blocked until the closing of the Meeting.

Shareholders may participate in the General Shareholders Meeting and exercise voting rights in person or by proxy. A power-of-proxy authorising participation in the General Shareholders Meeting should be rendered in writing under pain of nullity. A shareholder may grant the power-of-proxy to more than one person, with the proviso that he/she may be represented at the Meeting by no more than one person: a joint representation by several proxies is inadmissible. The provision referred to above pertains also to organisational entities with collective bodies represented by several persons, which entities may participate in the Meeting exclusively through a proxy.

According to the Articles of Association of Grupa LOTOS S.A., the powers of the General Shareholders Meeting include in particular:

- 1) Review and approval of the annual financial statements of the Company, the annual Directors' Report on the Company's operations, as well as of the consolidated financial statements of the Group and the Directors' Report on the Group's operations, for the previous financial year,
- 2) Discharge of duties by Members of the Supervisory Board and Management Board,
- 3) Making decisions with respect to profit distribution or coverage of loss, as well as on the use of funds/special accounts created out of profits, subject to specific regulations which provide for a different use of such funds/special accounts,
- 4) Appointment and removal of the Supervisory Board Members and definition of the rules of remuneration of the Supervisory Board Members,
- 5) Share capital increase and reduction,
- 6) Any decisions concerning claims for repair of damage inflicted in the establishment of the Company or in exercise of supervision or management,
- 7) Disposal and lease of a business or its organised part and creation of limited property rights in a business or its organised part,
- 8) Approval of purchase of real estate, perpetual usufruct rights or an interest in real estate, whose value, determined on the basis of valuation by an appraiser, exceeds PLN 5,000,000, as well as approving disposal of real estate, perpetual usufruct rights or an interest in real estate, whose value, determined on the basis of valuation by an appraiser, exceeds PLN 200,000,
- 9) Issuing consent to encumber and dispose of shares in Przedsiębiorstwo Poszukiwań i Eksploatacji Złóż Ropy i Gazu Petrobaltic S.A. and shares in Przedsiębiorstwo Przeladunku Paliw Płynnych Naftoport Sp. z o.o.,
- 10) Amendment to the Articles of Association,
- 11) Creation and liquidation of funds/special accounts, including the reserve account,
- 12) Approval of share retirement or purchase of shares for retirement, and defining the terms of such retirement,
- 13) Bonds issue,
- 14) Dissolution, liquidation and transformation of the Company or merger with another company,
- 15) Defining the rules of remuneration of the Management Board Members,
- 16) Defining the amount of monthly remuneration of the Management Board Members,
- 17) Approval of purchase of shares issued by the Company (treasury shares) and creation of pledge on treasury shares in the circumstances defined in Art. 362.1.2 of the Commercial Companies Code,
- 18) Defining the amount of the annual bonus for the President of the Management Board,

- 19) Approval of implementation of incentive programmes,
- 20) Dissolving the Company,
- 21) Transferring the Company registered office abroad,
- 22) Changing the Company's business profile as to limit its ability to produce, process and sell refined petroleum products,
- 23) Selling or leasing the Company's business or its organised part whose profile includes production, processing and sale of refined petroleum products, as well as encumbering such business or a part thereof with limited property rights,
- 24) Merging with another company,
- 25) Dividing the Company,
- 26) Establishing share preference,
- 27) Establishing a European company, joining such company or transforming the Company into a European company,
- 28) Amending the provisions of Par. 10.1 of these Articles of Association.

All and any issues addressed to during the General Shareholders Meeting are subject to prior consideration of the Supervisory Board. Rules governing the participation in the General Shareholders Meeting and exercising voting rights are set forth in the Rules of Procedure of the General Shareholders Meeting of Grupa LOTOS S.A. The Rules also contain provisions concerning the manner of convening and closing of the Meeting, its opening and proceedings as well as the procedure for election of the Supervisory Board Members.

The General Shareholders Meeting adopts resolutions by absolute majority of votes unless the Commercial Companies Code or the Articles of Association require more stringent rules governing adoption of resolutions on particular issues. Votes are cast in an open ballot. Secret ballot is ordered during elections and in the case of motions to dismiss a member of a governing body of the Company or its liquidator, or to hold them liable, as well as motions concerning personnel-related matters. Furthermore, a secret ballot is ordered if at least one shareholder, attending or represented at the Meeting, so demands.

One Company share confers the right to one vote at the General Shareholders Meeting, with the proviso that as long as Nafta Polska S.A. holds the Company shares conferring the rights to at least one-fifth of the total vote at the General Shareholders Meeting, the rights of the Company shareholders are limited so that neither of them can exercise at the General Shareholders Meeting more than one-fifth of the total number of votes at the Company on the day the General Shareholders Meeting is held. The limitation of the voting rights does not release the buyers and holders of the Company shares from the obligations provided for in laws governing public trade in securities, including in particular the disclosure requirement related to the purchase and sale of shares in a public company, the obligation to obtain approval of a relevant authority for purchase of a specific number of shares in a public company, the obligation to publicly announce tender offers for sale or exchange of shares in a public company, and to announce and carry out tender offers for sale of the remaining shares in a public company.

The person opening the General Shareholders Meeting (Chairperson of the Supervisory Board or Supervisory Board Member appointed by the Chairperson of the Supervisory Board, or in the event of their absence,

President of the Management Board or a person appointed by the Management Board) should order an immediate election of the Chairperson of the Meeting from among the persons entitled to participate in the General Shareholders Meeting.

The Chairperson of the General Shareholders Meeting conducts the meeting and is authorised to interpret the Rules of Procedure of the General Shareholders Meeting. The Chairperson should, among other things, ensure the efficient conduct of the meeting, ensure that the rights and interests of all the shareholders are respected, give floor to the participants, receive motions and draft resolutions, submit them for discussion, order and conduct voting, and ascertain that the agenda has been completed.

The Chairperson should prevent any abuse of rights by the participants of the General Shareholders Meeting and ensure that the rights and interests of the minority shareholders are respected. In accordance with the Rules of Procedure of the General Shareholders Meeting, the Meeting should be attended by members of the Management and Supervisory Boards, and the auditor if financial issues are discussed at the Meeting.

After presentation of each item on the agenda, the Chairperson of the General Shareholders Meeting opens the discussion and gives floor in the order in which the participants request to speak. Subject to the General Shareholders Meeting's consent, several related items on the agenda may be discussed jointly. While taking the floor, the speakers may speak on the issues included in the agenda and discussed at a given moment. During the discussion of each item on the agenda, each shareholder is entitled to a five-minute speech and three-minute replies. The shareholders are entitled to propose amendments and additions to draft resolutions included in the agenda until the discussion on the agenda item to which the resolution pertains is closed.

At the request of a person participating in the General Shareholders Meeting, his or her written statement is included in the minutes.

In formal matters, the Chairperson gives the floor to speakers disregarding the set order. Each shareholder may submit a motion concerning a formal matter. Motions concerning the procedure of the Meeting or voting are considered motions on formal matters. The Chairperson should resolve on formal matters; if need arises the Chairperson may seek opinion of the persons appointed by him.

If the scope of regulations specified in the Commercial Companies Code, Articles of Association and Rules of Procedure of the General Shareholders Meeting does not allow for resolving the issue contained in the motion, the Chairperson should submit the motion to the General Shareholders Meeting for voting.

3. COMPOSITION AND MODE OF OPERATION OF THE COMPANY'S MANAGING AND SUPERVISING BODIES AND THEIR COMMITTEES

3.1 MANAGEMENT BOARD OF GRUPA LOTOS S.A.

The Management Board of Grupa LOTOS S.A. operates in accordance with:

- The Company's Articles of Association – consolidated text incorporating amendments introduced by the General Shareholders Meeting (including the most recent one of February 22nd 2008), which was adopted by resolution of the Supervisory Board, dated March 5th 2008 (resolution No. 130/VI/2008),

- Rules of Procedure of the Management Board of Grupa LOTOS S.A. – adopted by Resolution No. 6/VI/2007 of the Management Board, dated January 23rd 2007 and approved by Resolution No. 70/VI/2008 of the Supervisory Board, dated January 29th 2007.

In accordance with the Company's Articles of Association, the Management Board is composed of three to seven members, including the President and Vice-Presidents of the Management Board. The Supervisory Board appoints the Management Board, by first appointing the President of the Management Board, and then – acting upon the President's proposal – the Vice-Presidents and the other Management Board Members. The term of office of the Management Board is a joint term of three years. The President, Vice-Presidents, other Management Board Members and the entire Management Board may be dismissed or suspended for sound reasons by the Supervisory Board at any time before the end of their term of office.

In 2007, the Management Board of Grupa LOTOS S.A. was composed of:

In the period January 1st – November 13th 2007

1. Paweł Olechnowicz – President of the Management Board,
2. Marek Sokołowski – Vice-President of the Management Board,
3. Mariusz Machajewski – Vice-President of the Management Board,
4. Jarosław Kryński – Vice-President of the Management Board.

During the meeting held on November 13th 2007, the Supervisory Board removed Mr Jarosław Kryński from the position of Vice-President of the Management Board responsible for trade, and entrusted his responsibilities to the President of the Management Board until appointment of a new Management Board Member. Hence, **in the period November 13th – December 31st 2007**, the Management Board of Grupa LOTOS S.A. was composed of:

1. Paweł Olechnowicz – President of the Management Board,
2. Marek Sokołowski – Vice-President of the Management Board,
3. Mariusz Machajewski – Vice-President of the Management Board.

The Management Board manages the Company's affairs and represents it in all actions taken by the Company before and out of courts with respect to conducting the Company's business, with the exception of the actions, which in accordance with the provisions of the Commercial Companies Code or the Company's Articles of Association, rest with the General Shareholders Meeting or the Supervisory Board, and matters beyond the scope of ordinary management of an undertaking, which require prior resolution by the Management Board, as well as matters assigned to particular Management Board Members under the Rules of Procedure of the Management Board.

The scope of issues to be resolved by means of resolutions is regulated by the Rules of Procedure of the Management Board.

A resolution will be deemed validly adopted if all Management Board Members have been notified of the Management Board meeting and if at least three-fifths of the Management Board Members are in attendance at that meeting. Resolutions are adopted by way of a simple majority of votes in favour of a resolution over the votes against it; abstaining votes are disregarded. Voting is open. A secret ballot may be held at the request of the President or two Members of the Management Board. In the case of a voting tie, the President of the

Management Board has the casting vote. When adopting resolutions, the Management Board Members should aim to reach consensus. The Management Board may adopt resolutions following a written procedure or with the use of direct remote communications facilities. Adoption of a resolution by this procedure requires prior presentation of the resolution draft to all Management Board Members. Resolutions adopted by this procedure are presented at the next Management Board session, along with results of the vote.

In 2007, the Management Board held in total 55 meetings, during which it adopted 166 resolutions.

3.2 SUPERVISORY BOARD

The Supervisory Board of Grupa LOTOS S.A. operates on the basis of:

- the Company's Articles of Association – consolidated text incorporating amendments introduced by the General Shareholders Meeting (including the most recent one of February 22nd 2008), adopted by resolution of the Supervisory Board, dated March 5th 2008 (resolution No. 130/VI/2008);
- Rules of Procedure of the Supervisory Board of Grupa LOTOS S.A. – consolidated text incorporating amendments introduced on July 11th 2007 (resolution No. 105/VI/2007 of the Supervisory Board, dated July 11th 2007).

Pursuant to the Company's Articles of Association, its Supervisory Board is composed of six to nine Members, including the Chairman, the Deputy Chairman and the Secretary. The number of the Supervisory Board Members is determined by the General Shareholders Meeting.

Supervisory Board Members are appointed and removed from office by the General Shareholders Meeting. Notwithstanding the above, as long as the State Treasury remains a shareholder in the Company, the State Treasury, represented by the competent minister, is entitled to appoint and remove one Member of the Supervisory Board.

The term of office of the Supervisory Board is a joint term of three years. Any or all Supervisory Board Members may be removed from office at any time prior to the expiry of their term of office.

The Chairman of the Supervisory Board is appointed by the General Shareholders Meeting. The Deputy Chairman and the Secretary are elected by the Supervisory Board from among its remaining Members.

In 2007, supervision over the Company's business was exercised by the Supervisory Board of Grupa LOTOS S.A. of the sixth term of office, composed of:

- six Members – in the period from January 1st to May 28th 2007;
- seven Members – in the period from May 28th to December 31st 2007.

In 2007, the following persons served as Members of the Supervisory Board of Grupa LOTOS S.A.:

In the period from January 1st to May 28th 2007:

1. Jan Stefanowicz – Deputy Chairman of the Supervisory Board,
2. Beata Zawadzka,
3. Jacek Mościcki,

4. Henryk Siodmok,
5. Jacek Tarnowski,
6. Grzegorz Szczodrowski – Secretary of the Supervisory Board.

On May 28th 2008, the General Shareholders Meeting removed Jacek Tarnowski from his position on the Supervisory Board, and appointed Jan Stefanowicz (former Deputy Chairman of the Supervisory Board of Grupa LOTOS S.A.) as Chairman of the Supervisory Board of Grupa LOTOS S.A., Marta Busz as Member of the Supervisory Board of Grupa LOTOS S.A. and Izabela Emerling as Member of the Supervisory Board of Grupa LOTOS S.A.

On June 14th 2007, the Supervisory Board appointed Henryk Siodmok as Deputy Chairman of the Supervisory Board.

As a consequence, in the period from May 28th to December 31st 2007, the Supervisory Board had the following composition:

1. Jan Stefanowicz – Chairman of the Supervisory Board,
2. Henryk Siodmok – Deputy Chairman of the Supervisory Board,
3. Beata Zawadzka,
4. Marta Busz,
5. Izabela Emerling,
6. Jacek Mościcki,
7. Grzegorz Szczodrowski – Secretary the Supervisory Board.

3.3 POWERS OF THE SUPERVISORY BOARD

The Supervisory Board exercises ongoing supervision over the Company's business. Furthermore, powers of the Supervisory Board include:

- 1) Appointing and removing from office the President, the Vice-Presidents, and other Management Board Members, and proposing rules of remuneration for the Management Board Members,
- 2) Suspending from office (for a good reason) any or all Management Board Members, and delegating Supervisory Board Member(s) to temporarily substitute for the Management Board Members who are unable to perform their duties,
- 3) Approving the Rules of Procedure of the Management Board,
- 4) Selecting an auditor to audit the financial statements of the Company and its Group, in accordance with the provisions of the Polish Accountancy Act,
- 5) Reviewing financial statements for compliance with accounting books and documents, as well as the actual state of affairs, reviewing the Directors' Report and the Management Board's recommendations concerning the distribution of profit or coverage of loss, and submitting written reports on the findings of such reviews to the General Shareholders Meeting,
- 6) Issuing opinions on all issues submitted for consideration to an Annual or Extraordinary General Shareholders Meeting,
- 7) Granting consent to Management Board Members to serve on the managing or supervisory bodies of other companies and to receive remuneration on account of this service,

- 8) Granting approval to implement investment projects and to contract liabilities related thereto, if the value of the resulting expenditure or encumbrances exceeds the equivalent of one-half of the Company's share capital,
- 9) Defining the scope, level of detail and deadlines for submission of annual budgets and long-term strategies by the Management Board,
- 10) Approving strategies of Grupa LOTOS S.A. and the LOTOS Group,
- 11) Issuing opinions on annual budgets,
- 12) Awarding annual bonuses to Vice-Presidents and Members of the Management Board and recommending award of annual bonus for the President of the Management Board,
- 13) Adopting rules for funds/special accounts management,
- 14) Granting approval to: establish a foreign branch within the meaning of the provisions of Double-Tax Treaties signed by Poland; sell non-current assets whose value exceeds the equivalent of one-twentieth of the net value of the Company's assets; contract another liability or make another disposal whose value – whether in a single or a series of related legal transactions which fall outside the scope of day-to-day management – exceeds the equivalent of one-half of the Company's share capital, unless it requires approval of the General Shareholders Meeting; make equity investments abroad, if their value exceeds one-twentieth of the Company's share capital, and all capital expenditure on property, plant and equipment; exercise the Company's voting rights at the general shareholders meetings of all subsidiaries and other companies, if the value, determined on the basis of the acquisition cost, of the shares the Company holds in a given company exceeds one-fifth of the Company's share capital (in the case of voting on the following issues: distribution of profit, coverage of loss, increase or reduction of share capital, merger with another company, transformation of the company, sale and lease of the company's business and encumbering it with usufruct rights or amendment of the company's articles of association); establish companies under commercial law and acquire interests in companies, as well as make payments for the share capital of a company or sell shares in a company, if the value, determined on the basis of the acquisition cost, of the Company's to-date equity investment in the company or the Company's equity investment in the company upon acquisition of the shares, exceeds one-twentieth of the Company's share capital, except for acquisitions of shares by way of conversion of claims pursuant to the provisions of the Polish Act on Financial Restructuring of Enterprises and Banks, dated February 3rd 1993, or in public trading in securities; purchase real estate, perpetual usufruct rights or an interest in real estate, whose value, determined on the basis of an appraiser's valuation, does not exceed PLN 5,000,000, as well as sell real estate, perpetual usufruct rights or an interest in real estate, whose value, determined on the basis of an appraiser's valuation, does not exceed PLN 200,000.

The Supervisory Board may – without prejudicing the powers of the Company's other governing bodies – deliver its opinions on all issues related to the Company's business, and submit motions and proposals to the Management Board, which then must inform the Chairman of the Supervisory Board – within twenty-one days of their submission – of the manner in which they were addressed.

The Supervisory Board submits to the General Shareholders Meeting a concise annual evaluation of the Company's standing, early enough for the Company's shareholders to become acquainted with its contents before the Annual General Shareholders Meeting is held.

Meetings of the Supervisory Board are held as need arises, however not less frequently than once every two months. They are convened by the Chairman of the Supervisory Board acting alone or upon a written request containing the proposed agenda for the meeting, submitted by the Management Board or a Member of the Supervisory Board.

A meeting of the Supervisory Board may be held if all Supervisory Board Members have been duly invited. A meeting of the Supervisory Board may also be held without being formally convened if all the Supervisory Board Members are present and agree to holding the meeting and including specific items in its agenda. Moreover, the Supervisory Board may adopt resolutions in writing or by means of remote communications, subject to Art. 388.4 of the Commercial Companies Code. Adoption of a resolution in this manner requires prior submission of the draft resolution to all Supervisory Board Members. Resolutions adopted in this manner are presented at the next meeting of the Supervisory Board, along with the voting results.

Subject to the provisions of the Company's Articles of Association, the Supervisory Board adopts its resolutions with an absolute majority of valid votes cast, in the presence of at least one-half of the Supervisory Board Members.

In 2007, the Supervisory Board held 11 meetings and adopted 55 resolutions, one of which was adopted in writing, in accordance with the procedure set out in Art. 388.3 of the Commercial Companies Code and Par. 12.3 of the Company's Articles of Association.

3.4 COMMITTEES OF THE SUPERVISORY BOARD

The Supervisory Board may set up standing or *ad-hoc* committees composed of its Members to examine specific issues. A committee is composed of three to five persons. The chairman of a committee is appointed by the Supervisory Board from among the committee members.

The committees report their activities to the Supervisory Board as need arises, however standing committees must report to the Supervisory Board at least once a year.

The chairman of a committee, or a person designated by the chairman, has the right to move to the Supervisory Board for adoption of resolutions concerning preparation for the committee of opinions or expert opinions concerning the scope of the committee's remit or engagement of an adviser.

The following standing committees operate within the Supervisory Board: the Audit Committee, the Strategy and Development Committee and the Organisation and Management Committee. The standing committees meet as required, however not less frequently than once a quarter.

Strategy and Development Committee

The Strategy and Development Committee is responsible for providing to the Supervisory Board opinions and recommendations regarding planned investment projects with material effect on the Company's assets.

In 2007, the Strategy and Development Committee was composed of:

from January 1st to June 14th 2007

1. Jan Stefanowicz – Deputy Chairman and acting Chairman, since Jan Szomburg tendered his resignation (on June 16th 2006),
2. Henryk Siodmok,
3. Jacek Tarnowski;

from June 14th to December 31st 2007

1. Jan Stefanowicz – Chairman,
2. Marta Busz,
3. Henryk Siodmok,
4. Grzegorz Szczodrowski.

Organisation and Management Committee

(formerly the Remuneration Committee – re-named on June 14th 2008)

The Organisation and Management Committee is responsible for providing to the Supervisory Board opinions and recommendations regarding the management structure, including organisation-related solutions, remuneration system and recruitment of personnel, with a view to enabling the Company to achieve its strategic objectives.

In 2007, the Remuneration/Organisation and Management Committee was composed of:

from January 1st to June 14th 2007

1. Jan Stefanowicz – Chairman,
2. Beata Zawadzka,
3. Grzegorz Szczodrowski;

from June 14th to December 31st 2007

1. Marta Busz – Chairperson,
2. Grzegorz Szczodrowski,
3. Beata Zawadzka.

Audit Committee

The Audit Committee is responsible for the provision of ongoing advisory support to the Supervisory Board with respect to correct implementation of the policies related to budgetary and financial reporting, the Company's internal audit function and cooperation with its auditors.

In 2007, the Audit Committee was composed of:

from January 1st to June 14th 2007

1. Henryk Siodmok – Chairman,
2. Beata Zawadzka,
3. Jacek Mościcki;

from June 14th to December 31st 2007

1. Henryk Siodmok – Chairman,
2. Beata Zawadzka,
3. Jacek Mościcki,
4. Izabela Emerling.

4. KEY CHARACTERISTICS OF INTERNAL AUDIT AND RISK MANAGEMENT SYSTEMS ON WHICH THE COMPANY RELIES IN PREPARING ITS FINANCIAL STATEMENTS

Pursuant to the Minister of Finance's Regulation on current and periodic information to be published by issuers of securities, dated October 19th 2005, the Management Board of Grupa LOTOS S.A. is required to maintain the internal audit system and is responsible for its effectiveness in supporting the preparation of financial accounts.

The guidelines to be followed in the preparation, approval and publication of financial accounts are laid down in "Rules for the Preparation, Approval and Publication of Annual, Semi-Annual and Quarterly Reports of the LOTOS Group". In line with the existing procedure, preparation of consolidated and non-consolidated accounts is overseen by the Director of the Accounting and Finance Department together with the person responsible for keeping the accounting books of the parent company (Chief Accountant). Responsibility for preparing the consolidated and non-consolidated financial statements lies with the Financial Reporting Office operating within the parent company.

The basis for the preparation of consolidated accounts are the financial statements of the parent company and of material undertakings controlled by the parent company. The financial statements of subsidiaries, after restatements made to ensure compliance with the International Financial Reporting Standards ("IFRS"), are prepared in accordance with uniform accounting policies applied to transactions and economic events of similar nature. In order to ensure accounting uniformity, the accounting policies effective at the Company were implemented across the LOTOS Group companies for application in preparing their consolidation packages.

Both consolidated and non-consolidated financial statements are subject to review and audit by an independent qualified auditor. In line with the adopted procedure, the Audit Committee is required to acquaint itself with the audit findings, as well as the contents of the auditor's opinion and report on the annual/consolidated annual report, paying particular attention to:

- main areas covered by the audit,
- material non-typical transactions and possibility of using various solutions,
- issues which involve adoption of certain assumptions and use of estimates,
- material adjustments resulting from the audit,
- compliance with the applicable accountancy and financial reporting regulations.