



Consolidated report on payments to governments for 2016



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1. Basis of preparation

This consolidated report of payments to governments (the “report on payments” or the “report”) has been prepared in accordance with the Polish Accountancy Act of September 29th 1994 (Dz.U. of 2013, item 330, as amended) (the “Act”). The Act implements into the Polish legal system the provisions of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC. Pursuant to the Act, the LOTOS Group (“LOTOS Group”, “Group”) prepares a report on payments for each financial year with respect to extraction activities carried out through its upstream segment, which is engaged in the acquisition of crude oil and natural gas deposits and oil and gas production. The consolidated report on payments covers Grupa LOTOS S.A., as the Parent, and the entities it controls. Entities over which the Parent has joint control are not covered in this report.

2. Reporting rules

Types of activities covered in the report

In this report, the Group discloses payments made to governments in 2016 in connection with the operations of its upstream segment. These operations comprise exploration, prospecting, discovery, development, and extraction of minerals, oil, natural gas deposits or other materials (“upstream operations”). Payments related to the downstream segment, comprising production and processing of refined petroleum products and their wholesale and retail sale, as well as auxiliary, transport, and maintenance activities, are not covered in this report.

Governments

Government means any national, regional or local authority of the countries covered by this report, including a department, agency or undertaking controlled by that authority.

Payment

Payment means an amount paid, whether in money or in kind, accounted for on a cash basis. This means that the Group discloses a payment in the period when it is made. Cash basis is the opposite of accrual basis, where the disclosure is made in the period in which the liability arises. Payments made to the Group are also disclosed in the report on payments to governments in the period in which they are received by the Group and are presented at negative values. In the case of in-kind payments, the report discloses their volumes and values along with information on how the values were determined.

Project

In accordance with applicable regulations, payments are reported on a project basis (as a category within disclosure on a country basis). A project is defined as the operational activities that are governed by a single contract, license, lease, concession or similar legal agreements and form the basis for payment liabilities to a government. Nonetheless, if a number of such agreements are substantially interconnected, they are considered a project. Substantially interconnected legal agreements should be understood as a set of operationally and geographically integrated contracts, licenses, leases, concessions or related agreements with substantially similar terms that are signed with a government, giving rise to payment liabilities. Such agreements can be governed by a single contract, joint venture, production sharing agreement, or other overarching legal agreement. The Group determines that agreements or licences are substantially interconnected as a set of operationally and geographically integrated agreements if they are jointly managed, situated within a specific area, and based on shared infrastructure. The number of projects depends on contractual arrangements within a country rather than on the scale of operations.

Sometimes it may be impossible to disclose a payment at project level. In such cases, the Group discloses obligations imposed at the country level rather than at project level. Corporate income tax is a typical case in point.

Materiality threshold

The Group presents a payment in this report if a single payment or a sum of related payments in a given financial year is equivalent to PLN 424.7 thousand or more.

Transaction currency

The functional currency of the Parent and the presentation currency of this consolidated report on payments to governments is the Polish złoty ("złoty", "PLN"). This report has been prepared in thousands of złoty. Payments in foreign currencies are disclosed in this report after translation into the presentation currency based on the arithmetic mean of the mid rates quoted by the NBP for the last day of each full month of the financial year.

Joint operations

Settlements relating to field work performed jointly with other interest holders are made between the operator and consortium members by way of cash calls, which are then settled using the operator's billings issued after subsequent steps are completed.

Payments relating to joint operations, made by the Group directly to governments, are recognised in this report in full only if the Group is the project operator, even if the payments are spread pro rata between the other partners.

Payments are not disclosed in this report if other consortium members act as the operator as part of joint operations, and transfer the Group's share in payments to governments.

Payment categories

The reporting entities are required to disclose the total amount of payments made annually to governments in a given country, in money or in kind, for individual projects, if the payments are made with respect to:

- **Production entitlements**

The obligation to transfer a contractually agreed portion of output to the government of a country. These are usually in-kind payments. No production entitlements were paid in the period ended December 31st 2016.

- **Taxes**

This report includes taxes levied on income, production or profits of the Group entities, as well as taxes on dividends, royalties and interest received. Taxes levied on consumption, such as value added taxes, personal income taxes or sales taxes, as well as environmental taxes, customs and excise duties, are not subject to disclosure in this report.

- **Royalties**

Royalties are payments for oil and gas production licences, representing a share of production that is due to the holder of the licence. Royalties may be paid in money or in kind.

- **Dividends**

These include dividends paid to the State Treasury, other than dividends paid on the same terms as to other shareholders, unless they are paid in lieu of production entitlements or royalties. No dividend payments were made to governments in the year ended December 31st 2016.

- **Bonuses**

Bonuses are payments received, relating primarily to the achievement of or failure to achieve a certain production level and to a discovery of mineral deposits. No bonuses were paid in the period ended December 31st 2016.

- **Licence fees and other fees**

This category comprises licence fees, rental fees, entry fees, and other considerations for licences or concessions. Administrative fees that are not explicitly related to upstream operations are beyond the scope of this report.

- **Payments for infrastructure improvements**

These are payments related to construction (improvement) of infrastructure (roads, bridges), except where the infrastructure is used only for operating purposes. No payments for infrastructure improvements were made in the period ended December 31st 2016.

3. Payments by country

The tables below present payments to governments made by the LOTOS Group in the financial year 2016, broken down by country, type of payment, and the recipient government authority.

Country	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
Poland	-	2,214	-	12,085	-	-	14,298
Norway	-	9,047	-	(387)	-	-	8,660
Lithuania	-	-	9,508	1,750	-	-	11,258
Total	-	11,261	9,508	13,447	-	-	34,216

POLAND

Recipient government authority	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
Pomeranian Tax Office	-	(1,542)	-	-	-	-	(1,542)
Gdańsk Municipal Office	-	1,064	-	645	-	-	1,709
National Fund for Environmental Protection	-	-	-	9,933	-	-	9,933
Ministry of the Environment	-	-	-	1,435	-	-	1,435
Municipality and Town Municipal Offices	-	-	-	71	-	-	71
First Tax Office in Gdańsk	-	2,692	-	-	-	-	2,692
Total	-	2,214	-	12,084	-	-	14,298

Project	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
B-3 Project	-	-	-	5,613	-	-	5,613
B-8 Project	-	3,756	-	4,311	-	-	8,067
Łeba Project	-	-	-	1,093	-	-	1,093
Gaz Południe Project	-	-	-	252	-	-	252
Młynary Project	-	-	-	170	-	-	170
Payments not assigned to projects	-	(1,542)	-	645	-	-	(897)
Total	-	2,214	-	12,084	-	-	14,298

NORWAY

Recipient government authority	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
The Norwegian Petroleum Directorate	-	-	-	(387)	-	-	(387)
The Norwegian Tax Administration	-	9,047	-	-	-	-	9,047
Total	-	9,047	-	(387)	-	-	8,660

Project	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
PL35B	-	-	-	64	-	-	64
PL362	-	-	-	(451) ¹	-	-	(451)
PL029 (Sleipner West)	-	9,047	-	-	-	-	9,047
Total	-	9,047	-	(387)	-	-	8,660

¹ Licence fee – licence PL362 – paid in full in 2015; following the relinquishment of the licence in December 2015, a refund was received in the reporting period.

LITHUANIA

Recipient government authority	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
Tax inspection (LR VMI)	-	-	9,508	1,715	-	-	11,223
Palanga Municipality	-	-	-	9	-	-	9
Kretinga Municipality	-	-	-	26	-	-	26
Total	-	-	9,508	1,750	-	-	11,258

Project	Production entitlements	Taxes	Royalties	Fees	Bonuses	Payments for infrastructure improvements	Total
Palanga	-	-	1,041	416	-	-	1,457
Kretinga	-	-	4,914	486	-	-	5,400
Klaipėda	-	-	3,501	783	-	-	4,284
Plungė	-	-	52	65	-	-	117
Total	-	-	9,508	1,750	-	-	11,258