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## Corporate governance report

### Introduction

This Corporate Governance Report of joint stock company “Ventspils nafta” (hereafter – Ventspils nafta) covers year 2011 (hereinafter – the Report) and is prepared on the basis of requirements of the Financial Instruments Market Law 56.<sup>2</sup>, Paragraph 15.14 of NASDAQ OMX Riga Rules “On Listing and Trading of Financial Instruments on the Markets Regulated by the Exchange” and “Corporate Governance Principles and Recommendations on their Implementation” issued by NASDAQ OMX Riga, in force from June 1, 2010, and which are available at the website [www.nasdaqomxbaltic.com](http://www.nasdaqomxbaltic.com) in the section’s “Exchange information” subsection “Rules and regulations”.

The Report is prepared by the Management Board of Ventspils nafta and reviewed by the Supervisory Council of Ventspils nafta. The Report takes into consideration the “comply or explain” principle recommended in “Corporate Governance Principles and Recommendations on their Implementation” issued by NASDAQ OMX Riga.

In 2011, Ventspils nafta complied with majority of the corporate governance principles contained in “Corporate Governance Principles and Recommendations on their Implementation” issued by NASDAQ OMX Riga. The principles that Ventspils nafta did not comply with in 2011 are included in this report with explanations for non-compliance or inadequate implementation.

The Report is submitted to JSC “NASDAQ OMX Riga” together with Ventspils nafta audited consolidated financial statement for 2011, published on the official web site of Ventspils nafta [www.vnafta.lv](http://www.vnafta.lv) in Latvian and English.

Riga, 26 April 2012

On behalf of the Supervisory Council:

On behalf of the Management Board:

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Vladimir Egger

Chairman of the Supervisory Council

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Simon Boddy

Chairman of the Management Board

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## Corporate governance report (cont'd)

### Principles of good corporate governance implemented by JSC “Ventspils Nafta” in 2011

#### A. Shareholders meeting

Shareholders exercise their right to participate in the management of the Issuer at shareholders' meetings. In compliance with legal acts the Issuer shall call the annual shareholders' meeting as minimum once a year. Extraordinary shareholders' meetings shall be called as required.

#### 1. Ensuring shareholders' rights and participation at shareholders' meetings

The Issuer shall ensure equal attitude towards all the shareholders – holders of one category of shares. All shareholders shall have equal rights to participate in the management of the Issuer – to participate at shareholders' meetings and receive information that shareholders need in order to make decisions.

- 1.1. It shall be important to ensure that all the holders of shares of one category have also equal rights, including the right to receive a share of the Issuer's profit as dividends or in another way in proportion to the number of the shares owned by them if such right is stipulated for the shares owned by them.

*According to the Articles of Association, Ventspils nafta has issued bearer and registered shares that are of one category and all entitle shareholders to receive dividends, liquidation quotas and right to vote at shareholders' meetings. Bearer shares are currently included in the regulated market of NASDAQ OMX Riga. Ventspils nafta has in total issued 104,479,519 shares, which include 60,598,121 bearer shares and – 43,881,398 registered shares. Therefore, Ventspils nafta complied with this best practice provision.*

- 1.2. The Issuer shall prepare a policy for the profit distribution. In the preparation of the policy, it is recommended to take into account not only the provision of immediate benefit for the Issuer's shareholders by paying dividends to them but also the expediency of profit reinvesting, which would increase the value of the Issuer in future. It is recommended to discuss the policy of profit distribution at a shareholders' meeting thus ensuring that as possibly larger a number of shareholders have the possibility to acquaint themselves with it and to express their opinion on it. In the Report, the Issuer shall specify where the Issuer's profit distribution policy is available.

*At the moment, Ventspils nafta has not developed a profit distribution policy. According to the Commercial Law the shareholders' meeting shall resolve on profit distribution. Taking into consideration the fact that the Management Board and the Supervisory Council of Ventspils nafta have not received proposals from its shareholders relating to profit distribution policy, administrative bodies of Ventspils nafta have not made a decision about development of a profit distribution policy.*

- 1.3. In order to protect the Issuer's shareholders' interest to a sufficient extent, not only the Issuers but also any other persons who in compliance with the procedure stipulated in legislative acts call, announce and organize a shareholders' meeting are asked to comply with all the issues referred to in these Recommendations in relation to calling shareholders' meetings and provision of shareholders with the required information.

*In 2011 only the Management Board convoked shareholders meetings and complied with all the issues referred to in these Recommendations in relation to calling shareholders' meetings and provision of shareholders with the required information. Therefore, Ventspils nafta complied with this best practice provision.*

- 1.4. Shareholders of the Issuers shall be provided with the possibility to receive in due time and regularly all the required information on the relevant Issuer, participate at meetings and vote on agenda issues. The Issuers shall carry out all the possible activities to achieve that as many as possible shareholders participate at meetings; therefore, the time and place of a meeting should not restrict the attendance of a meeting by shareholders. Therefore, it should not be admissible to change the time and place of an announced shareholders' meeting shortly before the meeting, which thus would hinder or even make it impossible for shareholders to attend the meeting.

*In 2011 all shareholders' meetings of Ventspils nafta were held in Riga, at the hotel “Hotel de Rome” and the hotel “Konventa Sēta”, which is convenient for shareholders. The time and venue of the meeting were not changed. Therefore, Ventspils nafta complied with this best practice provision in 2011.*

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## Corporate governance report (cont'd)

- 1.5. The Issuers shall inform their shareholders on calling a shareholders' meeting by publishing a notice in compliance with the procedure and the time limits set forth in legislative acts. The Issuers are asked to announce the shareholders' meeting as soon as the decision on calling the shareholders' meeting has been taken; in particular, this condition applies to extraordinary shareholders' meetings. The information on calling a shareholders' meeting shall be published also on the Issuer's website on the Internet, where it should be published also at least in one foreign language. It is recommended to use the English language as the said other language so that the website could be used also by foreign investors. When publishing information on calling a shareholders' meeting, also the initiator of calling the meeting shall be specified.

*Ventspils nafta* complied with this best practice provision.

- 1.6. The Issuer shall ensure that comprehensive information on the course and time of the meeting, the voting on decisions to be adopted, as well as the agenda and draft decisions on which it is planned to vote at the meeting is available in due time to the shareholders. The Issuers shall also inform the shareholders whom they can address to receive answers to any questions on the shareholders' meeting and the agenda issues and ensure that the required additional information is provided to the shareholders.

*See comment on Clause 1.4. In 2011 Ventspils nafta* complied with this best practice provision.

- 1.7. The Issuer shall ensure that at least 14 (fourteen) days prior to the meeting the shareholders have the possibility to acquaint themselves with the draft decisions on the issues to be dealt with at the meeting, including those that have been submitted additionally already after the announcement on calling the meeting. The Issuer shall ensure the possibility to read a complete text of draft decisions, especially if they apply to voting on amendments to the Issuer's statutes, election of the Issuer's officials, determination of their remuneration, division of the Issuer's profit and other issues.

*See comment on Clause 1.4. In 2011 Ventspils nafta* complied with this best practice provision.

- 1.8. In no way may the Issuers restrict the right of shareholders to nominate representatives of the shareholders for Supervisory Council elections. The candidates to the Supervisory Council and candidates to other offices shall be nominated in due time so that the information on the said persons would be available to the shareholders to the extent as stipulated in Clause 1.9 of this Section as minimum 14 (fourteen) days prior to the shareholders' meeting.

*Ventspils nafta* encourages shareholders to nominate the candidates to the Supervisory Council and candidates to other offices in due time so that the information on the said persons is be available to all shareholders to the extent as stipulated in Clause 1.9 of this Section as minimum 14 (fourteen) days prior to the shareholders' meeting. Therefore in 2011, *Ventspils nafta* complied with this best practice provision as much as it was dependent on the management board of the *Ventspils nafta*.

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## Corporate governance report (cont'd)

- 1.9. Special attention should be paid that the shareholders at least 14 (fourteen) days prior to the shareholders' meeting have the possibility to acquaint themselves with information on Supervisory Council member candidates, as well as candidates of members of the audit committee whose approval is planned at the meeting. When disclosing information on Supervisory Council member candidates, also a short personal biography of the candidates shall be published.

*Ventspils nafta encourages shareholders to nominate candidates to the Supervisory Council and other offices at least 14 (fourteen) days prior to the shareholders' meeting, so that shareholders are able to acquaint themselves with information on candidates, whose approval is planned at the meeting. Ventspils nafta encourages shareholders when disclosing information on Supervisory Council member candidates, to also publish a short personal biography of the candidates. Therefore in 2011, Ventspils nafta complied with this best practice provision as much as it was dependent on the management board of the Ventspils nafta.*

- 1.10. The Issuer may not restrict the right of shareholders to consult among themselves during a shareholders' meeting if it is required in order to adopt a decision or to make clear some issue.

*Ventspils nafta does not restrict the right of shareholders to consult among themselves during a shareholders' meeting if it is required in order to adopt a decision or to make clear some issue; therefore, Ventspils nafta complied with this best practice provision.*

- 1.11. To provide shareholders with comprehensive information on the course of the shareholders' meeting, the Issuer shall prepare the regulations on the course of shareholders' meeting, in which the agenda of shareholders' meeting and the procedure for solving any organizational issues connected with the shareholders' meeting (e.g., registration of meeting participants, the procedure for the adoption of decisions on the issues to be dealt with at the meeting, the Issuer's actions in case any of the issues on the agenda is not dealt with, if it is impossible to adopt a decision etc.). The procedures adopted by the Issuer in relation to participation in voting shall be easy to implement.

*In order to ensure smooth process of shareholders' registration for the meeting and in due time solve possible problem, Ventspils nafta has determined that shareholders shall inform the Management Board of Ventspils nafta about the representatives and authorised persons of shareholders who shall participate in the meeting, by submitting copies of the power of attorneys or the documents certifying the authorisation at least 5 (five) days before the day of shareholders' meeting.*

*At the shareholders meetings of Ventspils nafta the chairman of the meeting who is elected according to the Commercial law, suggests to determine the regulations for the discussions and decision making during the shareholders' meeting which is in force only in case the shareholders meeting approves them with majority of votes; therefore, Ventspils nafta complied with this best practice provision.*

- 1.12. The Issuer shall ensure that during the shareholders' meeting the shareholders have the possibility to ask questions to the candidates to be elected at the shareholders' meeting and other attending representatives of the Issuer. The Issuer shall have the right to set reasonable restrictions on questions, for example, excluding the possibility that one shareholder uses up the total time provided for asking of questions and setting a time limit of speeches.

*The shareholders meetings in 2011 were attended only by members of the Management Board and a part of the candidates to be elected at the shareholders' meeting; therefore, Ventspils nafta partly complied with this best practice provision.*

- 1.13. When recording the course and contents of discussions on the agenda issues to be dealt with at the shareholders' meeting in the minutes, the chairperson of the meeting shall ensure that, in case any meeting participant requires it, particular debates are reflected in the minutes, or that shareholder proposals or questions are appended thereto in written form.

*Ventspils nafta complied with this best practice provision.*

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## Corporate governance report (cont'd)

### 2. Participation of members and member candidates of the Issuer's management institutions at shareholders' meetings

**Shareholders' meetings shall be attended by the Issuer's Management Board members, auditors, and as possibly many Supervisory Council members.**

- 2.1. The attendance of members of the Issuer's management institutions and auditor at shareholders' meetings shall be necessary to ensure information exchange between the Issuer's shareholders and members of management institutions as well as to fulfill the right of shareholders to receive answers from competent persons to the questions submitted. The attendance of the auditor shall not be mandatory at shareholders' meetings not discussing the finances of the Issuer. By using the right to ask questions, shareholders have the possibility to obtain information on the circumstances that might affect the evaluation of the financial report and the financial situation of the Issuer.

*Ventspils nafta complied with this best practice provision.*

- 2.2. Shareholders' meetings shall be attended by the Issuer's official candidates whose election is planned at the meeting. This shall in particular apply to Supervisory Council members. If a Supervisory Council member candidate or auditor candidate is unable to attend the shareholders' meeting due to an important reason, then it shall be admissible that this person does not attend the shareholders' meeting. In this case, all the substantial information on the candidate shall be disclosed before the shareholders' meeting.

*See comment on Clause 2.1. Ventspils nafta complied with this best practice provision.*

- 2.3. During shareholders' meetings, the participants must have the possibility to obtain information on officials or official candidates who do not attend the meeting and reasons thereof. The reason of non-attendance should be entered in the minutes of shareholders' meeting.

*During shareholders' meetings, the shareholders had the possibility to obtain information on officials or official candidates who do not attend the meeting and reasons thereof. It is recorded in the minutes of the shareholders' meeting, which officials have arrived to the shareholders' meeting, yet the reason of absence of individual officials is not specified. Ventspils nafta complied with this best practice provision.*

#### B. Management Board

The Management Board is the Issuer's executive institution, which manages and represents the Issuer in its everyday business, therefore the Issuer shall ensure that it is efficient, able to take decisions, and oriented to increasing the company's value, therefore its obligations and responsibilities have to be clearly determined.

### 3. Obligations and responsibilities of the Management Board

**The Issuers shall clearly and expressively determine the obligations and authorities of the Management Board and responsibilities of its members, thus ensuring a successful work of the Management Board and an increase in the Issuer's value.**

- 3.1. The Management Board shall have the obligation to manage the business of the Issuer, which includes also the responsibility for the realization of the objectives and strategies determined by the Issuer and the responsibility for the results achieved. The Management Board shall be responsible for the said to the Supervisory Council and the shareholders' meeting. In fulfillment of its obligations, the Management Board shall adopt decisions based on interests of all shareholders and avoiding the possibilities of conflicts of interests.

*The Management Board of Ventspils nafta adopts decisions based on interests of all shareholders and avoiding the possibilities of conflicts of interests. Therefore, Ventspils nafta complied with this best practice provision.*

- 3.2. The powers of the Management Board shall be stipulated in the Management Board Regulations or a similar document, which is to be published on the website of the Issuer on the Internet. This document must be also available at the registered office of the Issuer.

*The powers of the Management Board are stipulated in the Articles of Association of Ventspils nafta that are published in the website of Ventspils nafta. The Management Board Regulations, which are elaborated on the basis of Articles of Association of Ventspils nafta and rules of the Commercial Law provide for the organizing working principles of the Management Board. The Management Board Regulations are available in the registered office of Ventspils nafta but not published on the website of the Company; therefore, Ventspils nafta complied with this best practice provision.*

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## Corporate governance report (cont'd)

- 3.3. The Management Board shall be responsible also for the compliance with all the binding regulatory acts, risk management, as well as the financial activity of the Issuer.

*Ventspils nafta complied with all the binding regulatory acts, ensured risk management, as well as the financial activity of the Ventspils nafta. Therefore, Ventspils nafta complied with this best practice provision.*

- 3.4. The Management Board shall perform certain tasks, including:

- 1) corporate strategies, work plan, risk control procedure, assessment and advancement of annual budget and business plans, ensuring control on the fulfilment of plans and the achievement of planned results;
- 2) selection of senior managers of the Issuer, determination of their remuneration and control of their work and their replacement, if necessary, in accordance with the effective internal procedures (e.g. by complying with the personnel policy adopted by the Issuer; remuneration policy, etc.)
- 3) timely and qualitative submission of reports, ensuring also that the internal audits are carried out and the disclosure of information is controlled.

*Ventspils nafta complied with this best practice provision.*

- 3.5. In annual reports, the Management Board shall confirm that the internal risk procedures are efficient and that the risk management and internal control have been carried out in compliance with the said control procedures throughout the year.

*In the annual report, the Management Board confirmed that the internal risk procedures are efficient and that the risk management and internal control have been carried out in compliance with the determined control procedures throughout the year; therefore, Ventspils nafta complied with this best practice provision.*

- 3.6. It shall be preferable that the Management Board submits decisions that determine the objectives and strategies for achievement thereof (participation in other companies, acquisition or alienation of property, opening of representation offices or branches, expansion of business etc) to the Issuer's Supervisory Council for approval.

*Ventspils nafta complied with this best practice provision.*

### **4. Management Board composition and requirements for the Management Board members**

**A Management Board composition approved by the Issuer shall be able to ensure sufficiently critical and independent attitude in assessing and taking decisions.**

- 4.1. In composing the Management Board, it shall be observed that every Management Board member has appropriate education and work experience. The Issuer shall prepare a summary of the requirements to be set for every Management Board member, which specifies the skills, education, previous work experience and other selection criteria for every Management Board member.

*Ventspils nafta complied with this best practice provision.*

- 4.2. On the Issuer's website on the Internet, the following information on every Issuer's Management Board member shall be published: name, surname, year of birth, education, office term, position, description of the last three year's professional experience, number of the Issuer's or its parent company's/subsidiary's shares owned by the member, information on positions in other capital companies.

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## Corporate governance report (cont'd)

*Ventspils nafta partially complied with this best practice provision.*

- 4.3. In order to fulfill their obligations successfully, Management Board members must have access in due time to accurate information on the activity of the Issuer. The Management Board must have the possibility to provide objective evaluation on the activity of the Issuer. Management Board members must have enough time for the performance of their duties.

*Ventspils nafta complied with this best practice provision.*

- 4.4. It is not recommended to elect one and the same Management Board member for more than four successive terms. The Issuer has to evaluate whether its development will be facilitated in the result of that and whether it will be possible to avoid a situation where greater power is concentrated in hands of one or a number of separate persons due to their long-term work at the Issuer. If, however, such election is admitted, it shall be recommended to consider changing of the field of work of the relevant Management Board member at the Issuer.

*None of the members of the Management Board of Ventspils nafta has been elected for more than four successive terms; therefore, Ventspils nafta complied with this best practice provision.*

### **5. Identification of interest conflicts in the work of the Management Board members**

**Every Management Board member shall avoid any interest conflicts in his/her work and be maximally independent from any external circumstances and wishing to assume responsibility for the decisions taken and comply with the general ethical principles in adopting any decisions connected with the business of the Issuer.**

- 5.1. It shall be the obligation of every Management Board member to avoid any, even only supposed, interest conflicts in his/her work. In taking decisions, Management Board members shall be guided by the interests of the Issuer and not use the cooperation offers proposed to the Issuer to obtain personal benefit.

*Ventspils nafta complied with this best practice provision.*

- 5.2. On the occurrence of any interest conflict or even only on its possibility, a Management Board member shall notify other Management Board members without delay. Management Board members shall notify on any transaction or agreement the Issuer is planning to conclude with a person who has close relationship or is connected with the Management Board member in question, as well as inform on any interest conflicts occurred during the validity period of concluded agreements.

For the purposes of these Recommendations the following shall be regarded as persons who have close relationship with a board member: spouses, a relative or brother-in-law, including kinship of second degree or brother-in-law of first degree, or persons with whom the Management Board member has had a common household for at least one year. For the purposes of these recommendations the following shall be regarded as persons who are connected with a Management Board member: legal persons where the Management Board member or a person closely related to him/her is a Management Board or Supervisory Council member, performs the tasks of an auditor or holds another managing office in which he or she could determine or affect the business strategy of the respective legal entity.

*Ventspils nafta complied with this best practice provision.*

- 5.3. Management Board members should not participate in taking decisions that could cause an interest conflict.

*Ventspils nafta complied with this best practice provision.*

### **C. Supervisory Council**

In compliance with legal acts a Supervisory Council is the institution that supervises the Issuer and represents interests of shareholders between meetings and, in cases stipulated in the law and in the statutes of the Issuer, supervises the work of the Management Board.

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## Corporate governance report (cont'd)

### 6. Obligations and responsibilities of the Supervisory Council

The objective of the Issuer's Supervisory Council is to act in the interests of all the shareholders, ensuring that the value of the Issuer grows. The Issuer shall clearly determine the obligations of the Supervisory Council and the responsibility of the Supervisory Council members, as well as ensure that individual Supervisory Council members or a group thereof do not have a dominating role in decision making.

- 6.1. The functions of the Supervisory Council shall be set forth in the Supervisory Council regulation or a document equated thereto that regulates the work of the Supervisory Council, and it shall be published on the Issuer's website on the Internet. This document shall be also available at the Issuer's office.

*The functions of the Supervisory Council are stipulated in the Articles of Association of Ventspils nafta that are published in the website of Ventspils nafta. The Supervisory Council Regulations, which are elaborated on the basis of Articles of Association of Ventspils nafta and rules of the Commercial Law, provide for the organizing working principles of the Supervisory Council. The Supervisory Council Regulations of Ventspils nafta are available in the registered office of Ventspils nafta but not on the website; therefore, Ventspils nafta complied with this best practice provision.*

- 6.2. The supervision carried out by the Supervisory Council over the work of the Management Board shall include supervision over the achievement of the objectives set by the Issuer, the corporate strategy and risk management, the process of financial accounting, Management Board's proposals on the use of the profit of the Issuer, and the business performance of the Issuer in compliance with the requirements of regulatory acts. The Supervisory Council should discuss every of the said matters and express its opinion at least annually, complying with frequency of calling Supervisory Council meetings as laid down in regulatory acts, and the results of discussions shall be reflected in the minutes of meetings of the Supervisory Council's.

*In 2011 the Supervisory Council carried out sufficient supervision over the achievement of the objectives set by the Company, the corporate strategy and risk management, the process of financial accounting and the business performance of the Company in compliance with the requirements of regulatory acts; therefore, Ventspils nafta complied with this best practice provision.*

- 6.3. The Supervisory Council and every its member shall be responsible that they have all the information required for them to fulfill their duties, obtaining it from Management Board members and internal auditors or, if necessary, from employees of the Issuer or external consultants. To ensure information exchange, the Supervisory Council chairperson shall contact the Issuer's Management Board, inter alia the Management Board chairperson, on a regular basis and discuss all the most important issues connected with the Issuer's business and development strategy, business activities, and risk management.

*Ventspils complied with this best practice provision.*

- 6.4. When determining the functions of the Supervisory Council, it should be stipulated that every Supervisory Council member has the obligation to provide explanations in case the Supervisory Council member is unable to participate in Supervisory Council meetings. It shall be recommended to disclose information on the Supervisory Council members who have not attended more than a half of the Supervisory Council meetings within a year of reporting, providing also the reasons for non-attendance.

*The Regulations of the Supervisory Council do not provide that a Supervisory Council member shall have an obligation to provide explanations in case of being unable to participate in a Supervisory Council meeting.*



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## Corporate governance report (cont'd)

### 7. Supervisory Council composition and requirements for Supervisory Council members

The Supervisory Council structure determined by the Issuer shall be transparent and understandable and ensure sufficiently critical and independent attitude in evaluating and taking decisions.

- 7.1. The Issuer shall require every Supervisory Council member as well as Supervisory Council member candidate who is planned to be elected at a shareholders' meeting that they submit to the Issuer the following information: name, surname, year of birth, education, office term as a Supervisory Council member, description of the last three year's Professional experience, number of the Issuer's or its parent companies/subsidiaries shares owned by the member, information on positions in other capital companies. The said information shall be published also on the Issuer's website on the Internet, providing, in addition to the said information, also the term of office for which the Supervisory Council member is elected, its position, including also additional positions and obligations, if any.

*Ventspils nafta partially complied with this best practice provision.*

- 7.2. When determining the requirements for Supervisory Council members as regards the number of additional positions, attention shall be paid that a Supervisory Council member has enough time to perform his or her duties in order to fulfill their duties successfully and act in the interests of the Issuer to a full extent.

*Ventspils nafta complied with this best practice provision.*

- 7.3. In establishing the Issuer's Supervisory Council, the qualification of Supervisory Council members should be taken into account and assessed on a periodical basis. The Supervisory Council should be composed of members whose knowledge, opinions and experience is varied, which is required for the Supervisory Council to fulfil their tasks successfully.

*Ventspils nafta complied with this best practice provision.*

- 7.4. Every Supervisory Council member in his or her work shall be as possibly independent from any external circumstances and have the will to assume responsibility for the decisions taken and comply with the general ethical principles when taking decisions in relation to the business of the Issuer.

*Ventspils nafta complied with this best practice provision.*

- 7.5. It is impossible to compile a list of all the circumstances that might threaten the independence of Supervisory Council members or that could be used in assessing the conformity of a certain person to the status of an independent Supervisory Council member. Therefore, the Issuer, when assessing the independence of Supervisory Council members, shall be guided by the independence criteria of Supervisory Council members specified in the Annex hereto.

*The Management Board of Ventspils nafta encourages its shareholders to apply this best practice provision.*

- 7.6. It shall be recommended that at least a half of Supervisory Council members are independent according to the recommended independence criteria specified by NASDAQ OMX Riga. If the number of Supervisory Council members is an odd number, the number of independent Supervisory Council members may be one person less than the number of the Supervisory Council members who do not conform to the recommended independence criteria specified by NASDAQ OMX Riga.

*The Management Board of Ventspils nafta encourages its shareholders to apply this best practice provision.*

- 7.7. As independent shall be considered persons that conforms to the recommended independence criteria specified by NASDAQ OMX Riga. If a Supervisory Council member does not conform to any of the recommended independence criteria specified by NASDAQ OMX Riga but the Issuer does consider the Supervisory Council member in question to be independent, then it shall provide an explanation of its opinion in detail on the tolerances permitted.

*Ventspils nafta did not comply with this best practice provision. According to Commercial Law nominating candidates for the Supervisory Council and electing members of the Supervisory Council is in the competency of the shareholders' meeting.*

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## Corporate governance report (cont'd)

- 7.8. The conformity of a person to the independence criteria of Supervisory Council members recommended by NASDAQ OMX Riga shall be evaluated already when the Supervisory Council member candidate in question has been nominated for election to the Supervisory Council. The Issuer shall specify in the Report who of the Supervisory Council members are to be considered as independent every year.

*The Management Board of Ventspils nafta encourages its shareholders to apply this best practice provision. Ventspils nafta did not comply with this best practice provision, see also Article 7.7 above.*

### 8. Identification of interest conflicts in the work of the Supervisory Council members

**Every Supervisory Council member shall avoid any interest conflicts in his/her work and be maximally independent from any external circumstances. Supervisory Council members shall comply with the general ethical principles in adopting any decisions connected with the business of the Issuer and assume responsibility for the decisions taken.**

- 8.1. It shall be the obligation of every Supervisory Council member to avoid any, even only supposed, interest conflicts in his/her work. When taking decisions, Management Board members shall be guided by the interests of the Issuer and not use the cooperation offers proposed to the Issuer to obtain personal benefit.

*Ventspils nafta complied with this best practice provision.*

- 8.2. On the occurrence of any interest conflict or even only on its possibility, a Supervisory Council member shall notify other Supervisory Council members without delay. Supervisory Council members shall notify on any deal or agreement the Issuer is planning to conclude with a person who has close relationship or is connected with the Supervisory Council member in question, as well as inform on any interest conflicts occurred during the validity period of concluded agreements.

For the purposes of these recommendations the following shall be regarded as persons who have close relationship with a Supervisory Council member: spouses, a relative, including kinship of second degree or brother-in-law of first degree, or persons with whom the Supervisory Council member has had a common household for at least one year. For the purposes of these recommendations the following shall be regarded as persons who are connected with a Supervisory Council member: legal persons where the Supervisory Council member or a closely related to him/her person is a Management Board or Supervisory Council member, performs the tasks of an auditor or holds another managing office in which he or she could determine or affect the business strategy of the respective legal entity.

*Ventspils nafta complied with this best practice provision.*

- 8.3. A Supervisory Council member who is in a possible interest conflict should not participate in decision taking that might be a cause of an interest conflict.

*Ventspils nafta complied with this best practice provision.*

### D. Disclosure of information

Good practice of corporate governance for an Issuer whose shares are included in the market regulated by the Stock Exchange means that the information disclosed by the Issuer has to provide a view on the economic activity of the Issuer and its financial results. This facilitates a justified determination of the price of financial instruments in public circulation as well as the trust in finance and capital markets. Disclosure of information is closely connected with investor relations (hereinafter – the IR), which can be defined as the process of developing Issuer's relations with its potential and existing investors and other parties interested in the business of the Issuer.

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## Corporate governance report (cont'd)

### 9. Transparency of the Issuer's business

The information disclosed by the Issuer shall be provided in due time and allowing the shareholders to assess the management of the Issuer, to get an idea on the business of the company and its financial results, as well as to take grounded decisions in relation to the shares owned by them.

- 9.1. The structure of corporate governance shall be established in a manner that ensures provision of timely and exhaustive information on all the substantial matters that concern the Issuer, including its financial situation, business results, and the structure of owners.

*Ventspils nafta complied with this best practice provision.*

- 9.2. The information disclosed shall be checked, precise, and unambiguous and prepared in compliance with high-quality standards.

*Ventspils nafta complied with this best practice provision.*

- 9.3. The Issuers should appoint a person who would be entitled to contact the press and other mass media on behalf on the Issuer, thus ensuring uniform distribution of information and evading publication of contradictory and untruthful information, and this person could be contacted, if necessary, by the Stock Exchange and investors.

*Ventspils nafta complied with this best practice provision.*

- 9.4. The Issuers should ensure timely and compliant with the existing requirements preparation and disclosure of financial reports and annual reports of the Issuer. The procedure for the preparation of reports should be stipulated in the internal procedures of the Issuer.

*Ventspils nafta has established a control and risk management system, which is applied when preparing financial statements. The internal control and management system of Ventspils nafta, which is applied for preparation of financial reports is formed so that it would give sufficient assurance that the financial statements that are prepared for the needs of external users in accordance with International Financial Statement Standards give a clear and true view of the financial situation of Ventspils nafta and its operating results. The internal control and risk management system of Ventspils nafta, which is applied in preparation of financial statements, includes procedures that:*

*(1) ensure that complete, precise and systematically arranged accounting entries are timely made and saved in order to truly reflect economic transactions made by Ventspils nafta, as well as extent of assets and liabilities of Ventspils nafta;*

*(2) ensure sufficient assurance that transactions are reflected in such way that financial statements could be prepared in accordance with International Financial Statement Standards;*

*(3) ensure that receipts and expenditures of Ventspils nafta are made only in accordance with authorization of Ventspils nafta management;*

*(4) ensure sufficient assurance that unauthorized acquisition, usage or sale of assets of Ventspils nafta, which could considerably affect financial reports of Ventspils nafta, is prevented and timely discovered.*

*Therefore, Ventspils nafta complied with this best practice provision.*

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## Corporate governance report (cont'd)

### 10. Investor relations

**Considering that shares of the Issuers are offered on a regulated market, also such activity sphere of the Issuers as investor relations (hereinafter – the IR) and the development and maintaining thereof is equally important, paying special attention to that all the investors have access to equal, timely and sufficient information.**

- 10.1. The main objectives of the IR are the provision of accurate and timely information on the business of the Issuer to participants of finance market, as well as the provision of a feedback, i.e. receiving references from the existing and potential investors and other persons. In the realization of the IR process, it shall be born in mind that the target group consists not only of institutional investors and finance market analysts. A greater emphasis should be put on individual investors, and more importance should be attached to informing other interested parties: employees, creditors and business partners.

*Ventspils nafta complied with this best practice provision.*

- 10.2. The Issuer shall ensure that all investors have equal and convenient access to important information related to the Issuer, including information on the Issuer's financial position, property structure and administration. The issuer shall provide information in clear and easily comprehensible language, revealing both the positive and the negative information in relation to the Issuer, thereby providing the investors with complete and comprehensive information on the Issuer, enabling the investors to evaluate all the information before taking a decision.

*Ventspils nafta complied with this best practice provision.*

- 10.3. A number of channels shall be used for the information flow in the IR. The IR strategy of the Issuer shall be created using both the possibilities provided by technologies (website) and relations with mass media and the ties with the participants of finance market. Considering the development stage of modern technologies and the accessibility thereof, the Internet is used in the IR of every modern company. This type of media has become one of the most important means of communications for the majority of investors.

*For the information flow in the IR Ventspils nafta uses possibilities provided by technologies (website), relations with mass media and ties with the participants of finance market; therefore, Ventspils nafta complied with this best practice provision.*

- 10.4. The basic principles that should be observed by the Issuers in preparing the IR section of their websites:
- 1) The IR section of website shall be perceived not only as a store of information or facts but also as one of the primary means of communication by means of which it is possible to inform the existing and potential shareholders;
  - 2) all the visitors of the IR section of website shall have the possibility to obtain conveniently all the information published there. Information on websites shall be published in all the foreign languages in which the Issuer normally distributes information so that in no way would foreign investors be discriminated, however, it shall be taken into account that information must be disclosed at least in Latvian and English;
  - 3) It shall be recommended to consider a solution that would allow the existing and potential investors to maintain ties with the Issuer by using the IR section of website – submit questions and receive answers thereto, order the most recent information, express their opinions etc.;
  - 4) the information published on websites shall be updated on a regular basis, and the news in relation to the Issuer and its business shall be published in due time. It shall not be admissible that outdated information that could mislead investors is found on websites;
  - 5) after the website is created the creators themselves should assess the IR section of the website from the point of view of users – whether the information of interest can be found easily, whether the information published provides answers to the most important questions etc.

*Ventspils nafta complied with this best practice provision.*

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## Corporate governance report (cont'd)

- 10.5. The Issuer shall ensure that at least the following information is contained in the IR section of website:
- 1) general information on the Issuer - history of its establishment and business, registration data, description of industry, main types of business;
  - 2) Issuer's Report ("comply or explain") on the implementation of the principles of corporate governance;
  - 3) Number of issued and paid financial instruments, specifying how many of them are included in a regulated market;
  - 4) information on shareholders' meetings, draft decisions to be examined, decisions adopted – at least for the last year of report;
  - 5) Issuer's statutes;
  - 6) Issuer's Management Board or Supervisory Council regulation or a document equated thereto that regulates its work, as well as the Issuer's remuneration policy (or a reference as to where it can be familiarized with) and the shareholders' meeting procedure regulation, if such has been adopted;
  - 7) Information on performance of the Audit Committee;
  - 8) information on present Issuer's Supervisory Council and Management Board members (on each individually): work experience, education, number of the Issuer's shares owned by the member (as at the beginning of year; the information shall be updated as required but at least annually), information on positions in other capital companies, and the term of office of Management Board and Supervisory Council members;
  - 9) Issuer's shareholders which/who own at least 5% of the Issuer's shares; and information on changes of shareholders;
  - 10) Financial reports and annual reports of the Issuer prepared in compliance with the procedure specified in legal acts and the Stock Exchange regulations;
  - 11) Any other information to be disclosed by the Issuer, e.g. information on any substantial events, Issuer's press releases, archived information on Issuer's financial and annual reports on previous periods etc.

*Although particular information is not published in the website of Ventspils nafta, overall Ventspils nafta complied with this best practice provision, see also Clause 7.1.*

### *E. Internal control and risk management*

**The purpose of internal control and risk management is to ensure efficient and successful work of the Issuer, the truthfulness of the information disclosed and conformity thereof to the relevant regulatory acts and business principles. Internal control helps the Management Board to identify the shortcomings in the administration of the Issuer as well as facilitates that the Supervisory Council's task - to supervise the work of the Management Board - is fulfilled efficiently.**

#### **11. Principles of the Issuer's internal and external control**

**To ensure successful work of the Issuer, it shall be necessary to plan regular its controls and to determine the procedure of internal and external (audit) control.**

- 11.1. To ensure successful operation, the Issuer shall control its work on a regular basis and define the procedure of internal control.

*Ventspils nafta complied with this best practice provision.*

- 11.2. The objective of risk management is to ensure that the risks connected with the commercial activity of the Issuer are identified and supervised. To ensure an efficient risk management, it shall be necessary to define the basic principles of risk management. It is recommended to characterize the most essential potential and existing risks in relation to the business of the Issuer.

*Ventspils nafta has characterized the most essential potential and existing risks in relation to the business of the company; therefore, Ventspils nafta complied with this best practice provision.*

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## Corporate governance report (cont'd)

- 11.3. Auditors shall be granted access to the information required for the fulfillment of the auditor's tasks and the possibility to attend Supervisory Council and Management Board meetings at which financial and other matters are dealt with.

*Ventspils nafta* complied with this best practice provision.

- 11.4. Auditors shall be independent in their work and their task shall be to provide the Issuer with independent and objective auditing and consultation services in order to facilitate the efficiency of the Issuer's business and to provide support in achieving the objectives set for the Issuer's management by offering a systematic approach for the assessment and improvement of risk management and control processes.

*Ventspils nafta* complied with this best practice provision.

- 11.5. It shall be recommended to carry out an independent internal control at least annually in order to assess the work of the Issuer, including its conformity to the procedures approved by the Issuer.

*Ventspils nafta* complied with this best practice provision.

- 11.6. When approving an auditor, it is recommended that the term of office of one auditor is not the same as the term of office of the Management Board.

*Ventspils nafta* complies with this best practice provision.

## 12. Audit Committee of the Issuer

**Audit Committee is established by a resolution of shareholders' meeting of the Issuer, defining its operation principles and scope of responsibility in accordance with the requirements of legislative acts.**

- 12.1. Functions and responsibility of the Audit Committee should be defined in regulations of the Committee or an equal document.

*Ventspils nafta* is currently working on regulations that will specify the Audit Committee's functions in more detail; therefore, *Ventspils nafta* will comply with this best practice provision in future.

- 12.2. In order to ensure effective work of the Audit Committee, it is desirable that it would consist of at least members having sufficient knowledge in accounting and preparation of financial statements, as one of the main areas of activities of the Audit Committee is matters related to the Issuer's financial reports and control.

*Ventspils nafta* complied with this best practice provision.

- 12.3. Information on the accounting methods used by the Issuer shall be available to all members of the Audit Committee. The Management Board shall inform the Audit Committee on the methods that are used when evaluating significant and uncommon transactions where different methods might be applied to the evaluation, as well as ensure that all the information prescribed by legislative acts shall be available to the Audit Committee.

*Ventspils nafta* complied with this best practice provision.

- 12.4. The Issuer shall ensure that it is possible for the Audit Committee to obtain the information necessary to ensure operation of the Committee from the Issuer's officials, Management Board members and other employees, as well as rights to carry out independent investigation in order to discover within its authority violations in the Issuer's activity.

*Ventspils nafta* complied with this best practice provision.

- 12.5. Audit Committee shall make decisions within its authority and account for its activity to the shareholders' meeting.

*Ventspils nafta* complied with this best practice provision.

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## Corporate governance report (cont'd)

### F. Remuneration policy

#### 13. General principles, types and criteria of fixing remuneration

**The remuneration policy of Management Board and Supervisory Council members – type, structure and amount of remuneration – is one of the spheres where the involved persons have a potentially greater risk to find themselves in a situation of conflict of interests. To avoid that, the Issuer shall develop a remuneration policy, defining general principles types and criteria of remuneration to be granted to Management Board and Supervisory Council members.**

- 13.1. The Issuers are called on to develop a remuneration policy in which the main principles for setting the remuneration, possible remuneration schemes and other essential related issues are determined. While preparing the remuneration policy Issuer should ensure that the remuneration of the Management Board and Supervisory Council members is proportionate to the remuneration of the Issuer's executive and managing directors and other employees.

*Ventspils nafta has not developed a special remuneration policy. The amount of remuneration of the members of administrative bodies of Ventspils nafta is determined according to the Commercial Law, Articles of Association of Ventspils nafta and resolutions of administrative bodies of Ventspils nafta. Remuneration of Supervisory Council members is determined by the shareholders' meeting of Ventspils nafta and currently it is set to zero. Remuneration of the Management Board members is determined by a resolution of the Supervisory Council.*

- 13.2. Without limiting the role and operations of the Issuer's management bodies responsible for setting remuneration to the Management Board and Supervisory Council members, the drafting of the remuneration policy should be made a responsibility of the Issuer's Management Board, which during the preparation of a draft policy should consult with the Issuer's Supervisory Council. In order to avoid conflicts of interest and to monitor the Management Board remuneration policy, the Issuer should appoint a responsible person having sufficient experience and knowledge in the field of remuneration for development of the remuneration policy.

*See the comment on Clause 13.1.*

- 13.3. Should the remuneration policy contain a remuneration structure with a variable part in the form of the Issuer's shares or share options or any other payments, including premiums, it should be linked to previously defined short-term and long-term goals and performance criteria. If remuneration depends on fulfillment of short-term goals only, it is not likely to encourage an interest in the company's growth and improved performance in the long-term. The scope and structure of the remuneration should depend on the business performance of the company, share price and other Issuer's events.

*See the comment on Clause 13.1.*

- 13.4. While setting the variable part of remuneration, Issuer should set limits on the variable component(s). The non-variable part of remuneration should be sufficient to allow the Issuer to withhold variable part of remuneration when necessary.

*See the comment on Clause 13.1.*

- 13.5. Where a variable part of remuneration provides Issuer's shares, share options or any other acquisition rights thereof, it should be desirable to prescribe a minimum non-used period of time.

*See the comment on Clause 13.1.*

- 13.6. Remuneration policy should include provisions that permit the Issuer to reclaim variable part of remuneration that were awarded on the basis of data which subsequently proved to be manifestly misstated. Such provision should be included in contracts concluded between the respective executives and the Issuer.

*See the comment on Clause 13.1.*

- 13.7. Remuneration schemes that include Issuer's shares as remuneration may theoretically cause loss to the Issuer's existing shareholders because the share price might drop due to a new issue of shares. Therefore, prior to the preparation and approval of this type of remuneration, it shall be required to assess the possible benefits or losses.

*Ventspils nafta does not provide for remuneration schemes that include the Ventspils nafta shares, as well as share options as remuneration.*

- 13.8. When preparing the remuneration policy where a variable part is in the form of the Issuer's shares or share options, the Issuer shall be obliged to disclose information on how the Issuer plans to ensure the amount of shares to be granted in compliance with the approved remuneration schemes– whether it is planned to obtain them by buying on a regulated market or by issuing new shares.

*See the comment on Clause 13.7.*

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## Corporate governance report (cont'd)

13.9. While drafting the remuneration policy and envisaging awarding options entitling to the Issuer's shares, the Stock Exchange rules regarding distribution of share options should be taken into account.

See the comment on Clause 13.7.

13.10. While setting remuneration principles with regard to members of the Management Board and Supervisory Council, they should include general approach as to compensations, if any, in cases when contracts with the said officials are terminated (termination payments). Termination payments should not be paid if the termination is due to inadequate performance.

See the comment on Clause 13.1.

13.11. It is recommended to set an adequate maximum amount of the termination payments which should not be higher than two years of the non-variable part of remuneration.

*Ventspils nafta* complied with this best practice provision.

### 14. Announcement on remuneration policy

**Shareholders shall be ensured with clear and thorough report on the remuneration policy applicable to members of administrative bodies of the Issuer. Publication of the mentioned information would allow the existing and potential shareholders to comprehensively evaluate the Issuer's approach to remuneration issues, therefore the responsible body of the Issuer shall prepare and publish a Remuneration Report once a year.**

14.1. The Issuer is obliged to publish a thorough report on the remuneration policy of members of the Issuer's administrative bodies – the Remuneration Report. The Remuneration Report can be prepared as a separate document, or included as a separate section in the Report prepared by the Issuer in line with the provisions of Clause 9 of introduction of these Recommendations. The prepared Remuneration Report shall be placed also in the Issuer's web-site.

14.2 Remuneration Report should contain at least the following information:

- 1) Information as to the application of the remuneration policy to members of the Management Board and Supervisory Council in the previous financial year, specifying the material changes to the Issuer's remuneration policy compared to the previous reporting period;
- 2) The proportion between the fixed and variable part of the remuneration for the respective category of officials, including information with regard to period of time when a person cannot fully use the share options granted to them, or other type of variable part of remuneration;
- 3) Sufficient information as to linking the remuneration with performance. To consider the information sufficient, the report should contain:
  - An explanation how the choice of performance criteria contributes to the long term interest of the Issuer;
  - An explanation of the methods applied in order to determine whether performance criteria have been fulfilled;
- 4) Information about the Issuer's policy with regard to the contracts with the members of the Issuer's management bodies, the terms and conditions of the contracts (duration, notice deadlines about termination, including payments due in case of termination);
- 5) Information about the incentive schemes and the specifications and reasons for awarding any other benefits;
- 6) A description of any pension or early retirement schemes;
- 7) An overview of the remuneration paid to or any benefits received by each individual that has been a member of the Management Board or Supervisory Council in the reporting period – disclosing at least the information required in Items 14.5, 14.5 and 14.7 below.

*The total remuneration paid to the members of the Supervisory Council and the Management Board is included in the Annual report of Ventspils nafta. Pursuant to a resolution of the shareholders' meeting of Ventspils nafta, at present the Supervisory Council members do not receive a remuneration. Ventspils nafta does not disclose information mentioned in the Clause 14.2 regarding the each separate Management Board member because of social and economic situation in Latvia, as well as considering fact that this information is commercially sensitive. See also the explanations to Clause 13.1 and Clause 13.7.*



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## Corporate governance report (cont'd)

14.3. In order to avoid overlapping of information, the Issuer is allowed not to specify in the Remuneration Report the information required in sub-clauses 1 to 7 of Clause 14.2 of this section, if it is already mentioned in the Issuer's remuneration policy. In such case, a reference to the remuneration policy shall be given in the Remuneration Report, as well as indication as to where the Issuer's remuneration policy is available.

*See comment on Clause 14.2.*

14.4. If the Issuer holds a view that as a result of publishing the information mentioned in Clause 14.2. of these recommendations, commercially sensitive information might be disclosed possibly having a harmful effect on the Issuer's strategic position, the Issuer is allowed not to disclose the mentioned information, by stating the respective reason.

*See comment on Clause 14.2.*

14.5. In relation to remuneration and/or other income, the following information shall be disclosed about each member of the Supervisory Council and Management Board:

- 1) the total sum of remuneration (salary) paid or due during the accounting year for the performed duties;
- 2) remuneration and other preferences received from any related company of the Issuer. The term "related company" used in this Clause corresponds to definition of the term of related company given in Section 1 of the Financial Instrument Market Law;
- 3) remuneration paid as profit distribution or bonuses and substantiation for granting such payments;
- 4) payment for the activities performed in addition to the direct duties;
- 5) compensations and other payments to be paid to or received by a member of the Supervisory Council or Management Board that has resigned from the position in the accounting year;
- 6) total value of any material benefits received as remuneration to which sub-clauses 1) to 5) of this Clause are not referable.

*See comment on Clause 14.2., as well as comments on Clause 13.*

14.6. The following information shall be disclosed in relation to shares and/or share options or other remuneration schemes, under which the Issuer's shares can be acquired:

- 1) the number of shares or share options entitling to acquire the Issuer's shares granted in the accounting year to a member of the Issuer's administrative body, as well as conditions of their usage;
- 2) number of options entitling to acquire the Issuer's shares that have been used during the accounting year, on each of them specifying the number of the acquired shares and the set share price, or the value of the part of a member of an administrative body in the remuneration scheme related to shares in the end of the accounting year;
- 3) the number of the unused share options entitling to acquire the Issuer's shares as at the end of the accounting year, as well as the share price set in the agreement, implementation date and the main provisions regarding usage of the mentioned option;
- 4) information on the amendments made during the accounting year in the conditions of agreements of the granted options entitling to acquire the Issuer's shares (e.g. changes made in the provisions regarding usage of the option, changed the period for usage of the option, etc.).

*Ventspils nafta did not prescribe remuneration in the form of the Ventspils nafta's shares or share options.*

14.7. The following information shall be disclosed in relation to savings or instalments into pension plans of private pension funds:

- 1) on the amount of instalments made by the Issuer in the benefit of a person into a pension plan or plans and rules regarding paying out the pension capital;
- 2) on provisions regarding participation in the respective pension plan applicable to the particular person, inter alia regarding termination of participation.

*Ventspils nafta does not make accruals or instalments into pension plans of private funds.*

14.8. Remuneration schemes, under which remuneration is fixed by granting the Issuer's shares, share options, or in any other way entitling to acquire the Issuer's shares, shall be approved by a resolution of the general shareholders' meeting. Upon deciding on approval of the remuneration scheme, shareholders' meeting shall not resolve on applying it to particular individuals.

*Ventspils nafta did not prescribe remuneration in the form of the Ventspils nafta shares or share options.*