

# THE EVALUATION OF THE STANDING OF PROCHEM S.A. IN 2008 INCLUDING THE CONTROL SYSTEM AND THE RISK MANAGEMENT SYSTEM

The evaluation of PROCHEM S.A. in 2008 will be effected in four aspects:

- results of the activities,
- situation of the company,
- functioning of the internal control system,
- risk management.

## **I.THE APPRAISAL OF PERFORMANCE OF THE COMPANY IN 2008**

Considering turnovers the year 2008 was one from best at the history of the company. Only sales of PROCHEM S.A. reached nearly 290 million PLN and sales of Capital Group over 365 million PLN what means increase in relation to 2007 in the first case about over 74 % and in the second case close to 54%. Such increase show that Company as well as companies associated in the very effective way used the investment situation lasting in the first half-year and they accommodated competently themselves to the economic depression revealed in the second half.

The influence of this situation on engineering and building sales of services was curbed. Investment enterprises both in the design phase but above all connected with realization have their power of the inertia and they are braking more slowly than the sale of products or of consumer services.

Recent months of the passing year and the beginning of the current year revealed waiting Polish economy slowing down what directly is having effect and will be having effect on the situation of PROCHEM S.A. and majority of companies being included in Capital Group PROCHEM S.A.

Many current and potential customers are verifying their investment programmes, and are transferring decisions on the undertaking or even a continuation of investment aims into the time of the general improvement in the state of the market.

Apart from the deteriorating economic situation a politics of limiting financing by banks investment projects is a not-supporting additional factor. It is being combined on one hand with liquid problems of the sector, on the other with the increasing general business risk, what results in withdrawing financing of more risky ventures, or clearly toughened requirements which investors cannot comply with.

If in turnovers one should recognize results as distinguishing, in the reached level of profit one should judge the situation as more compound.

Total result expressed in level of the net profit of the Capital Group amounting to 15,401 thousands PLN, and in part falling to PROCHEM S.A. – 12,721 thousands PLN, one should recognize as very good. But its structure isn't already so fully satisfactory.

PROCHEM S.A. on account of the reserve for settling accounts of contracts with the Hungarian company amounting nearly to 6 million PLN and the reserve of 2.5 million PLN being the amount due from construction companies, achieved in comparison to results achieved so far modest result amounting to a little bit over 2 million PLN of the net profit.

Good results of companies affected good results of the capital group peculiarly it concerns company Elektromontaż Cracow.

Also a revaluation of the value of one real estate in Warsaw owned by company IRYDION was a crucial factor shaping the level of profit of the Capital Group.

Profitability ratios of the PROCHEM S.A. Capital Group were lower than in the previous year - rate of profit on the sale dropped from 6.9 % to 5 %, net rate of profit from 5.4 % to 3.6 %.

## **II. SITUATION OF THE COMPANY**

If one should assess the performance of the company well so current and future situation of the company one should regard more complex.

The strategically accepted scope of the diversification of activity appearing in the Capital Group of PROCHEM S.A. is the consequence of the approach based on the principle of the blood relationship of activity. These activities were supposed from one side to differ between themselves, but from second were supposed to be based on professional engineering qualifications, that is were supposed to come to these areas, in which these qualifications brought the value added. Therefore apart from the main activity capital property projects were taken up in the Capital Group as well as maintenance services in industrial companies and real estate sector were being developed.

Scale of the crisis and its specificity - strong entangling of the financial sector - cause that it is interacting in different directions what is reducing the amortisation and depreciation ability of the company based on diversification.

Not only demand for engineering and building services is falling off but problems in starting property projects also appear as well as slackening of demand for maintenance services is taking place what is being bound with appearing generally cutting costs and weakening dynamics of serviced companies. It is not unlikely that in current year property projects such as construction of office buildings in Cracow and Warsaw won't manage to be started mainly due to problems in acquiring financing.

Earlier preparing of these projects was connected with the meaning expenditure on purchasing ground, performance of works design and administrations.

As a result of it a level of reserves which PROCHEM S.A. had earlier at their disposal reduced.

Taking above into consideration the structural position of the company in the critical environment can be relatively difficult. Environment will be characterized by the fast and deep fall in the demand for engineering and building services, what can affect the scale of turnovers and the result of the company. A risk of limiting and slowing property projects down and at most stabilization in the area of maintenance services at simultaneous moderate reserves being at disposal of the company is an additional factor justifying this evaluation. The purpose of the Management Board is optimizing of operating costs at simultaneous protecting essential sources above all personnel.

It will require leading permanent monitoring in the course of adaptation processes resulting from the crisis with simultaneous using mechanisms of the risk control and with leading the financial policy appropriate to the critical situation.

## **III. ASSESSMENT OF THE INTERNAL CONTROL SYSTEM**

In the opinion of the Supervisory Board the control system of the PROCHEM S.A. didn't undergo the substantial change in comparing to 2007 year.

Comprehensive character of the system guarantees timely and accurate revealing facts concerning essential elements of company's activity. It lets the Management Board as well as the Supervisory Board get the full knowledge about the financial standing, operating performances, the state of the company's assets, as well as the effectiveness of the management.

Scope of supervision covers above all:

- basic and support business activity of the company,

- the financial reporting and accounting settlements,
- compliance of the company's activity with effective laws and regulations and internal regulations,
- the employment and remuneration.

Specificity of the activity of PROCHEM S.A. is connected with realization for customers complex investment enterprises.

In connection with the above in the Company are applied systems of the planning and the inspection of undertakings carried out . These systems are monitoring activity in the real time allowing for possible action in case of the appearance of undesirable phenomena. They allow also for conducting manoeuvrable inspections of selected projects after finishing them aimed at avoiding mistakes in the future.

Main task of institutional controlling is the conducting comprehensive inspections within the scope of the most important issues for the company as well as collecting and drawing up the information concerning activities of organisational units of the company, chosen economic problems and other issues which in the given period were regarded most significant by the company Management Board. Apart from the institutional internal control also a so-called functional control made by managers of different ranks exists in the company. These managers are in charge of employees reporting to them, consisting in checking the state of the accomplishment of established objectives.

Test action is being conducted in all phases of activity in the preliminary, current and next form of the control. Financial and accounting documents are being subjected to the technical, formal and accounting control. The information about the formal-technical and accounting correctness is provided with the signature drawn up in the identifiable way (full name) provided with the personal stamp of the authorised person and the date of approving the document.

The Supervisory Board is judging, that the control system functioning in PROCHEM S.A. in 2008 guaranteed the completeness of the approach to business transactions, correct classification of source documents, as well as correct evaluation of stock in possession on individual stages of the registration, and hence ensures the correctness of drawing up a financial statement and he let the Management Board conduct company's activity based on the verified and complete information.

#### **IV. RISK MANAGEMENT**

In PROCHEM S.A. isn't appearing a separate risk management system, allocated organizationally and procedural. The risks typical of the given kind service of the Company are dealing with the identification and the evaluation of areas of the risk. Also defining action essential to reduce the risk is included in their duties. Management Board is conducting supervision but also is taking crucial decisions concerning reducing the exposure to the risk.

In 2008 within operational risks appeared as follows:

##### **1. Risk of economic fluctuations**

The change in the economic trend associated with the worldwide crisis affected the situation of the Company particularly in the second half 2008. It manifested itself with reducing the demand for services engineering provided by PROCHEM S.A. and the worsening of business conditions and the possibility of financing of property projects.

For reducing this risk Company:

- is keeping the diversification strategy of activity,
- is getting ahead in cutting costs,
- is keeping the optimal level of reserves.

Depth of the crisis, conservatism of the financial sector reduced the possibility of using these instruments considerably. The crisis afflicted all activities appearing in the PROCHEM S.A. Capital Group, and restrictions in the area of the external financing reduced and partly stopped the possibility of property implementations of projects as well as possibilities of the optimization of reserves.

## **2. Risk of the appearance of threats at carrying contracts out**

Types of activity conducted in PROCHEM S.A. - preparing and managing of investment projects for customers cause, that there is this constantly appearing risk.

For limiting it PROCHEM S.A. is administering:

- realistic price calculation at entering into a contract,
- monitoring progresses of the contract and revealing threats,
- selection of credible subcontractors,
- contractual clauses limiting upper amount of contractual penalties.

In spite of applying these system instruments the Company didn't manage to avoid substantial problems at the realization of the difficult contract on the Hungarian market in 2008 what resulted in the need to create reserves (admittedly to the amount of reduced contractually contractual penalties).

Financial risks appearing in 2008 are as follows:

## **3. Risk of the payment unreliability**

The instruments limiting this constantly appearing kind of risks are:

- monitoring of the standing of customers,
- applying of special debt collection procedures,
- optimization of structures of the payment.

In the crisis conditions, worsening the liquidity, this risk can gain the greater significance in current and next year.

## **4. Risk of disadvantageous settling the litigation with PERN S.A.**

The current court course of the dispute shows little risk of the incident of such a situation.

In the evaluation of the Supervisory Board both identification of risk factors in 2008, monitoring them, as well as also a system of precautions are in the company on the good level. A feedback exists in PROCHEM S.A. between the control system and appearing risks. The control system is helping to detect and determine size of risks and next areas of the increased risk are controlled more thoroughly.

It is worth considering whether conditions of the functioning in the crisis - more difficult and burdened with the higher level of the risk should not result in creating formalized and institutionalized procedures of the risk management in the near future.

Chairman of the Supervisory Board      Mr Andrzej Karczykowski