

# **THE EVALUATION OF THE STANDING OF PROCHEM S.A. IN 2010 INCLUDING THE INTERNAL CONTROL SYSTEM AND THE RISK MANAGEMENT SYSTEM**

The evaluation of PROCHEM S.A. in 2010 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 2010**

2010 was a consecutive year of the fall in turnover of the Company. The income reached the level of the PLN 51 million and were lower about ca 46% as compared with 2009. The scale of the fall resulted mainly from reducing the income from contracts for implementation. The distinctly smaller decrease, over the 27%, was recorded in design and engineering services. Climate unfavourable to the investment projects and the short supply of new projects could not be balanced with the high marketing activity and the elastic pricing policy.

The decrease in turnovers and margins caused that PROCHEM S.A. recorded loss amounting to PLN 0.4 million on the operational level. Profits on financial transactions and activating the deferred income tax permit to reach net financial result on the level of PLN 1.3 million in 2010.

The Capital Group also obtained noticeable worse results as compared with the previous year, however the scale of the reduction is lower than for company PROCHEM SA.

Revenues achieved in 2010 by the Group in the amount of PLN 127 million were by 30 % lower than revenues achieved in the previous year. Fall in sales was mainly due to lower revenues achieved by company PROCHEM.

In practice it means, that apart from the PROCHEM SA, companies being in the Group in the majority obtained results on the level of the previous year. And so they had an amortizing influence on the whole of the group.

Net result achieved by Capital Group was satisfying considering crisis condition and amounted to above PLN 4 million.

In 2010 we failed to start office property projects in Cracow and Warsaw mainly due to policy of financial institutions.

The improvement in the net result, in spite of the decrease in turnovers, is confirming the capability of PROCHEM S.A. for the cost and organizational adjustment to changing economic conditions.

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

In 2010 situation of PROCHEM S.A. was shaped from one side by the maintaining disadvantageous state of the investment market, caused by the crisis and the high level of the uncertainty prevailing in the economy, and on the other side by the capability of PROCHEM S.A. for adjustment to activity in the conditions caused by crisis.

Capital expenditures dropped in the first half of 2010. The slight growth appeared in two last quarters. On the market an uncertainty still dominated, as for the economic situation in the country, as well as in relation to economic situation of the main partners of Poland too. This uncertainty affected negatively the developmental conducts of entrepreneurs who didn't undertake meaning investment projects.

Sections which were characterized by the dynamic growth in investment projects in the last year were situated outside the principal competence area of PROCHEM S.A. (infrastructure investment projects).

In the end of the previous year and in the first months of 2011 the increasing tendency to undertaking new investments can be noticed, however still it maintains on relatively low level.

Improvement in the economic situation of enterprises, as well as relieving the credit policy for the widely understood business should influence positively the completion of investment undertakings. A rate of utilization of production capacities also grows and it will also force gradually into investing in new manufacturing capacities.

In the last year PROCHEM S.A. had to adapt its potential and costs involved to limited - out of necessity - scope of activity. The achieved result confirmed this adaptable capability of PROCHEM.

Scope of diversification strategically undertaken by the Capital Group of PROCHEM was built from the one side aiming at creating the value added, resulting from the blood relationship of activity and possessed abilities, on the other - was supposed to be a form of reducing the overall level of the risk. Apart from the main activity of the Group, the developer's projects were assumed and the maintenance activity in industrial companies and in the real estate sector was being developed.

The protecting ability only partly turned out to be effective, because one of main development activities - starting and the implementation of developer's projects was blocked by the crisis.

Last year, as well as current, requires from the company the concentration on the financial standing, permanent monitoring and the gradual reconstruction of financial reserves.

Conditions pointing at the improvement in the investment climate are still relatively weak and they are only creating conditions for the improvement in the volume of sales and the result, but not for their radical change.

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

In the opinion of the Supervisory Board the control system of the PROCHEM SA didn't undergo the substantial change compared to 2009 year.

Comprehensive character of the system guarantees timely and accurate revealing the 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 activities of PROCHEM S.A. is connected with realization of complex investment projects for customers.

In connection with the above the systems of planning and supervision of undertakings carried out are applied in the Company. 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 reinspections of selected projects after their completion aiming 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 preparing the information concerning activities of organizational units of the

company, chosen economic problems and other issues which in the given period were regarded as most significant by the company's Management Board. Apart from the institutional internal control also so-called functional control made by managers of different ranks exists in the company. The managers supervise employees being subject to a control, consisting in checking the accomplishment of set tasks.

The control is exercised in all phases of activity as the preliminary, current and successive inspection. Financial and accounting documents are being subjected to the technical, formal and accounting control. The information about the formal-technical and accounting correctness is accompanied with the signature made in the identifiable way (full name) provided with the personal stamp of the authorized person and the date of approving the document.

The Supervisory Board is judging, that the control system functioning in PROCHEM S.A. in 2010 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 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 with procedural rules. The Company's service competent to the risks of the given kind 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.

##### ***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 whole year 2009. It manifested itself with reducing the demand for engineering services provided by PROCHEM S.A. and the worsening of business conditions and the possibility of financing of property projects.

For reducing this risk the Company:

- keeps the strategy of diversification of activities,
- gets ahead in cutting costs,
- strives for the optimal level of reserves.

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

## ***2. Risk of the appearance of threats at execution of contracts***

Types of activity lead in PROCHEM S.A. - pre-investment activities and management of investment projects for customers cause that the risk is constantly appearing.

For limiting it PROCHEM S.A. applies:

- realistic price calculation at concluding a contract,
- monitoring of the progress of the execution of contract and revealing threats,
- selection of credible subcontractors,
- contractual clauses limiting contractual penalties as for the ceiling.

In 2009 in spite of applying these system instruments the Company didn't manage to avoid financial consequences at the realization of the contracts concluded in crisis conditions, including those concluded in conditions of the strong price competition.

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

The instruments limiting this constantly appearing kind of risks are:

- monitoring of the standing of customers before and during the process of the implementation of contracts,
- applying of special debt collection procedures,

- optimization of structures of the payment.

In the crisis conditions the risk of worsening the liquidity can be of the substantial significance in current year.

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

The current court course of the dispute shows little risk that such a situation will happen.

In the evaluation of the Supervisory Board the identification of risk factors in 2010, and monitoring them, as well as system of precautions are in PROCHEM SA on the good level. A feedback exists in the Company between the control system and appearing risks. The control system is helping to detect and determine size of risks and it helps in turn to control the areas of the increased risk more thoroughly.

1. Andrzej Karczykowski - Chairman \_\_\_\_\_

2. Marek Garliński - \_\_\_\_\_

3. Krzysztof Obłój \_\_\_\_\_

4. Dariusz Krajowski - Kukiel \_\_\_\_\_

5. Adam Parzydeł \_\_\_\_\_