

## **The assessment of the situation of the Company PROCHEM S.A. in 2015 including the assessment of the internal controls and risk management system**

The assessment of the Company PROCHEM S.A. for 2015 was carried out in four aspects:

- results of operations,
- Company's position,
- functioning of internal control system,
- risk management.

### **I. THE ASSESSMENT OF THE COMPANY'S RESULTS IN 2015**

In the scope of basic activity – sale of engineering and construction services – the Company reached the amount of PLN 217.6 million, that is by 90.0 million more than volume of sales achieved in 2014. The achieved result at the operating level in the amount of PLN 9.1 million was also better than the result achieved in the previous year (PLN 7.5 million). Therefore, it should be stressed that it was a successive good year in the basic activity of the Company, confirming the stable position of PROCHEM S.A. on the market. Net profit of PLN 6.2 million achieved by the Company should also be assessed as satisfying.

In the scope of basic activity PROCHEM S.A. Capital Group achieved revenues on the level of PLN 266.4 million. Operating profit of the Group was slightly better than of the PROCHEM and amounted to PLN 9.6 million, and net profit achieved by the Group amounted to PLN 4.4 million. Thus, the Group's net profit was clearly lower than the result achieved by alone PROCHEM S.A. , but also at the same time higher than the result achieved in the previous year (PLN 3.7 million).

The factors influencing this result were: loss of PLN 1.7 million on financial operations, and loss of associated companies in the amount of PLN 1.1 million resulting mainly from transaction hedging the level of the Euro exchange rate of investment loan contracted for the construction of the Astrum Business Park by IRYDION.

It should also be noted that succeeded in the last year, as a result of the recovery program run by the new Management Board, restore the profitability of Elektromontaż Krakow.

## **II. THE COMPANY'S POSITION**

Year 2015 maintained the growth trends in the economy. GDP grew by 3.6%, which is slightly more than in 2014. (3.3%). The growth rate of investment outlays, however, is weakened compared to 2014 and respectively amounted to 6.1%, against 9.8% in 2014. Also, corporate investment have noted weaker growth - 11.9% in 2015 against 16.9% in the previous year.

Potential possibilities of self-financing of investments by enterprises are still high, although slightly lower than last year.

Can therefore be concluded that the macroeconomic situation in 2015 was still favorable for PROCHEM S.A., though slightly worse than the year before.

The ability to use this situation confirms the previously presented good results achieved by the company last year.

With ongoing undertakings two have required and require special supervision, both in respect of scale, as well as business risks, which are different from standard. This applies to the contract implemented by PROCHEM in Belarus, and to Astrum development project.

The first one was associated , and still is associated with risks of a political nature and of systemic nature, but also with the risks arising from a different culture and administration.

The current course of this project, despite a series of tensions and of protracted procedures allows for the preliminary positive assessment of the possibilities of its efficient completion, as well as it enables to build an independent position in business in Belarus.

The second project is the nature of own investment undertaking and is implemented jointly with the financial partner.

The size of the project in the first stage is about 22 thousand m<sup>2</sup> - a significant scale of own resources, which are already engaged, credit funds, which are launched, but also the unfavorable situation in the office market in Warsaw require careful supervision over project and also carrying ongoing assessments of the risks associated with the implementation, including in particular regard to the gaining of reliable tenants.

It should be noted that the positive assessment of the previous year does not allow for a similar optimism which concerns the future.

Despite the good economic situation in Poland, which still maintains in the current year, the forecasts for the development of the economic situation in the successive quarters are burdened with the large scale of incertitude.

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

In the opinion of the Supervisory Board the control system in PROCHEM S.A. has not changed in comparison with the previous year.

The comprehensive nature of the system provides timely and accurate disclosure of facts regarding the essential elements of the Company's operations. It enables the Management Board and the Supervisory Board a complete understanding of the financial position, operating results, the state the Company's assets and management efficiency.

Scope of the controls includes above all:

- company's economic activities - principal activity and auxiliary
- financial reporting and accounting settlements,
- compliance of the company's activities with the applicable laws and with the company's internal regulations,
- employment and wages.

The specificity of the activities of PROCHEM S.A. is associated with the implementation of the complex investment projects for the customers.

Accordingly in the company exist and are used the planning and control systems of implemented projects. These systems monitor the activities in the real time, what is

enabling the possible actions in the event of undesirable phenomena. They also allow the monitoring of the feedback inspection of the selected projects when they are completed in order to avoid future mistakes.

The main task of institutional control is to conduct comprehensive checks in the scope of the most important issues for the company, and the collecting and preparing the information on the activities of the organizational units of the company, selected economic problems and other issues that in the given period were regarded by the Board as the most important. Apart from the institutional internal control in the company, there is also the so-called functional control exercised by managers at various levels. Managers have led the supervision over subordinates, which is consisting in checking of the degree of accomplishment of established objectives.

Checks are carried out in all phases of activity in the form of the preliminary control, the current control and the successive. Financial and accounting documents are subjected to the substantive, formal and accounting checking. Information about the correctness substantive, formal and calculating shall be signed in the identifiable way (full name), or shall bear the personal stamp of authorized person and the date of approval of the document.

The Supervisory Board appraises that the control system which was functioning in PROCHEM S.A. in 2015 ensures the completeness of recognition of economic operations, correct classification of source documents as well as the correct valuation of existing resources at various stages of registration, and thus assured the correct preparation of the financial statements and allowed the Management Board for the conducting of the business activity of the Company based on verified and complete information.

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

In PROCHEM S.A. does not occur a distinct, and separated organizationally and procedurally system of risk management. Identification and assessment of risk areas are done by the services of the Company which are proper for specific risk. Their duties include also the defining of the actions which are necessary to reduce the risk.

Supervision, but also the key decisions relating to the scale of the exposure to risk are undertaken by the Management Board of the Company.

Despite the absence of a separate organizational structure, risk analysis in PROCHEM S.A. has systemic character, which is included in various types of procedures concerning particular risks.

### **1. The risk of economic fluctuation**

The Company's situation is strongly dependent on the market conditions and it reflects in diversified level of demand for engineering services, and has a permanent character in PROCHEM S.A..

In order to reduce the impact of that risk on the results and the Company's position:

- is carried out monitoring of the macroeconomic situation and the situation in selected industries
- is continued the diversification of activities (execution of works, developer's activity and the maintenance)
- is started the geographical diversification (through expansion of exports)
- is optimized the level of financial reserves.

### **2. The risk of the occurrence of threats in the performance of contracts**

Types of activities conducted in PROCHEM S.A. - the preparation and management of investment projects for clients - cause that it is a risk constantly occurring.

For limiting it PROCHEM S.A. applies:

- realistic price calculation during the concluding contracts,
- monitoring of the progress in the implementation of contracts and disclosure of threats,
- selection of reliable subcontractors,
- stipulations in contracts limiting the upper level of contractual penalties.

The use of the system's instruments has allowed to avoid the financial consequences during the implementation of the contracts concluded under crisis conditions, including the conditions of strong price competition.

### **3. The risk of the payment unreliability**

The instruments limiting this constantly occurring type of risk are:

- monitoring of the financial standing of customers before and during the execution of contracts,
- the use of specialized debt collection procedures,
- optimization of payment structures.

### **4. The risk of adverse settlement of litigation with PERN SA**

The current course of judicial proceedings indicates a low risk of occurrence of such a situation.

In the opinion of the Supervisory Board both identification of risk factors in 2014, and monitoring them, as well as the system of preventive actions are in PROCHEM S.A. at a good level. There is a feedback between the Company's control system and the risk occurring. Company's control system helps to detect and quantify the size of the risk, and this, in turn, helps for more precisely monitoring all areas of increased risk.

Signatures of the Members of the Supervisory Board:

1. Marek Garliński

---

2. Andrzej Karczykowski

---

3. Wiesław Kiepel

---

4. Krzysztof Obłój

---

5. Steven Tappan

---