

# **Assessment of the situation of Company PROCHEM S.A. in 2012 including an evaluation of the internal control system and risk management system**

Assessment of the company PROCHEM S.A. for the year 2012 will be made in four aspects:

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

## **I. ASSESSMENT OF PERFORMANCE OF THE COMPANY IN THE YEAR 2012**

After a relatively satisfying results in 2011, the situation of Prochem SA in 2012 has deteriorated markedly. This concerned both the sales volume as well as the results achieved.

Company in the scope of basic activity – sale of engineering services and construction services – reached level of 84.3 million PLN i.e. over 43.0 million PLN lower than the level reached in 2011. As a result of this decline, resulting in underutilisation of its engineering potential (especially in the design) Prochem SA at the operational level reported a loss of 5.4 million PLN.

The net profit achieved by the Company in the amount of 3.1 million PLN was mainly the result of the sale of the part of shares of company Elektromontaż Krakow SA.

Result of Prochem SA Capital Group amounted to 3.2 million PLN net loss. The loss on the operating level of 3.8 million PLN indicates that companies remaining in the Capital Group partly cushioned the losses incurred by Prochem SA.

Sale in the Group amounted to 136 million PLN and was lower as compared to 2011, by almost 25%. The decrease in sales was a result of decrease in revenue which have been noted mainly by the parent company.

The results of last year, have their source in a significant scale in the stagnant processes taking place in the Polish economy.

After a relatively slightly better the year 2011, the GDP growth weakened and there was a

stagnation in investment activity. This resulted in a decrease in demand for design services and engineering services and was leading, despite strong marketing activities and a flexible pricing policy, to reduction of the backlog. Against the background of the results of last year and the persisting weakness of the Polish economy, the outlook of Prochem SA in the current year for a change are very promising.

Good filling of the portfolio, the significant contracts, the high probability of implementation of a large project in Belarus, the gaining over a financial partner to the construction of an office building in Warsaw, create serious premises to expect good results.

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

The situation of the Company's business in 2012 was unfavorable. Still in the scope of basic activity - engineering activities - the company has been under the strong influence of the deteriorating situation in the investment market. Such situation, in turn, was determined by the high level of uncertainty as to the future course of the process of economic recovery.

Formulated by analysts forecasts of development of economic situation, particularly in Europe, constantly revised "down", such a uncertainty even has augmented.

In effect, the vast majority of companies, although often in good financial position, still refrained before decisions on the starting of significant investment projects.

Possibility of further adjustment of the engineering potential of PROCHEM S.A. to a limited – of necessity – scale of activity is also depleted.

Deepening of efforts in this direction could weaken the company's ability to implement of complex and significant as to the scale of investment projects.

This imbalance between the limited possibilities of the filling of the backlog, and the maintained engineering potential caused negative result in the scope of basic activity.

The aforementioned good prospects for 2013 create a serious chance, both on an improvement of the results and liquidity position.

It should be noted that this projected improvement of the business situation of the Company in 2013 is not the effect of changes in the external situation. The results of the first months of this year, as well as forecasts for the remainder of the year point to a further weakening of economic growth and the probably stagnation in investments. It is difficult in these circumstances to talk about a favorable change in the economic situation.

It seems that two factors contributed to the favorable change in the current situation, Prochem S.A.

The first - is an active and consistently implemented by the company marketing activities, frequently conducted with selected counterparties on an ongoing basis.

The second factor - to maintain, important for customers of credibility, which is the result of maintained potential engineering at a level that allows the implementation of significant and more technologically complex projects.

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

In the opinion of the Supervisory Board the control system for the PROCHEM SA didn't change significantly as compared to the last year.

The comprehensive nature of the system provides timely and accurate disclosure of the facts concerning the essential elements of the Company's activity. It allows the Management Board as well as the Supervisory Board to obtain complete understanding of the financial position, operating results, the state of the company's assets, and management efficiency.

Scope of supervision includes above all:

- business activities of the company – basic and auxiliary ,
- financial reporting and accounting ,
- compliance of the company's operations with applicable and internal regulations,
- employment and remuneration.

Specifics of the activities of PROCHEM S.A. is connected with the implementation of complex investment projects for customers.

In connection with the above in the company exist and are used planning and control systems for implemented projects. These systems monitor activity in real time allowing for possible action in case of adverse events. They also allow for the monitoring of the feedback control of the selected projects after their completion, aiming at avoiding the mistakes made in the future.

The main task of institutional control is the conducting comprehensive inspections within the scope of the most important issues for the company as well as collecting and development the information on the 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. In addition to the institutional internal control, there is also so-called functional control in the company exercised by managers of various ranks. These managers exercise

supervision over subordinates, consisting in checking the accomplishment of set tasks.

Control activities are conducted in all phases of activity in the form of the preliminary checks, the current and the next. Financial and accounting documents are subjected to the substantive, formal and accounting control. Information about the substantive, formal and accounting correctness shall be signed in the identifiable way (full name) or bears the personal stamp of authorized person and the date of approval of the document.

The Supervisory Board appraise that the control system functioning in PROCHEM S.A. in 2012 ensures the completeness of the approach to economic operations, the correct classification of the source documents, as well as proper valuation of resources at various stages of registration, and thus ensures proper preparing of financial statements and allow the Management Board to conduct company's activity based on a verified and complete information.

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

In PROCHEM S.A. does not appear distinct, separated organizationally and procedurally risk management system. Identification and assessment of risk areas is conducted by the proper for specific risk the suitable department of the Company. Their duties also define the actions necessary to reduce the risk. Management Board conducts supervision but also takes the key decisions on reducing the exposure to the risk.

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

The poor economic situation, persisting in 2012, related to the global crisis had an impact on the Company throughout 2012. It manifested itself in a low demand for engineering services provided by Prochem SA, particularly in the scope of engineering and design and resulted in the deterioration in business conditions and opportunities for financing development projects. To reduce this risk, the Company:

- keeps the strategy of diversification of activities ,
- reduce the costs in advance,
- strives for the optimal level of financial reserves.

Depth of the crisis and the conservatism of the financial sector considerably reduced the possibility

of using these instruments. The crisis affected majority of activities appearing in the PROCHEM S.A. and Capital Group, and the restrictions in the area of the external financing stopped the possibility of implementations of development projects last year.

The company decided that a further cost reductions, especially personal costs could significantly reduce the ability of Prochem for comprehensive realization of more complex projects.

## **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. uses:

- 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 height.

By applying these system instruments the Company manage to avoid financial consequences during 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 execution of contracts,
- applying of special debt collection procedures,
- optimization of structures of the payment.

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

The current course of judicial proceedings indicates a low risk of the occurrence of such a situation. In the result of the prolonged dispute is the risk of deterioration in the liquidity connected with financial obligations arising from the deposit guarantee. In the evaluation of the Supervisory Board

the identification of risk factors in 2012, 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.

Signatures of the members of Supervisory Board

1. Andrzej Karczykowski - Chairman

2. Marek Garliński

3. Krzysztof Obłój

4. Dariusz Krajowski-Kukiel

5. Adam Parzydeł