

# **Evaluation of the situation of the Company PROCHEM SA in 2020 including the assessment of the internal control system and risk management system**

The Company PROCHEM SA evaluation for 2020 was made in three aspects:

- results of operations,
- the Company's situation,
- functioning of the internal control system and risk management system..

## **I. ASSESSMENT OF THE COMPANY'S RESULTS for 2020**

The Company in the scope of its basic activity – sales of engineering and construction services – reached PLN 317.9 million and this is the sales level approximately 18% higher than in 2019. The progress in sales also significantly improved the result on basic activities, which should be assessed very positively.

At the net profit level, the year 2020 ended with a profit of PLN 10,076 thousand i.e. more than two and a half times higher than in the previous year.

Also, the Prochem Capital Group achieved higher sales and a much higher result compared to 2019. Sales amounted to almost PLN 349 million, net profit was PLN 13,854 thousand.

So, the results for 2020. should be considered very good, especially considering that the high dynamics of growth, both in terms of revenue and profit, was achieved in the conditions of the ongoing COVID-19 epidemic.

## **II. COMPANY'S SITUATION**

From the macroeconomic point of view, the situation of PROCHEM in terms of its basic business is affected by two groups of factors.

The first is related to the general economic situation, the change in GDP, and above all to the level of corporate investment.

In this respect, 2020 was definitely unfavorable. For the first time since 1991, Poland experienced a recession. The Gross Domestic Product fell by 2.8%, investments fell by 8.4%, which meant a further decline in the already low investment rate from 18.5% in 2019. up to 17.1%.

The second group of factors important for the company's results is the investment activity of companies from industries in which PROCHEM has a strong position, i.e. chemicals, petrochemicals, industrial construction, power industry.

For a change, the situation in this group of factors was in 2020. favorable. The main topics in 2020. were contracts implemented for companies Bioagra S.A. and Anwil S.A. Sales to these two customers accounted for over 85% of the company's sales volume in 2020.

2021 is also going to be interesting in this respect. New investment projects announced by some companies from the petrochemical or chemical industry, combined with the strong marketing activity of Prochem and its high engineering position on the market, create a chance that also the results achieved this year should be satisfactory. Subsequent large and complex investment projects successfully implemented by the company should also result in an increasingly stronger market position of Prochem.

Despite the situation described in this way, the awareness of Prochem's strong dependence on the investment situation prompts the company's management to seek actions that would help to stabilize the company's position also in less favorable periods.

The first group includes the activity of technical consulting, a service developed in the last years. PROCHEM joins the technological topics at their first stage, where the investor focuses on the recognition and preliminary assessment of the technical and economic feasibility of the project. Proprietary technological competencies of PROCHEM and scientific institutes cooperating with PROCHEM allow for the provision of technical advisory services for clients. Commencing cooperation at this early stage allows to build the company's competency position and create a strong foundation for further cooperation. It should be noted, however, that in Poland awareness of the importance of this pre-investment stage is still low.

The second group, aimed at obtaining significant financial surpluses, fulfilling cushioning functions in relation to the basic activity, is carried out sporadically, though with some regularity, developer activity. A large office project Astrum Business Park, implemented with a financial partner, has been confirmed by the market in the effective lease of over 95% of office space to renowned tenant. In

accordance with the adopted business model, after the commercialization of the building, it is assumed that the facility will be sold and the development cycle will be closed. Due to market conditions, in particular related to the epidemic, in 2020 it didn't happen. This year, efforts to sell the building will be continued.

In summary, it can be said that 2021 allows for some optimism both in basic engineering activities, supplemented with technical consulting services and in the area of development activity.

The outbreak of the epidemic complicated the situation, both on the side of the Company's activity (remote work) and on the side of clients, some of whom are considering making a decision to postpone planned investment projects in time.

The scale of the pandemic's impact on the economy is difficult to predict. On the one hand, it may be a negative impact, expressed as a slowdown, recession. A high level of uncertainty and ambiguity in forecasts may rather induce companies to inhibit investment activity, postpone the decision to start an investment, or slow down the implementation of already started projects. On the other hand, the end of the epidemic may be a liberating and pro-development factor, which will allow Prochem to operate effectively in the coming years.

### **III. EVALUATION OF THE INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT**

- The scope of control covers mainly:
- business activities of the company - basic and auxiliary,
- financial reporting and accounting settlements,
- compliance of the company's activities with the applicable laws and with internal regulations,
- employment and wages.

Specificity of the activity of PROCHEM SA is associated with the implementation of comprehensive investment undertakings for clients.

In the company exist and are in use the planning and control systems of the undertakings executed. These systems do not operate in real time and the signals flowing from them are analyzed with delay. After the poor experiences of previous

years regarding the operation of the control system, the Management Board undertook corrective actions in 2017. In the same year, the „Service cost control” manual was changed and a new manager of the „Cost control team” was appointed responsible for the implementation both of modifications and of streamlined procedures. The year 2018 was the second in which the system has operated according to new rules. In 2018 further modifications were made to the „Service cost control” system in the area of budget presentation and they are applied to new topics from January 1, 2019.

The main task of institutional control is to carry out comprehensive control in the scope of the most important issues for the company and to collect and elaborate information on the activities of the organizational units of the company, selected economic issues and other issues being recognized by the Company’s Management Board as the most essential in the given period. Apart from the institutional internal control, there is also the so-called functional control in the Company, which is exercised by managers at various ranks. Such the managers perform the supervision over the employees subject to them, consisting in the checking of the status of accomplishment of tasks set.

Checks are carried out in all phases of activity in the form of the preliminary control, current and next. Financial and accounting documents are subject to substantive, formal and accounting control. Information on formal and substantive correctness and calculation correctness bears a signature in an identifiable manner (full name and surname), or bears the personal stamp of the authorized person and the date of approval of the document.

In PROCHEM SA no exists distinct, organizationally separated risk management structure. Identification and assessment of risk areas are done by the respective services of the Company appropriate for relevant risk type. They are also responsible for defining the actions needed to mitigate the risks.

Supervision, but also key decisions on the scale of risk exposures are taken by the Management Board of the Company. The risk analysis in PROCHEM SA has systemic nature, and is covered by various types of procedures, which are concerning the particular risk.

In 2017 the risk management system was reviewed and improved during the execution of contracts under the „Integrated management system” process through the „Risk and opportunity management” sub-process. This procedure is based on the requirements of the international ISO-31000 standard. The procedure is obligatory in all organizational units of Prochem SA involved in preparing the offer and in executing of projects.

In the current year, the Supervisory Board familiarized itself with and analyzed, as part of the annual assessment, the current information on the company's internal control, risk management and internal audit systems.

The following risks were identified in Prochem's activities:

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

The Company is highly susceptible to fluctuations in the construction market, and it strongly depends on the demand for engineering services, such demand has cyclical nature.

In order to limit the impact of this risk on the results and situation of the Company:

- monitoring of the macroeconomic situation and the situation in selected industries is carried out
- the diversification of activities is continued (execution, technical consulting, developer's activity),
- the level of financial reserves is being optimized.

### **2. The risk of loss of key employees**

The Company's activity is based on a well-educated and qualified staff, who are also an attractive recruitment target for the competitors.

In order to mitigate this risk, in Company the following are applied:

- monitoring of the labor market and of level of remuneration,
- maintaining a system of training and raising of qualifications
- incentive programs for the key employees
- active recruitment system through cooperation with universities

### **3. The risk of threats occurrence during the execution of contracts**

Types of activity conducted in PROCHEM SA – preparation and management of investment projects for clients – cause that it is a constantly occurring risk.

In order to mitigate this risk PROCHEM SA applies:

- realistic price calculation at the concluding of contracts,
- monitoring the progress in execution of contracts and disclosure of threats,
- selection of reliable subcontractor,
- contract clauses restricting the maximum amount of contractual penalties.

The application of these systemic instruments allowed to avoid financial consequences when executing contracts concluded under the crisis conditions, including those under conditions of strong price competition.

### **4. The risk of payment unreliability**

The instruments that mitigate this type of risk are:

- monitoring of the financial standing of clients before and during the execution of contracts,
- the use of specialized recovery procedures,
- optimization of payment structures.

### **5. The foreign currency risk**

The instruments that mitigate this type of risk are:

- monitoring and forecasting of currency exchange rates,
- forward type currency transactions,
- purchase of equipment and services in the currency of the contracts

### **6. The risk of dependence on significant buyers of services**

The instruments that mitigate this type of risk are:

- monitoring of contracts with the significant suppliers
- contractual provisions containing the cushioning elements
- maintenance of the partner relations with recurring customers

## **SUMMARY**

Both in the scope of the control system and risk management, introduced systemic and personnel changes have increased the level of security in the Company's functioning and reduced the risk of not being able to notice a significant threat in the area of the company's basic activity.

Signatures of the Members of the Supervisory Board: \*

1. Marek Garliński \_\_\_\_\_
2. Karol Żbikowski \_\_\_\_\_
3. Andrzej Karczykowski \_\_\_\_\_
4. Wiesław Kiepiel \_\_\_\_\_
5. Krzysztof Oblój \_\_\_\_\_

*\* (appropriate signatures on the original document)*