



НИС а.д. Нови Сад / NIS j.s.c. Novi Sad
Народног фронта 12 / Narodnog fronta 12
ОДБОР СКУПШТИНЕ АКЦИОНАРА / SHAREHOLDERS' ASSEMBLY BOARD
Број (№): 70-3/SA-iz/XLI-3a
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**REPORT OF THE SHAREHOLDERS' ASSEMBLY BOARD
FOR SUPERVISION OF OPERATIONS AND PROCEDURES FOR REPORTING TO THE
SHAREHOLDERS of NIS j.s.c. NOVI SAD
FOR THE PERIOD APRIL 2018 – MAY 2019**

Pursuant to Article 329, paragraph 1, item 16, of the Companies Law and Article 8.23 of the Articles of Association of NIS j.s.c. Novi Sad, for the purpose of reporting to Shareholders at the Shareholders' Ordinary (Annual) Meeting, the Shareholders' Assembly Board for Supervision of Operations and Procedures for Reporting to the Shareholders, within the scope of its authorizations and competencies, hereby submits the following report for the NIS j.s.c. Novi Sad Shareholders' Annual Meeting (hereinafter "Shareholders' Meeting"), scheduled for June 2019:

- **Giving opinion on reporting on accounting and financial reporting practices in NIS j.s.c. Novi Sad and in its subsidiaries**

Shareholders' Assembly Board for Supervision of Operations and Procedures for Reporting to the Shareholders (hereinafter "SA Board") monitored the application of the accounting practice and financial reporting practice, analysed annual and quarterly financial and consolidated financial statements and reports on business operations, discussed them with management and received explanations, giving opinion that mentioned reports could be reviewed on meetings of the competent authorities. Financial reports are prepared in compliance with the regulations of the Republic of Serbia, as well as with the International Financial Reporting Standards, and the reports on business operations in compliance with the Corporate Governance Code. Pursuant to the first-time application of amended International Financial Reporting Standards, the impairment was recognized in the business books of NIS j.s.c. in respect of investments under long-term loans granted to subsidiaries and short-term financial investments and was charged to retained profit of previous years in the amount of 8.9 billion RSD (€75 million EUR). Accounting policies, applied during preparation of the annual financial statements for 2018, were disclosed in detail in the notes to financial statements for 2018, on which the independent auditor gave its positive opinion.

SA Board for supervision analysed quarterly business reports and the annual business analysis report and in respect of such reports, SA Board prepared its comments, which it discussed with the management, and provided recommendations for improving the quality of the reporting process such as including additional information in such reports which would enable more detailed analysis of operations and regular reporting to members of the Board of Directors appointed by the minority shareholders. SA Board also suggested that changes to reporting methodology should be implemented as soon as possible and not after the adoption of the Business plan in order to facilitate monitoring of the achieved results in comparison to the Business plan, and also proposed closer cooperation with the management in respect of the Business plan preparation process.

SA Board also analysed financial statements of the subsidiary companies of NIS in the Republic of Serbia and abroad and gave the opinion that such financial statements, which are included in consolidated financial statements, may be discussed at the meetings of the competent bodies.

SA Board for Supervision monitored and analysed the operations of the subsidiary companies abroad on a regular basis and provided suggestions to the Board of Directors on measures to be taken to improve the operation of such companies, by drawing its attention to the losses continually generated by foreign assets in Bulgaria, Romania and B&H thus preventing repayment of loans granted and resulting in the above mentioned impairment of such loans in the financial statements of NIS j.s.c. Total amount of loans invested in foreign assets, with pertaining interests, and cumulative losses of the subsidiary companies were disclosed in the financial statements of NIS j.s.c. Considering that large amounts of funds were invested in the operation of foreign assets, SA Board warned about the continuous losses of these companies, year after year, at the meetings the company's management and through periodic analysis of operation which included questions and suggestions for the management.

SA Board paid special attention to the operation of the subsidiary company in Bulgaria and proposed the audit to be performed of its operations by the Internal Audit. SA Board repeatedly drew the attention to and asked questions about the purchase of petrol stations and land plots for petrol stations as well as purchase and operation of the Kostin Brod Warehouse. Having in mind the foregoing as well as analyses completed by the Internal Audit, the management of NIS appointed a new management which was required to submit its business plan for its one-year term to the SA Board, within three months of its appointment. Until the date of this report, no such business plan has been submitted to the SA Board.

The applied accounting policies were aligned with the legal regulations of the Republic of Serbia and, correspondingly, the financial statements of the Company were aligned with the regulations as well. Based on the aforesaid, SA Board passes its opinion to the Shareholders' Assembly that all financial statements and Reports on business operations for 2018 to be adopted by the Shareholders' Assembly, are authentic and complete.

- **Reporting on NIS's business operations and compliance of NIS j.s.c. Novi Sad business activity with legal and other requirements of regulatory bodies and monitoring of the contracts entered into with related parties in terms of the Companies Law**

The SA Board monitored business operations of NIS on regular basis, by means of analysing documents delivered for review and giving opinions. The aforesaid documents include business plans, reports on business operations, reports on post-investment monitoring, contracts with related parties involving personal interest, reports on contracts in the value exceeding EUR 5 million, as well as other documents related to business operations of the Company.

The SA Board monitored the selection of contractors performing works and the process of realization of the Bottom of the Barrel project, asked questions of importance regarding the project in respect of which it received requested documentation. Representatives of the Board repeatedly indicated that there was the need for the contracting and realisation of the Bottom of the Barrel Project to be implemented by applying methodology applied to other investment projects in NIS. Deviations from prescribed procedure leave room for subjectivity and arbitrariness in decision-making process and may result in the selection of a contractor the justification of which, in terms of pricing and technology, is not obvious. For this reason, SA Board organised meetings with the management and continued to monitor the course of realisation and implementation of the Bottom of the Barrel Project, including the workover of the refinery, continually stressing the importance of the quality of works and adherence to the defined deadlines.

Since the start of the Bottom of the Barrel process, the management of Project Office reported to the representatives of the minority shareholders, in the form of regular monthly reports, on the degree of completion of the Bottom of the Barrel Project. At the moment, there are some delays in time schedule according to the report issued by the Project Office, which was also noted by the SA Board. This particularly refers to realisation of the construction and installation of the pipeline which was precisely what the SA Board warned about at the time of selection of the contractor and delivery of individual parts of equipment. All of the above caused project delays.

Capital workover was planned for February-March 2019, and the accompanying activities were to be divided between the Refining Block and Bottom of the Barrel Project Office for the purpose of merging the future Bottom of the Barrel plant with the rest of the refinery (primary MHC plant). It was planned for the Project Office to undertake activities related to the workover of the Refinery until 30th March 2019. Due to delays in workover, the Refinery was opened for commercial operations on 6th May instead of 8th April 2019. SA Board requested a full report to be submitted by the management on the reasons for such delay and estimated damage incurred as a consequence of delayed workover in Refinery. However, until the date of this report, no response has been received.

SA Board for Supervision analysed the contracts for sale of motor fuels which were included in the quarterly reports and which are worth more than 5 million EUR and insisted on aligning such contracts with the pricing policy and aligning the pricing policy enacted by the Sales and Distribution Block with other normative acts in place in NIS, including PO-04.00.01 – Commercial Policy of the Sales and Distribution Block which, on page 19, referring to rebate scale, defines that the rebate scale may be specified in the pricelist only as follows “**in absence of ambiguous interpretation of terms and conditions**”. SA Board for Supervision believes that Commercial Policy must be strictly observed i.e. persons responsible for commercial activities are not allowed to make special decisions, for “exceptional cases”, which are not envisaged by the pricing policy. The pricing policy must be aligned with the commercial policy defined by the document PO-04.00.01 to ensure transparent and identical implementation in respect of all buyers.

SA Board for Supervision also warned of the omissions made in preparing annexes to the contracts with buyers. Inconsistencies were identified in the procedure for obtaining approvals and in presenting the said annexes before the SA Board. Representatives of the SA Board insisted on the stance that annexes to all contracts which were the subject matter of reports to the SA Board for Supervision must be approved by the members of the Board of Directors through identical procedure. Subsequent analysis determined that such annexes effectively changed the commercial terms and conditions in the manner which was not defined in advance by the current commercial policy. Representatives of the SA Board for Supervision insisted on adherence to adopted commercial policies with the aim to improve transparency of company's operations and preserve its competitiveness in the oil products wholesale market.

SA Board for Supervision analysed the potential projects related to the expansion of the retail network in Serbia. In relation thereto, the representatives of the Board organised meetings with the representatives of other state authorities also and assisted in collection of information which provide a full picture of the project's profitability. The management of NIS accepted the suggestions of the SA Board when reaching decision on the abovementioned project.

The SA Board gave opinion on the defined ponders, targets and amtargets within production contracts as well as on the management assessments of the fulfilment of targets in compliance with the methodology, in order to determine overall evaluation within the MBO system. Regarding the above, the SA Board asked specific questions to which adequate answers were given by the management.

When performing these activities, the SA Board cooperated with the Audit Commission of the Board of Directors and its members attended all meetings of the Audit Commission. Members of the SA Board for Supervision also attended all meetings of the Board of Directors.

- **Monitoring work of the Independent Auditor in terms of competence, independence, and skills of the Independent Auditor of NIS j.s.c. Novi Sad**

SA Board for Supervision monitored the work of the independent auditor and noted that the independent auditor conducted the audit professionally, in compliance with procedures set forth by the International Standards on Auditing. Based on the data obtained through the monitoring of work and cooperation with the Independent Auditor, the SA Board determined that the Independent Auditor conducted the audit efficiently and expressed positive opinion on annual individual and consolidated financial statements for 2018, prepared in compliance with the regulations of the Republic of Serbia, as well as on financial statements prepared in accordance with the International Financial Reporting Standards.

Independent auditor also submitted a special report containing findings and observations acquired in the course of audit which are of importance for the improvement of Company's operations.

The Audit Commission, with which the SA Board cooperated on a regular basis, is also in charge of monitoring the work of the Independent Auditor. The Audit Commission prepared its Report, which includes the observation that the independent auditor is qualified and independent from the Company's management and that the audit was completed in a high-quality manner and in accordance with the International Standards on Auditing.

The SA Board reviewed the management's proposal regarding the election of the auditor of its financial statements which suggest that the auditing company PriceWaterhouseCoopers d.o.o. Beograd should be elected for the auditor of financial statements for 2019. The SA Board gave its positive opinion on draft Decision on the Election and gave its recommendation to the NIS j.s.c. Novi Sad Shareholder's Assembly Board to elect PriceWaterhouseCoopers d.o.o. Beograd as the Auditor of Financial Statements of NIS j.s.c. Novi Sad for the year 2019.

- **Decision on Profit Distribution for 2018**

The SA Board reviewed the proposal under the Decision on Profit Distribution for 2018, dividend payment, and determining the total amount of retained profits of NIS j.s.c. Novi Sad. By this draft of the Decision it was proposed to pay up dividends to shareholders in the amount of 25% of the generated profit shown in the 2018 Income statement of NIS j.s.c. Novi Sad. The Agreement for Sale and Purchase of shares of NIS stipulates that the payment of the dividends shall be in made the amount of up to minimum 15% of the generated profit, therefore the proposed decision was in accordance with the regulations and Agreement for Sale and Purchase of shares of NIS.

- **Cooperation with the Internal Audit**

The SA Board monitored activities of the Internal Audit by reviewing its Activity Plans and individual audit completion reports and gave its proposals for performance of audit of individual areas of business. The SA Board is of the opinion that internal audits have been conducted and reports prepared in accordance with standards of the professional practice. Having analysed the business activities of NIS and its subsidiaries, the SA Board gave recommendations to the Internal Audit to conduct audits of business activities of some subsidiaries and business processes, whenever they observed risks which require management's attention. One of the findings of the Internal Audit to which SA Board paid special attention was the Audit Completion Report – Sales of Bitumen in Sales and Distribution Block. Since the said report identified irregularities in the very process and method of sales, at the meeting held with the representatives of Internal Audit, the SA Board warned of the negative impact it may have on the results achieved by the Sales and Distribution Block and its reflection on the overall business performance of NIS. Having reviewed results of the conducted internal audits, the SA Board learned that the recommendations to the

Internal Audit were justified. Based upon findings of the Internal Audit, the management took adequate measures to correct the unsatisfactory performance and to improve the efficiency of business operations.

- **Other activities of SA Board**

For the purpose of monitoring the Company’s business activity, the SA Board hired a chief expert and two experts to monitor business activity and implementation of the strategy, who prepared layouts for analysis financial statements, analysis of the 2019 Business Plan, analysis of proposed investment decisions and Report on post-investment monitoring as well as for regular business operations monitoring. The SA Board reported their findings and opinions to the members of the Board of Directors. Members of the SA Board for Supervision took part in the work performed by the Commission for Crude Oil Purchase/Sale. Likewise, they attended other meetings they were invited to.

27.05.2019

CHAIRMAN OF SA BOARD
