1st Annex

To the minutes of the meeting of Audit committee of JSC Olainfarm

No. RK-2020/09-1, dated 02.09.2020.

Olaine, August 24, 2020

**Report of Audit Committee of JSC “Olainfarm " for meeting of participants.**

Audit Committee of Joint Stock Company “Olainfarm” (hereinafter – JSC “Olainfarm”) since previous Extraordinary Shareholders Meeting of April 1, 2019, has worked in constant structure. The Audit committee has carried out the necessary actions to fulfill the tasks specified in the laws and regulations of the Republic of Latvia. The meetings of the Audit Committee have been held on a regular basis. At random, both on the initiative of the Audit Committee and at the request of the Council and the Board, the existing control mechanisms of JSC “Olainfarm” were examined, and other important tasks were performed.

The work of the Audit committee was delayed in some cases without timely receipt of the necessary information for the execution of tasks, for example, in the case of the representative office of Ukraine.

**Compilation of the annual report**

The Audit committee has overseen the process of preparing the annual financial statement of the year 2019. There have been several meetings with auditor of the 2019 annual report - SIA "PricewaterhouseCoopers" (hereinafter - auditors). In the opinion of the Audit Committee, which has also been approved by the auditors, JSC Olainfarm and its subsidiaries have provided full information to the auditors. It was found that due to changes in financial management, certain documents were submitted late, which did not prevent the completion of the audit of the annual report within the previously scheduled deadline.

Also this year, according to the auditors' report, the Audit Committee draws attention and invites the management of JSC “Olainfarm” to continue to pay attention to the essential issues identified in the report - assessment of the value of goodwill, pharmaceutical licenses and lease agreements, investment in subsidiaries and evaluation of return on investment in marketing.

**Changes in accounting**

JSC "Olainfarm" has changed the principles of accounting in two areas. Since 2019 annual intangible investments in the registration of existing products (file restoration, clinical studies, registration costs) are listed as long-term investments, with a depreciation period of up to 10 years and included in the calculation of the cost price of products, while previously they were listed as expenses.

With the introduction of International Financial Reporting Standard (IFRS) No. 16, the accounting of lease agreements has been changed in relation to lease of premises and operational leasing of transport.

**Independence of the auditor and conduct of the audit**

The Audit Committee of JSC “Olainfarm " has received assurances on the independence of auditors and its employees. The statutory audit carried out by the auditor took place without significant deviations in the planned schedule.

**Auditor for the annual report of the year 2020**

Pursuant to Commission Delegated Regulation (EU) 2018/815 (17.12.2018), supplementing directive 2004/109/EC of the European Parliament and of the European Council, regarding the regulatory technical standards on the specifications for the single electronic reporting format, for companies listed since 2020, the publication of annual reports in electronic formats should begin annually starting in 2021, additionally to the customary annual reports and management reports. Auditor should also give an opinion on the appropriate use of this electronic format standard in JSC “Olainfarm” annual report for the year 2020.

The Audit committee recommends the management of JSC “Olainfarm” to begin preparations for the practical implementation of this electronic annual report format and to prepare the annual report for the year 2020, also in the format required by the regulation.

The Audit Committee proposes to continue the contract for the provision of audit services to JSC ”Olainfarm" concluded with SIA “PricewaterhouseCoopers“ for a three-year term in 2018 according to the decision of the shareholders' meeting of JSC ”Olainfarm“.

**Internal control system**

During the year 2019 the Internal Audit department was reorganized and expanded. Outside the internal audit activity, the professionalism and quality of which has significantly improved, the Audit Committee. during the year 2019 has not identified other significant changes in the internal control system of JSC “Olainfarm".

Selecting directions for in-depth inspection, the cross-border marketing test of JSC Olainfarm was carried out by the Audit committee in 2019. Failures in the accounting and control of marketing expenses by previous management were noted, as a result of which cases of irrational use of funds in significant volumes were revealed.

Recommendations have been prepared on improving the internal control system in the field of marketing, management of representative offices and dependent (subsidiary) companies. Recommendations have been prepared to improve the budgeting process so that investments in different products and marketing channels are appropriately accounted.

During the year 2019, the Audit Committee paid significant attention to the company's foreign subsidiaries and representative offices providing marketing services, including getting acquainted with their activities personally. A system was established by the previous management, in which there was no internal control over the work of the marketing manager in the management and control of the work of foreign representative offices of the company. In part of the relevant markets for the company – Ukraine, Russia and part of Kazakhstan - there was also no company`s control over the marketing activities carried out by the outsourcer in these countries.

The absence of a single administrative management system of subsidiaries and representative offices was revealed. The Audit committee has proposed to improve the management of subsidiaries by implementing effective corporate governance, including a common policy, and operational standards for the management of subsidiaries and representative offices.

**Risks**

Audit committee during the years 2019 – 2020, carried out JSC Olainfarm risk mapping to identify the most significant risks to the company's activities. Audit Committee identifies the following risks as the most significant medium-term or long-term risks:

- Regulatory (registration) requirements in the future;

- Product development;

- Business Portfolio Management, Marketing;

- Efficiency (relatively high costs), cost calculation reporting and control system;

- Previously unidentifiable risk - COVID-19 pandemic of the 2019;

- New risk, unidentified in 2019, is political risk abroad (for example, the political situation in Belarus).

**Additional 2019 annual and 2020 annual events that have influenced or are expected to affect the company's performance in year 2020 or in the future**

At the end of the year 2019, there were additional deliveries in the amount of a few months of turnover to the Russian market in connection with the expected change of regulatory requirements at the beginning of the year 2020. This has increased JSC Olainfarm profit and receivables in 2019. in the annual report and expected to decrease supplies by an appropriate amount in 2020.

Fluctuations in the Russian exchange rate have led to additional profits in 2019. and there is a risk that these fluctuations, especially as a result of COVID-19, may lead to losses related to exchange rate fluctuations in 2020.

Terminating the marketing agreements with marketing service provider in Russia, Ukraine and Kazakhstan in 2019 and without taking marketing steps in these markets during the remainder of this year, year 2019 resulted in a reduction in marketing costs, which increased annual profit in 2019. In the year 2020 after the resumption of marketing activities in these markets, marketing-related expenses are expected. The change in turnover resulting from the interruption of marketing and its renewal in these markets remains to be assessed.

**COVID-19**

According to the Audit committee, JSC “Olainfarm” has not yet suffered directly from the risks associated with the pandemic, but indirectly this risk has already caused losses related to exchange rate fluctuations. The COVID-19 pandemic has affected the activities of several subsidiaries, reducing demand for their products and services. In the opinion of the Audit Committee, the Board of JSC “Olainfarm” takes appropriate actions to reduce the risk of COVID-19 and prepare for possible consequences.

The direct impact of the COVID-19 pandemic has been assessed as relatively minor in terms of the day-to-day operation of the company, but it can have a significant impact on the solvency of buyers and partners, and on the exchange rates in certain important markets, and has already caused exchange rate losses.

The management of JSC “Olainfarm” has actively acted to apply the company's activities to pandemic conditions and reduce the risk of COVID-19 spread inside the company. There are action plans for different situations. In the opinion of the Audit Committee, a significant fall in turnover is not expected due to the pandemic.

**Belarus**

At the time of preparation of the report it is not clear how the development of events in Belarus after the presidential elections will affect the activities of JSC “Olainfarm”.

**Asset Management**

The Audit committee has established that the previous management of JSC “Olainfarm” - the Board consisting of Grigoriev Oleg, Krukle Inga, Dubitskaya Veranika, Raizberg Mikhail, Krushinsky Vladimir, Tambaks Martins, Terentyev Raimonds - did not systemically assess the return on investment in assets. The Audit Committee proposes to further assess the return on investment in each of the assets.

Once again we propose to consider the possibility of divestment of an asset – real estate in Thailand that is not relevant to the main activity of JSC Olainfarm, and to evaluate the previous management – members of the Board of the subsidiary SIA “FIRST CLASS LOUNGE” Graholskaya Svetlana, Gennady Melnis and Inga Krukle, as the holder of the asset - an official of the subsidiary of SIA “FIRST CLASS LOUNGE” - First Class Lounge Samui, registered in the Kingdom of Thailand; and the Board of JSC “Olainfarm” - Grigorjev Oleg, Krūkle Inga, Dubitskaya Veranika, Raizberg Mikhail, Krush insky Vladimir and, Tambaks Martins, Terentjev Raimond's responsibility, if as the result of theirs activity JSC “Olainfarm” control over these assets has deteriorated; the loss of control of SIA “FIRST CLASS LOUNGE” assets i.e., investment in Thailand, has allowed, and a significantly reduced chance of recovering in active investment funds as a result of the sales of AS “Olainfarm” Board was forced to make a decision to write down this investment in loss.

**Management remuneration**

The Board of JSC “Olainfarm " has confirmed that the remuneration of the Board corresponds to the decisions of the Council on the remuneration of the Board.

By request of the Audit Committee, the Internal Audit has carried out the verification of compliance of the remuneration of the Board of JSC “Olainfarm” with shareholders` decisions and has established that the remuneration of the Board during the year 2019 has complied with the decisions shown in the minutes of shareholders' meetings. In the opinion of the Audit Committee, additional checks may have to be carried out regarding the wording of the decisions of the shareholders' meeting dated by September 4, 2018.

The remuneration of the other senior officials of the company is determined by the company's Board and has not been separately verified.

**Verification of transactions**

In the course of a separate transaction inspection, it was found, a suspicious transaction with signs of money scams was organized and executed by chairman of the Board Oleg Grigoriev, who held this position until April 5, 2019, granting a one-time, economically unjustified debt discount of more than 400 000 EUR to the wholesaler “BRIZ” for export to Belarus, bypassing company's internal controls and contracting procedures.

The Audit Committee invites the Board and shareholders of JSC “Olainfarm” to evaluate the performance of the previous Board and, if necessary, to bring a claim for damage caused to JSC “Olainfarm”. According to the Audit committee, Oleg Grigoriev, the former chairman of the Board, did not act “as a decent and diligent manager” and has to be held responsible for this.

In the summer of 2019, JSC "Olainfarm" Ukrainian representative office refused to obey the requirements of the Audit Committee to conduct inspections. The Audit Committee invites the Board and shareholders to carry out a detailed examination of marketing and commercial transactions in Ukraine and, if violations are found and it is established that damage has been caused, to bring a claim for damages from the head of the representation Lyudmila Polachenko and other persons, including to evaluate the responsibility of the previous Board of the company - chairman of the Board Grigoriev Oleg, Krukle Inga, Dubitskaya Veranika, Raizberg Mikhail, Krushinsky Vladimir, Tambak Martins, Terentyev Raimonds (hereinafter - The Board headed by O.Grigoriev) for not providing the control, if as a result of inspections it is revealed that JSC “Olainfarm” has suffered damage.

**Previous violations of the Board and Council against shareholders**

JSC “Olainfarm” Board and Council at the beginning of the year 2019 has committed a significant violation of shareholders' rights by attempting to arbitrarily restrict shareholders' rights to hold a shareholders' meeting. The Council of JSC “Olainfarm", which operated until April 1, 2020, was chaired by Pavel Rebenok, and members Maligina Irina, Kriekis Martins, Sirlaka Daina (hereinafter - P. Rebenok-chaired Council), before the shareholders' meeting on April 1, publicly announced that the shareholders' meeting was being canceled, and P. Rebenok, as chairman of the Council, gave instructions on behalf of the Council to the board headed by Grigoriev to take an illegal decision - to cancel the shareholders' meeting. The law does not provide neither the Board nor the Council with the right to cancel an already announced shareholders' meeting, thus such action is to be assessed as unlawful, which may result in unjustified restrictions on the rights of other shareholders of JSC “Olainfarm”. In the opinion of the Audit Committee, the members of the Council headed by P. Rebenok knew that the shareholders' meeting would cancel it and acted in this way, guided by their personal interests and not by the interests of the company. In view of the fact that the illegal decision, which is fundamentally offensive to shareholders' rights, was widely disseminated and defended in the media by chairman of the Council P. Rebenok, such action may adversely affect the image of JSC “Olainfarm”.

On April 1, 2019, the company's funds were used by the Board supervised by the Council, to illegally impede the holding of the shareholders' meeting, additional security was hired for the company's funds to prevent shareholders from entering the company's territory. The Audit Committee calls to jointly and severally recover these funds spent for unjustified and illegal purposes from the members of the Board headed by O.Grigoriev and the Board headed by P.Rebenok. The Audit Committee also invites the Board to assess whether any other contracts organized by P. Rebenok headed Council and concluded by the Board headed by O.Grigoriev, such as legal service contracts or public relations and similar contracts, have not been used to prepare illegal, shareholder’s rights restrictive decisions, to execute them for public propaganda or other non-legal purposes; and to recover unduly spent funds jointly and severally from the Board headed by O.Grigoriev and the Council headed by P. Rebenok.

After the legitimate shareholders’ meeting on April 1, 2019, the Council headed by P. Rebenok, organized activities that, in the opinion of the Audit Committee, contain signs of criminal offense, including possible fraud and falsification of documents, which manifested itself in the way that Inga Krukkle, Board member of JSC “Olainfarm”, at the beginning of April, 2019, submitted to the Register of enterprises of the Republic of Latvia falsified documents of the April 1, 2019, shareholders' meeting, including an application to the Commercial Register authority on the withdrawal of the Council and the Board and the election of a new one, based on a not existing decision of the shareholders' meeting and the Council meeting.

These violations actively supported and promoted by Pavel Rebenok and the Council he chaired, and most likely also organized by the Board, in an attempt to illegally cancel the shareholders' meeting, have caused damage to both the JSC “Olainfarm” and the shareholders of JSC “Olainfarm”, as well as the Latvian financial system and reputation.

The Stock Exchange, in response to the administration's attempt to illegally restrict the rights of shareholders, suspended the quotation of JSC “Olainfarm” on the Stock Exchange (from 30.03.2019. until 04.04.2019). This caused significant damage to JSC Olainfarm's reputation and undermined investors' confidence in JSC “Olainfarm” and the Latvian financial system as a whole, since JSC “Olainfarm” is one of the leading listed companies in Latvia.

In the opinion of the Audit committee, JSC “Olainfarm” reputation suffered, which significantly hampered the ability of JSC Olainfarm to refinance loans, the terms of which followed quite soon after April 1, 2019. The Board headed by O. Grigoriev and the Council headed by P. Rebenok did not act “as a decent and diligent manager” in ensuring the timely refinancing of these loans at the end of the terms of the loans. Similarly, the Board headed by O.Grigoriev and the Council headed by P.Rebenok did not ensure that the company had sufficient financial reserves or other prepared solutions in case one of the lending banks chose not to extend the loan agreements. Thus, illegal actions of the Board headed by O.Grigoriev and the Council headed by P.Rebenok together with mismanagement of the Board created the risk of insolvency of JSC “Olainfarm”, which could have occurred if the banks, seeing a break in the quotation of shares on the Stock Exchange, had refused to credit JSC “Olainfarm”. This reputational damage caused the increase of interest on loans in the amount of several percentage points at the conclusion of loan agreements, and in general caused very negative consequences for shareholders and investors of JSC “Olainfarm”. The interruption of the stock quotation is related to the fall in the exchange rate of shares of JSC “Olainfarm” from 6,55 EUR before the termination of the stock quotation (Friday, March 29, 2019) to 5,9 EUR after the renewal of the stock quotation (Friday, April 12, 2019). If it is very plausible to assume that this fall is due to the interruption of the quotation of shares caused by the illegal decision of the governing bodies to cancel the shareholders' meeting, then this event resulted in a total loss of 9 155 301 EUR (nine million one hundred fifty five thousand three hundred one EUR), which was expressed as a fall in the value of the shares (14 085 078 shares, each drop of 0,65 EUR) as a result of illegal attempts of the Board headed by O.Grigoriev and the Council headed by P.Rebenok to prevent the holding of the shareholders' meeting. The Audit Committee invites shareholders to consider the possibility of recovering these losses from the Board headed by O.Grigoriev and the Council headed by P.Rebenok.

This event has also caused a long-term reputation decline, as it raised doubts of foreign investors about the reliability of JSC “Olainfarm” and the Latvian stock market as a whole. Such activity could and probably, have resulted by a decision taken by some foreign and domestic investors to refuse to invest or retain investments in JSC “Olainfarm” and in the Latvian stock market as a whole, since JSC “Olainfarm” is one of the leaders of the Latvian stock market. This, in turn, can lead to a decrease in the exchange rate and cause long-term losses for shareholders.

Council, headed by P.Rebenok, did not hand over to the company the minutes and decisions of the Council meetings, they are not available in the company. In the opinion of the Audit committee, there are signs of suspicion that P. The board headed by Rebenoka could have given separate, not quite legitimate or appropriate instructions to the Board of JSC Olainfarm headed by O.Grigorjev, thereby violating its competence. The Audit committee shall encourage an revision of the activities of the said Council chaired by P.Rebenok and whether its activities as a whole have not caused damage to the company.

**Follow-up plans**

The Audit committee intends to continue its work in monitoring the process of preparing the annual report. The Audit Committee also intends to continue monitoring the company's risk management control. Together with the internal audit structure to carry out supervision of internal controls of the enterprise.

Supervision of the activities of cooperation with the sworn auditor will be continued, as well as other activities that will contribute to the achievement of the objectives of the Audit Committee.

JSC "Olainfarm”

Audit Committee