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INDEPENDENT AUDITOR'S REPORT

To the shareholder of ELKO Grupa AS

Opinion

We have audited the accompanying consolidated financial statements of ELKO Grupa AS and its subsidiaries (the Group) set out on pages 6 to 49 of the accompanying consolidated annual report, which comprise the consolidated statement of financial position as at 31 December 2016 and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2016 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the independence requirements included in the Law on Audit Services of Republic of Latvia that are relevant to our audit of the consolidated financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with the Law on Audit Services of Republic of Latvia and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter

Revenue recognition

As disclosed in Note 6 *Operating segment information*, sales to CIS countries amount to 773 314 thousand EUR for the year 2016. Russia and Ukraine cover 99% of sales to CIS countries.

Several entities of the group are involved in sales in Russia and Ukraine (Alma OOO and Elko Ukraine TOB, Elko Trading Switzerland AG and Elko Mobile Limited). Elko Trading Switzerland AG and Elko Mobile Limited sell to the final customers through a number of intermediaries.

How we addressed the key audit matter

We performed the following procedures, among others:

- We performed the sales process walkthrough;
- We tested a sample of manual controls over the revenue recognition and measurement;
- We tested the relevant IT system controls over the revenue recording, calculation of amounts billed to the Group's customers and matching of cash receipts to the accounts of the Group's customers;
- We obtained agreements with significant intermediaries, assessed the main terms and conditions of respective agreements;
- We obtained an external customer confirmation from all intermediaries and confirmed trade receivable balances, the



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During the year sales are recognized at the time invoice is issued. Based on the terms specified in the contracts, title to the goods shall be transferred to the intermediaries only after the payment for the goods has been made to the Group in full. In general the Group receives payments only after the intermediaries have sold the goods and received cash from the final customers. As a result, the Group considers that the intermediaries act as agents and the Group recognises sales only after the intermediaries have invoiced the goods to the final customers and received the payment. Accordingly, goods that have been invoiced to the intermediaries but for which payments have not been received at the end of the year are recognised as trade inventory in transit and the respective sales and trade receivable balances are adjusted correspondingly.

Revenue recognition for sales to Russia and Ukraine was significant to our audit due to the materiality of respective revenues to the consolidated financial statements where these revenues constitute 58% of the total sales carried out by the Group and the complex transfer of ownership of goods and respective revenue recognition.

Geopolitical and currency risk

As disclosed in Note 6 *Operating segment information*, sales to CIS countries amount to 773 314 thousand EUR for the period ending 31 December 2016. Russia and Ukraine cover 99% of sales to CIS countries.

As a result of the geopolitical tension in eastern Ukraine, the sanctions imposed by Western countries on Russian economy that followed the escalation of the military conflict in Ukraine as well as the decrease in oil prices, the economic conditions in the East European sub-region, including the respective countries, have been negatively affected starting from 2014.

Sales to the intermediaries by the Group are in USD or in local currencies (Russian rubbles and Ukrainian hryvnia). The final customers pay to the Group in local currencies. The conditions mentioned above have an adverse effect on both intermediaries and final customers' ability to purchase goods, settle debts as well could result in losses for the Group due to exchange rate fluctuations.

Geopolitical and currency risk was material to our audit due to the fact that a significant part of the Group revenues are generated from sales to Russia and Ukraine and if those markets further deteriorate it would have an adverse effect on Group's business volumes, recoverability of Group's receivables and losses of the Group from the changes in foreign currency exchange rates.

Group's stock held by the intermediaries' balances and reconciled turnovers for the reporting period;

- We participated in stock counts in January 2017 in the inventory locations of the intermediaries. We tested the existence of the Group's inventories held by the intermediaries;
- We tested a sample of revenue transactions at the end of the financial year for periodization;
- We assessed year-end corrections related to consignment goods and assessed the respective corrections made to trade receivables, stock, revenues and cost of sales.

We also assessed the adequacy of the revenue related disclosures included in Note 6 *Operating segment information* and Inventory related disclosures in Note 18 *Inventories* and Trade receivable related disclosures in Note 19 *Trade and other receivables and prepayments*.

We performed the following procedures, among others:

- We obtained an assessment on geopolitical and currency risks prepared by the Group's management and identified respective risk management principles;
- We tested receivables ageing and assessed provisions for bad debts that have been made for the entities selling in Russia and Ukraine;
- We reviewed subsequent payments from debtors for the entities selling in Russia and Ukraine;
- We reviewed Group's interim financial results for 1Q 2017, including the CIS business segment;
- We reviewed the Group's internal procedures in respect of the assessment of provisions for doubtful trade receivables;
- We performed analytical review procedures in respect of receivables aging structure and year-to-year changes for unusual fluctuations;
- We discussed with the Group's management the procedures of managing foreign currency exchange risk.
- We performed analytical review procedures by forming an expectation of gains and losses arising from the changes in foreign currency exchange rate based on the currency exchange rate movements.

We evaluated adequacy of the Group's disclosures in relation to trade receivable related disclosures in Note 19 *Trade and other receivables and prepayments* and foreign exchange related disclosures in Note 5.1.1 *Market risk*

Transactions with related parties

A significant part of the Group's revenue is earned through the involvement of related parties as disclosed in Note 5.1.5 *Related party transaction compliance risk*. Largest volumes of intragroup transactions are between Elko Group SIA and Elko Trading Switzerland.

Each company of the Group operates under different jurisdiction and applies its own pricing model to be compliant with the respective legal framework of the jurisdiction.

Transactions between related parties are significant for audit due to the materiality of revenue which is generated through related parties and the possible transfer pricing risk associated with transactions between related parties.

This was important to our audit due to the magnitude of the transactions and the possible transfer pricing risk associated with these transactions.

Other information included in the Group's 2016 Annual Report

Management is responsible for the other information. Other information consists of:

- the Management Report as set out on pages 4 to 5 of the accompanying consolidated annual report and
- the Statement of Corporate Governance for the year 2016, set out in separate statement provided by ELKO Grupa AS management and available on the ELKO Grupa AS website <http://www.elkogroup.com> section *Investor relations*,

but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except as described in the *Other reporting responsibilities in accordance with the legislation of the Republic of Latvia* section of our report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed and in light of the knowledge and understanding of the Group and its environment obtained in the course of our audit, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Other reporting responsibilities in accordance with the legislation of the Republic of Latvia

We have other reporting responsibilities in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Management Report. These additional reporting responsibilities are beyond those required under the ISAs.

Our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

Based solely on the work required to be undertaken in the course of our audit, in our opinion:

- information given in the Management Report for the financial year for which the consolidated financial statements are prepared is consistent with the consolidated financial statements, and
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

We performed following the procedures, among others:

- We performed the sales process walkthrough between related parties;
- We tested controls over sales process between related parties;
- We tested the relevant IT system controls over the sales transactions between related parties and correct margin application for related party transactions;
- We obtained the transfer pricing documentation prepared by Group. We involved Tax specialists to assess the key assumptions made by the Group's management;
- We assessed the application of the Group's transfer pricing documentation in executing the business transactions.

In addition, in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Statement of Corporate Governance, our responsibility is to consider whether the corporate governance report includes the information required in the clause 56.¹ first paragraph clauses 3, 4, 6, 8 and 9 and the section 56.² second paragraph clause 5 of the Law on Financial Instruments Market of the Republic of Latvia.

In our opinion, the Statement of Corporate Governance includes the information required in the 56.¹ first paragraph clauses 3, 4, 6, 8 and 9 and the section 56.² second paragraph clause 5 of the Law on Financial Instruments Market of the Republic of Latvia.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.



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From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Diāna Krišjāne.

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Diāna Krišjāne
Chairperson of the Board
Latvian Certified Auditor
Certificate No. 124

Riga,

28 April 2017