

TO THE SHAREHOLDERS OF  
„SOPHARMA“ AD

## AUDIT COMMITTEE REPORT

### 2020

**Dear Shareholders,**

This report has been prepared and adopted in connection with the completion of the work on the preparation, adoption and audit of the financial statements of the Company and the consolidated financial statements of Sopharma Group for the year 2020.

The Audit Committee was elected at the General Meeting of Shareholders of „SOPHARMA“ AD on 05.06.2020 on the grounds of Art. 107 of the Law on Independent Financial Audit, for a new three-year term of office and comprises of three members:

1. Vasil Naydenov
2. Cvetanka Zlateva
3. Kristina Atanasova-Elliot

On the grounds of Art. 107, para 6 of the Law on Independent Financial Audit, the Audit Committee has elected as its Chairman Mr. Vasil Naydenov.

In this composition, the Audit Committee performed its functions in the reporting year 2020, in accordance with Art. 108 of the LFIA, the Statute of the Audit Committee adopted by the General Meeting of Shareholders and observing the other requirements of the Independent Financial Audit Act.

From 13 March 2020 to 13 May 2020, the Audit Committee operated in a National state of emergency announced by the Parliament and for the remaining of the reporting period in a state of emergency epidemic situation announced by the Concil of Ministers. During both periods the Committee had to comply with the restrictive measures, which lead to reorganization of the work of the Committee, but in compliance with the functions and performance of its duties.

At a meeting, the Audit Committee adopted a plan for its work during the reporting period and identified the main objectives in its activity, which included:

- Review and coordination of the audit engagement materials provided by the independent Auditor and preparation of opinion on the Letter of Acceptance of

Audit Commitment - contract between the Company and the registered Auditor for an independent financial audit of the financial statements of "SOPHARMA" AD and the consolidated statements of SOPHARMA Group for 2020, prior to signing;

- Monitoring of the financial reporting processes in „SOPHARMA“ AD and preparation, when necessary, of recommendations and suggestions for ensuring and improving its effectiveness;
- Monitor the effectiveness of the internal control systems in the Company;
- Monitor the effectiveness of the Company's risk management systems;
- Establishing contacts and cooperation with the Management of "SOPHARMA" AD - mutual awareness of key issues relating to the business of the Company;
- Monitor the activities of the independent financial audit in the Company;
- Verification and monitoring of the independence of the registered Auditor of the Company in accordance with the requirements of the Law and the Code of Ethics of Professional Accountants, including the provision of permitted outsourced services by the registered Auditor of the Company, if any, as well as any identified threats to the independence of the registered Auditors and the mitigation measures applied to them;
- Understand and provide an opinion on the registered Auditors' report on the main issues related to the performance of the audit;
- Acquaint with and provide an opinion on the additional report of the Auditor of the Company under Art. 60 of LIFA to the Audit Committee;
- Prepare and submit to the General Meeting of shareholders and management of the Company a recommendation regarding the election of a registered auditor to perform the independent financial audit of the Company for the next reporting period.

**The permanent objective of the Audit Committee** is to verify and monitor the independence and objectivity of the independent Auditor in carrying out his work and provide active assistance in the process of work of the independent Auditor and the persons responsible for the financial activity in the Company.

The activities of the AC in pursuance of the adopted Work Plan can be summarized as follows:

**Pursuant to Art. 12, item 11 of the Statutes of the Audit Committee**, the latter provided an opinion regarding the contract for assigning an audit engagement for an independent financial audit of the financial report of „SOPHARMA“ AD for the year 2020 and consolidated financial report of SOPHARMA GROUP preceding its signing. The audit program was discussed in detail and a review of the envisaged specific deadlines was performed in order to gain confidence that the latter have the potential to ensure the timely exchange of information between the Company and the Auditor and the full, accurate and timely implementation of audit procedures, as well as the potential for compliance with the statutory deadlines for disclosure of the financial statements. Attention was paid to the new regulatory requirements of Art. 37, para 6, item 6 of the LSA and Art. 100n, al. 13 of the Law on Public Offering of Securities, requiring the opinion of the Auditor on the remuneration policy report, which was duly reflected in the contract. In view of the above, the Audit Committee brought to the attention of the Management its positive opinion on the submitted contract.

**The monitoring of the financial reporting of "SOPHARMA" AD** is a continuous process in which the Audit Committee establishes that the management of the Company applies adequate accounting policy and directly controls the financial reporting processes. For the reporting financial year, the Company has adopted new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and resp. by the IFRS Interpretations Committee, which were relevant to its work. Since the adoption of these standards and / or interpretations, effective for annual periods beginning on or after 1 January 2020, there have been no changes in the Company's accounting policy, except for a few new disclosures and the expansion of already existing disclosures, without an impact and other changes in the classification or evaluation of individual reporting objects and operations.

The members of the Audit Committee held special consultative meetings with the Chief Financial Officer, the Chief Accountant and the Head of the Reporting Department of "SOPHARMA" AD. The issues discussed were the quality indicators of the accounting, its completeness, comprehensibility and reliability, communication with the Auditors, in relation to the changes in IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policy. Changes in estimates and errors and, in particular, refinement of the definition of materiality were discussed. From the information received, the Audit Committee found that the Company has established a streamlined organization for reporting during the financial year. The activity of the Reporting Department, created especially to work with the subsidiaries, effectively contributes to improving the quality of the reporting processes for the financial year on a consolidated basis.

From the information gathered and the meetings held, a full and responsible joint work of the financial and accounting team of the Company with the independent Auditor was established, while maintaining the practice of providing the audit team with complete and accurate financial and accounting information. The Auditor reports to the Audit Committee that in the course of the audit he received all the required documents and explanations, and no significant difficulties were encountered, except for partial delays in providing information in connection with the audit of the consolidated report.

The financial reporting of the business, as far as we are aware, presents reliably the financial position of the Company and the Group. The information provided in the annual reports of the management for the activities of „SOPHARMA“ AD and Sopharma Group corresponds in all material respects to the information presented and disclosed in the financial statements of the Group and the consolidated financial statements of the Group as at 31.12.2020, in accordance with International Accounting Standards. This statement is also confirmed by the independent Auditor in the expressed Audit opinion and the findings under Art. 37, para. 6 of the Accountancy Law and Art. 100n of LPOS, contained in the Audit Reports on the Financial Statements. The findings of the Audit Committee are that no omissions, lack of reliability of financial information or non-compliance with the policy of financial reporting of business operations have been identified. There were no significant findings in the process of implementation of the audit program for the independent financial audit, which were not taken into account by the responsible specialists, respectively have not been reflected in the financial statements. The monitoring of the financial reporting processes contributes to the

reliability of financial reporting. In this context, the Audit Committee should report that it did not receive any signals of irregularities in the Company's financial reporting and auditing activities.

The Audit Committee takes a special approach to **monitoring the effectiveness of the Company's internal control and risk management systems**. The management of the Company is responsible for risk management in the Company and in the group. Management is responsible for identifying, assessing and taking corrective action to eliminate or reduce the relevant risks. The management has taken an approach to expand the scope of internal control by assigning control functions to individuals and structures related to both financial and production and economic activities. The Audit Committee found that the established system of internal control operates in a way that allows identifying the risks associated with the activities of the Company and supporting their effective management. **The Board of Directors has adopted basic principles for the general management of financial risk**, on the basis of which specific procedures have been developed for the management of individual specific risks:

**Currency** – To control the currency risk the Company introduced import supply planning system, foreign currency sales, as well as procedures for daily monitoring of movements in the USD exchange rate and control of forthcoming payments. The management conducts, through its subsidiaries, a currency policy in order to optimize and minimize the currency risk;

**Price** - To eliminate this risk, the Company has applied a strategy aimed at optimizing production costs, validating alternative suppliers offering favorable trading conditions, expanding the nomenclature by developing new generic products for the market and last but not least, flexible marketing and pricing policy;

**Interest** - The Company's management is currently monitoring and analyzing its exposure to changes in interest rates. Different scenarios of refinancing, renewal of existing positions and alternative financing are simulated;

**Credit** - A number of policies and practices to reduce the credit risk of loans are introduced. The most common is providing a collateral. The Company assigns an evaluation by external experts - independent appraisers of the collateral received, as part of the lending process. This assessment is reviewed periodically.

As a result of the meetings with the Management, during which the approaches for monitoring and risk management were discussed, the Audit Committee was able to find that an adequate policy is pursued in terms of risk clarification and prevention of actions. The latter is also reflected in the Reports of the Management for the activity of "SOPHARMA" AD and Sopharma Group for 2020, as well as in the Corporate Governance Declarations under Art. 40 of the Accounting Act and Art. 100n, para 8 of the Public Offering of Securities Act. The risk management policy is subject to ongoing analysis and control.

During the reporting period the Audit Committee assists in improving the conditions created by the management of the Company and the responsible employees in order to achieve an environment that ensures transparency and complete independence in the process of performing the Auditor's duties. Throughout the duration of the audit, the Registered Auditor maintained communication with the Audit Committee on the key matters related to the implementation on different stages of the Audit, the progress of the audit and other

ongoing issues; the essential aspects and risks to which the Company and the Group are exposed are also being communicated. At a meeting of the Audit Committee with the Registered Auditor in December 2020, the Auditor identified significant risks of misstatement and planned measures for addressing them as well as issues of communication with the responsible persons. Following an analysis, the Auditor considered as key audit matters the evaluation of trade receivables, related party receivables and loans to third parties and the valuation of investments in subsidiaries. The Auditor has identified a major risk in the inadequate evaluation of trade receivables, related party receivables and loans to third parties, since the application of IFRS 9 requires the application of models with significant judgments and assumptions. The Auditor has performed a number of procedures to ensure the accuracy of the application of the requirements of IFRS in the financial reporting of the Company, incl. reviewing and assessing the adequacy of the Company's methodology, evaluating and testing the design and operational effectiveness of key controls in the process of monitoring and determining the amount of impairment for credit losses. Appropriate procedures are also followed in connection with the consolidation of the Group.

In order to avoid the risk of overestimation of investments in subsidiaries, the Auditor has taken measures related to a thorough review of the financial position of the subsidiaries, as well as estimates made on the basis of future discounted future cash flows. Relevant procedures have been performed in connection with the consolidation of the Group, where as key audit issues are identified valuation of trade receivables, receivables from related parties and loans to third parties and assessment of reputation and specific intangible assets arising from the business combination. The thorough and comprehensive analysis and audit procedures performed by the Auditor in relation to the implementation of the new regulatory requirements in the accounting policy of the Company and the Group creates additional safeguards for the correctness of the financial reporting.

At the same time, the discussed turn of the identified key Audit matters and significant risks of misinterpretation with the Audit Committee of an early stage of the Audit, allows the Auditor to fully monitor the focus of audit procedures to eliminate the risks and obtain sufficient audit evidence to form an audit opinion on the financial statements. This asserts the role of the Committee in assuring the credibility of the financial reporting, which is the focus of the statutory audit.

In view of the above and as a result of the overall communication with the independent Auditor, the Audit Committee finds that the audit work during the reporting period has been performed in a comprehensive, responsible and regulatory manner. It is worth noting that the emphasis in the audit is in line with the general European priorities in law enforcement for financial reporting in the annual financial statements for 2020 of companies whose securities are admitted to trading on a regulated market, outlined in the annual public statement of the European Securities and Markets Authority, published on 28.10.2020. The good practice of accurate audit planning has been reinforced, which provides control of results and prevention of mistakes. The latter integrally contributes to the reliability of the financial reporting in the audited entity.

The Audit Committee's observations show that the Audit Program presented in the engagement letter was fulfilled. The crisis situation on a national and global scale, dictated by

the continuing COVID-19 pandemic did not impede the proper organization of both the financial reporting processes in the Company and the statutory audit and compliance with the terms under art. 100n, para 1 and 2 of the LPOS.

The Audit Committee appreciates the readiness of both the Company and the Auditor for the implementation of the Single European Financial Reporting Format (ESEF) and the marking of the CSR in the Extensible Business Reporting Language (XBRL) under Commission Delegated Regulation (EU) 2018/815 of 17 December 2018 supplementing Directive 2004/109 / EC of the European Parliament and of the Council as regards the annual accounts for 2020, notwithstanding the reasonable expectation that the application of the requirements will be postponed as an additional measure to support recovery from the COVID-19 pandemic . As a result of the actions taken to amend Directive 2004/109 / EC and to notify Bulgaria to the European Commission on 27 January 2021, for the country such a delay of one year became a fact, as the obligation to prepare and publish annual financial statements in accordance with the new format will enter into force on January 1, 2022.

**In compliance with the statutory obligations of the Audit Committee, a review of the independence of the registered Auditor "Baker Tilly Klitou and Partners" OOD was performed in accordance with the statutory requirements and the Code of Ethics for Professional Accountants.**

The Auditor provided a declaration of independence from the audited entity as well as declarations by team members as required by the Law on the Independent Financial Audit. No other Auditors and external experts were used in the audit of the individual statement. No external experts were used in the audit of the consolidated report; the work of the Auditors carrying out the audit of the subsidiaries of the enterprise is used. In view of the latter, the Auditor reports to the Audit Committee that it has requested and obtained from the subsidiaries' Auditors a confirmation of their independence vis-à-vis the companies in the Group. The Auditors have confirmed their independence according to the applicable legal requirements and in the Supplementary Reports to the Audit Committee, incl. the implementation of the procedures under art. 53 and 67 of the LIFO for preparation of the financial audit and evaluation of the threats to independence, as well as a review for the quality of the engagement under art. 68 of the LIFO and art. 8 of Regulation (EU) 537/2014 prior to the issuance of the audit opinion and the reports under art. 60 of the LIFO. The auditor has reported on the internal organization of work in accordance with art. 55 of the LIFO. The Auditor has also confirmed that they have not established infringements of the LIFO and Regulation (EU) 537/2014. There are no reports of complaints received in connection with the audit performed and no reports of omissions and irregularities in the performance of the Independent Auditor's duties have been received.

The Audit Committee finds, on the basis of the submitted documents, that the registered Auditor meets the criteria of independence from the audited entity. It was also found, at the date of this report, that the Independent Auditor fulfills its obligation to publish on its website a Transparency Report that includes legally required information.

In accordance with the requirements of the LIFO (Art. 60), the applicable auditing standards and the provisions of Art. 11 of Regulation (EU) No 537/2014, the Independent

Auditor provided the Audit Committee with a Report to the Audit Committee of „SOPHARMA“ AD dated 26.03.2021 concerning the audit of the Company's individual financial statements for 2020 and a Report to the Audit Committee of „SOPHARMA“ AD dated 28.04.2021 on the auditing of the consolidated financial statements of Sopharma Group for 2020.

The Registered Auditor has not informed and has not initiated a procedure for approval with the Audit Committee for additional services beyond the audit of the Company. The Audit Committee finds that the registered Auditor did not provide additional services beyond the scope of the audit contract concluded for the reporting period in respect of which the Auditor's independence requirements under Art. 64 of the LIFO and Art. 5 of Regulation (EU) 537/2014. In view of the latter, during the reporting period the Audit Committee did not grant approvals under Art. 64, para. 3 of the LIFO.

The Auditor has confirmed the assessment under art. 66, para 2 and 3 of the LIFO and art. 4 of Regulation (EU) 537/2014 resulting in the remuneration received being below the thresholds laid down in those provisions. In view of the latter, during the reporting period, the Auditor has not identified any threats to his / her independence, has not conducted communication under art. 66 of the LIFO with the Audit Committee, respectively the latter did not provide approvals under para 3 of the same provision.

In accordance with its obligations underlined in art. 108, para 1, item 4 of the LIFO, the Audit Committee found that the Commission for Public Oversight of Registered Auditors publicly announced on its website the results of scheduled inspections in 2019, when the latest inspection of "Baker Tilly Klitou and Partners" OOD reg. No 0129 has been carried out for the period under review: "from 1 July 2017 to 30 June 2018, the specialized audit firm has operated in accordance with all the essential aspects of the quality requirements of the audit services performed by applying the procedures laid down in the professional standards". In addition, in conclusion of a thematic inspection of the quality of the performance of a statutory financial audit engagement of a public company for 2018 The Commission stated that "the audit firm has fulfilled its commitment in accordance with all material aspects of the quality requirements of the audit services performed by applying the procedures set out in professional standards, fundamental ethical principles, legal and other regulatory provisions."

It should be noted that the results of the previously performed quality control audit of registered Auditors providing services to public entities in 2015 also noted that "for the period under review, the specialized audit firm was active in compliance with all material aspects of the quality requirements of the audit services provided in applying the procedures laid down in professional standards.". Other results of inspections and / or investigations were not found, respectively findings under art. 26, para 6 of Regulation (EU) 537/2014, of the Commission regarding the Auditor "Baker Tilly Klitou and Partners" OOD reg. No 0129. Taking into consideration the positive findings of the Independent Auditor's activity, the Audit Committee finds that the Audit Firm "Baker Tilly Klitou and Partners" OOD has the necessary resources for auditing and certification of the Annual Financial Report of the Company for 2021, according to the requirements of the International Financial Reporting Standards.

**Due to the above, the Audit Committee recommends that the General Meeting of Shareholders renews the audit engagement of the auditing Company "Baker Tilly Klitou and**

**Partners" OOD, Sofia 1612, 5 "Stara Plinana" with UIC 131349346 by choosing it for external independent Auditor of „SOPHARMA“ AD** for verifying and certifying the Annual Individual and Consolidated Financial Statements of the Company for 2021. The Company is registered with registration number 0129 in the Register of Audit Companies art. 20, promulgated by the Institute of Certified Public Accountants in Bulgaria. As a result of the documentary survey we conducted, we believe that the proposed Independent Auditor meets the generally accepted criteria for selection of an independent Auditor.

The recommendation of the Audit Committee for the election of independent Auditor of „SOPHARMA“ AD for 2020 is not influenced by a third party. The Audit Committee does not have a clause of the kind referred to in art. 16, para 6 of Regulation (EU) 537/2014.

Given the fact that the reporting year 2021 is the fourth year in which the independent financial audit of the financial statements of the Company was assigned to the recommended Auditor, the recommendation complies with the requirements of art. 65 of the LIFO on the maximum duration of audit engagements.

In view of the fact that the recommendation relates to the renewal of an audit engagement and has been made in compliance with art. 65 of the LIFO and art. 17, para 1 and 2 of Regulation (EU) 537/2014, on the basis of art. 16, para 2, para 2 and para 3, para 1 of Regulation (EU) 537/2014, for the purposes and prior to its submission, the selection procedure under art. 17, para 3 of Regulation (EU) 537/2014 should not be applied, i.e. it is not required to justify it and to provide selection options with preference. The proposal is also communicated with the management of "SOPHARMA" AD.

The report was adopted at a meeting of the Audit Committee held on 28 April 2021.

CHAIRMAN:                      /signature/  
Vasil Naidenov

AND MEMBERS:

/signature/  
Cvetanka Zlateva

/signature/  
Kristina Atanasova-Elliot