

Long-term incentive programme (LTI)

(see note 26 to the financial statements)

Risk	<p>The Group has a long term incentive plan in place. The long-term incentive programme (LTI) is a programme in several stages which runs until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management. The targets represent the Group's long-term ambitions, with a specific focus on revenue and market share growth relative to the competition, without sacrificing EBITDA margin.</p> <p>The total available fund for all pay-outs under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. Each stage of the programme includes a deferred component of conditional pay-outs in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI pay-out may be adjusted downwards based on individual performance during the period of the programme.</p> <p>We consider this to be a key audit matter due to significant judgment involved in determination of appropriate accounting policies and estimates used in LTI calculations.</p>
Audit approach	<p>We obtained an in-depth understanding of the Group's LTI program and methodology used for recognition of LTI expense.</p> <p>We challenged management's key assumptions used in the LTI expense calculations. This included the period over which the expenses should be accrued in relation to both the LTI phases and targets achieved in 2017 as well as those expected to be achieved in future years.</p> <p>We tested accuracy of prior year estimates and assumptions used by management to identify possible bias.</p> <p>We tested mathematical accuracy of LTI expense calculations, reconciled internal inputs in the calculations with audited accounting records and ensured consistency of data used for LTI calculations with other information obtained during the audit.</p>
Key observations	<p>We did not identify material exceptions in the LTI expenses and we consider the Management Board's key assumptions to be within a reasonable range of our own expectations.</p>

In prior year we included a key audit matter in relation to the impact of the Russian economic crisis. We consider this no longer a key audit matter as a result of the improvements in the economic environment.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- the Chairman's statement;
- the Management Report;
- the Supervisory Board Report;
- the Remuneration Report;
- Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Based on the following procedures performed, we conclude that the other information:

- is consistent with the financial statements and does not contain material misstatements;
- contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.

The Management Board is responsible for the preparation of the other information, including the Management Report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

Following the appointment by the extraordinary general meeting of shareholders on 12 November 2015, we were engaged by the Supervisory Board on 15 December 2015 as auditor of X5 Retail Group N.V. as of the audit for the year 2016 and have operated as statutory auditor since that date.

No prohibited non-audit services

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

Other non-prohibited services provided

In addition to the statutory audit of the financial statements we provided assurance services in relation to the Group's Eurobonds offering in 2017 (see note 19).

Description of responsibilities for the financial statements

Responsibilities of the Management Board and the Supervisory Board for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Management Board is responsible for such internal control as the Management Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Management Board is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Management Board should prepare the financial statements using the going concern basis of accounting unless the Management Board either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Management Board should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud.

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 financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included e.g.:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining 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.
- Obtaining 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 company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Concluding on the appropriateness of the Management Board'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 company'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 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 a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit. In this respect we also submit an additional report to the audit committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

We provide the Supervisory Board 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.

From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the 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, not communicating the matter is in the public interest.

Amsterdam, 28 March 2018

Ernst & Young Accountants LLP

Signed by G.A. Arnold