



Al Fozan & Partners
Certified Public Accountants

Independent Auditors' Report on the Audit of the Consolidated Financial Statements to the Shareholders of The Saudi British Bank (A Saudi Joint Stock Company)

Opinion

We have audited the consolidated financial statements of The Saudi British Bank (“SABB”) and its subsidiaries (collectively referred to as the “Bank”), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated income statement; consolidated statement of comprehensive income, consolidated statement of changes in shareholders’ equity and consolidated statement of cash flows for the year then ended, and summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying consolidated financial statements taken as a whole:

- present fairly, in all material respects, the consolidated financial position of the Bank as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Agency (“SAMA”) and with International Financial Reporting Standards (“IFRS”); and
- comply with the requirements of the Regulations for Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank’s Articles of Association in so far as they affect the preparation and presentation of the consolidated financial statements.

Basis for Opinion

We conducted our audit in accordance with generally accepted auditing standards in the Kingdom of Saudi Arabia and International Standards on Auditing (“ISAs”). Our responsibilities under those standards are further described in the Auditors’ Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (“IESBA Code”) together with the ethical requirements that are relevant to our audit of the financial statements in the Kingdom of Saudi Arabia, and we have fulfilled our other ethical responsibilities in accordance with these requirements 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 judgement, were of most significance in our audit of the consolidated financial statements of the current year. 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 key audit matter, a description of how our audit addressed the matter is set out below:

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Key Audit Matters (continued)

The key audit matter	How the matter was addressed in our audit
<p><i>Loan and advances impairment</i> At 31 December 2016, gross loans and advances of the Bank were Saudi Riyals 123,855 million against which impairment provisions of Saudi Riyals 2,890 million was maintained (including impairment against specific loans and collective impairment maintained on a portfolio basis).</p> <p>We considered this as a key audit matter as the Bank makes complex and subjective judgements and makes assumptions to determine the impairment and the timing of recognition of such impairment and the potential impact of impairment could be material to the consolidated financial statements.</p> <p>In particular, the determination of impairment against loans and advances includes:</p> <ul style="list-style-type: none"> ○ The identification of impairment events and methods and judgments used to calculate the impairment against specific corporate loans and advances; ○ The use of assumptions underlying the calculation of collective impairment for portfolios of loans and advances, and the use of the models to make those calculations; ○ An assessment of the Bank's exposure to certain industries affected by short term economic conditions. <p><i>Refer to note 2(l) to the consolidated financial statements for the significant accounting policy and significant accounting estimates relating to impairment of loans and advances, note 6 which details the disclosure of impairment against loans and advances and note 1.1(f)(i) which explains the impairment assessment methodology used by the Bank.</i></p>	<p>We assessed the design and implementation, and tested the operating effectiveness of key controls including the following:</p> <ul style="list-style-type: none"> - management's processes for establishing and monitoring both specific and collective impairment. - the identification of impaired loans and advances <p>For loans which are individually assessed for impairment, we performed the following procedures on a sample basis:</p> <ul style="list-style-type: none"> - tested assumptions underlying impairment identification including forecasted future cash flows, discount rates and estimated recovery from any underlying collateral etc. - tested loans and advances (including loans that had not been identified by management as potentially impaired) to form our own assessment as to whether impairment events had occurred and to assess whether impairment had been identified and recorded in a timely manner. - tested loans for industries adversely affected by the current short term economic conditions to evaluate management's impairment assessment for such loans as per the Bank's internal credit grading processes. <p>For collective impairment, we also assessed the appropriateness of the qualitative and quantitative changes in the underlying loan portfolio. We also tested, on a sample basis, data used in the models including grading of loans, historical losses, movements between various grades of loans and analysis of loans into delinquency bandings.</p>

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Key Audit Matters (continued)

<p><i>Valuation of derivatives</i></p> <p>The Bank has entered into various derivatives including special commission rate and currency swaps (“Swaps”), special commission rate futures (“Futures”), spot and foreign exchange forward contracts (“Forwards”), special commission rate and currency options (“Options”). Certain derivative contracts are over the counter (“OTC”) derivatives and hence, the valuation of these contracts is subjective as it takes into account a number of assumptions and model calibrations.</p> <p>The majority of these derivatives are held for trading. However, the Bank utilizes certain Swaps for hedge accounting purposes in the consolidated financial statements for hedging fair value or cash flow risks.</p> <p>We considered this a key audit matter as there is complexity and subjectivity involved in determining the valuation, where complex modelling techniques are being used and the valuation inputs in certain cases are not market observable.</p> <p><i>Refer to the significant accounting policies note 2(c) to the consolidated financial statements and note 10 which explains the derivative positions and the valuation methodology used by the Bank.</i></p>	<p>We assessed the design and implementation, and tested the operating effectiveness of the key controls over management’s processes for the identification, measurement, management and accounting of derivative financial instruments.</p> <p>We selected a sample of derivatives and:</p> <ul style="list-style-type: none"> - Tested the accuracy of the particulars of derivatives by comparing the terms and condition with relevant agreements and deal confirmations; - Evaluated the methodologies, inputs and assumptions used by the Bank in determining fair values; - Considered the adequacy of the Bank's disclosures about the valuation basis and inputs used in the fair value measurement.
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Key Audit Matters (continued)

<p><i>Fee from banking services</i></p> <p>The Bank charges loan transaction and service fee upfront to the customers on loan. All such fees are an integral part of generating an involvement with the resulting financial instrument and therefore all such fees should be considered for making an adjustment to effective yield and such adjustment should be recognised in accordance with IFRS. Management uses certain assumptions and thresholds for making adjustment to the effective yield of loan.</p> <p>We considered this as a key audit matter since use of management assumptions and thresholds could result in material over / under statement of Bank's profitability.</p> <p><i>Refer to the significant accounting policies note 2(f) to the consolidated financial statements.</i></p>	<p>We performed the following audit procedures:</p> <ul style="list-style-type: none"> - We assessed the design and implementation and tested the operating effectiveness of the controls over the consistent application of management's assumptions and thresholds for recognition of fee income. - We evaluated the assumptions and thresholds used by management for making adjustments to the effective yield of loan and recording such adjustment. - We obtained management's assessment of the impact of the use of assumptions and thresholds and: <ul style="list-style-type: none"> - traced the historical and current year data used by management to the underlying accounting records; - assessed management's estimation of the impact on the recognition of fee and commission income and special commission income.
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Key Audit Matters (continued)

<p><i>Valuation of available for sale investments</i></p> <p>Available for sale investments comprise a portfolio of debt and equity investments. These instruments are measured at fair value with the corresponding fair value change recognised in other comprehensive income. The fair value of these financial instruments is determined through the application of valuation techniques, which often involve the exercise of judgment by management and the use of assumptions and estimates.</p> <p>Estimation uncertainty exists for those instruments not traded in an active market and where the internal modelling techniques uses significant observable valuation inputs</p> <p>The management has described in the consolidated financial statements the key sources of estimation involved in determining the valuation of financial instruments and in particular when the fair value is established using a valuation technique due to the instruments' complexity.</p> <p>The valuation of the Bank's available for sale investments was considered a key audit matter given the degree of complexity involved in valuing these financial instruments and significance of the judgment and estimates made by management.</p> <p><i>Refer to notes 33 which explains the investment valuation methodology used by the Bank and note 1.1(f)(ii) which explains critical judgments and estimates.</i></p>	<p>We assessed the design and implementation and tested the operating effectiveness of key controls over management's processes for performing valuation of investments classified as available for sale, which are not traded in an active market.</p> <p>We performed an assessment of the methodology, assumptions, appropriateness of valuation models and the inputs used to value available for sale investments.</p> <p>We tested the valuation of a sample of available for sale investments not traded in an active market. As part of these audit procedures we assessed the key inputs used in the valuation such as expected cash flows, risk free rates and credit spreads by benchmarking them with observable external data.</p>
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Key Audit Matters (continued)

<p><i>Impairment of non-trading investments</i></p> <p>As at 31 December 2016, the Bank had non-trading investments of Saudi Riyals 29,273 million. These non-trading investments comprise equities, government and corporate bonds/sukuks, which are subject to the risk of impairment in value due to either adverse market situation and/or liquidity constraints faced by the issuers.</p> <p>For assessing the impairment of equities, management monitors volatility of share prices and uses the criteria of significant or prolonged decline in their fair values below their costs as the basis for determining impairment. A significant or prolonged decline in fair value of an equity instrument below its cost represents objective evidence of impairment. The determination of what is significant or prolonged requires judgment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the equity instrument. In assessing whether it is prolonged, the decline is evaluated against the time-period for which the fair value of the equity instrument has been below its original cost.</p> <p>For other instruments including debt instruments such as government and corporate bonds/sukuk management considers them to be impaired when there is evidence of a deterioration in the financial health of the investee, industry, country or sector performance, changes in technology and operational and financing cash flows.</p> <p>We considered this as a key audit matter since the assessment of impairment requires significant judgment by management and the potential impact of impairment could be material to the consolidated financial statements.</p> <p><i>Refer to note 2 (l) of the consolidated financial statements for the accounting policy relating to the impairment of non-trading investments, note 1.1 (f)(ii) for the critical accounting estimates and judgements, and notes 29 and 30 for the disclosures of credit and market risks respectively.</i></p>	<p>We assessed the design and implementation and tested the operating effectiveness of the key controls over management's processes for assessing impairment of non-trading investments including:</p> <ul style="list-style-type: none"> - management's identification of indicators of impairment such as significant or prolonged decline in the fair value of equities and/or any issuer defaults relating to other investments including government and corporate bonds/sukuk; - management's review and approval of impairment methodology and outcome. <p>For equity investments, on a sample basis, we:</p> <ul style="list-style-type: none"> - Assessed the appropriateness of management criteria for determining the significant or prolonged decline in the value of investments; - Evaluated the basis for determining the fair value of investments; - Tested the valuations of investments; and - Considered the price fluctuation / movement during the holding period to determine if the significant or prolonged criteria is met. <p>For other investments including bonds and sukuks, on a sample basis, we assessed the creditworthiness of counter parties based on available market information and assessed cash flows from the instruments to consider any defaults based on contractual terms and conditions of these instruments.</p>
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Key Audit Matters (continued)

<i>Zakat and income tax</i>	
<p>The Bank files its tax/zakat return with the General Authority of Zakat and Tax (“GAZT”) on an annual basis. The GAZT has issued assessment orders for the years from 2005 up to 2009, which resulted in significant additional zakat exposure of the Bank amounting to Saudi Riyals 433 million. The significant additional zakat exposure resulted mainly due to disallowance of certain long-term investments and the addition of long term financing to the Zakat base by the GAZT. The interpretation of the GAZT is being challenged by the Bank and the appeal proceedings are underway at various levels of available appellate forums.</p> <p>Assessments for the years 2010 to 2015 are yet to be raised. However, in line with the assessments finalized by the GAZT for the years 2005 to 2009, if long-term investments are disallowed and long-term financing is added to the Zakat base this would result in significant additional zakat exposure. The amount of the potential additional zakat exposure is not disclosed in the consolidated financial statements as management expects that such disclosure might affect the Bank’s position in this matter.</p> <p>The management makes judgments about the incidence and quantum of zakat liabilities (which are subject to the future outcome of assessments by the GAZT) and based on such judgments, management expects a favourable outcome of the appeal process.</p> <p>We considered this as a key audit matter as it involves significant management estimation and assessments and and the additional demands by the GAZT are material to the consolidated financial statements.</p> <p><i>Refer to note 2(u) for the accounting policy relating to zakat and income tax and note 26 for the related disclosures for zakat and income tax.</i></p>	<p>In order to assess the status and likely outcome of the matter, we obtained correspondances between the Bank, GAZT and Bank’s tax and zakat consultants to determine the amount of the additional demand made by the GAZT. We further obtained the related appeal documents to confirm the fact that the matter has been contested at various appellate forums and to assess the status of the outcome of those appeals.</p> <ul style="list-style-type: none"> - We held meetings with those charged with governance and senior management of the Bank to obtain update on the tax and zakat matter and the results of their interactions with the relevant appeal committees. - We also assessed the adequacy of the net exposure disclosed and the appropriateness of the management’s judgements relating to the zakat matter in light of the facts and circumstances of the Bank. - We also assessed the appropriateness of the disclosures included in the consolidated financial statements of the Bank.



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Other Information included in the Bank's 2016 Annual Report

Other information consists of the information included in the Bank's 2016 annual report, other than the consolidated financial statements and our auditors' report thereon. Management is responsible for the other information in its annual report. The annual report is expected to be made available to us after the date of this auditors' report.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above 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.

When we read the other information, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

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 the Accounting Standards for Commercial Banks issued by SAMA, IFRSs, the applicable requirements of the Regulations for Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's Articles of Association, 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 Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditors' 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 auditors' 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 generally accepted auditing standards in the Kingdom of Saudi Arabia and 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.

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Auditors' Responsibilities for the Audit of the Consolidated Financial Statements (continued)

As part of an audit in accordance with generally accepted auditing standards in the Kingdom of Saudi Arabia and 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 Bank'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 Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' 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 auditors' report. However, future events or conditions may cause the Bank 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 Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Bank 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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to the Shareholders of The Saudi British Bank (A Saudi Joint Stock Company)**

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements (continued)

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 year and are therefore the key audit matters. We describe these matters in our auditors' 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.

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