



KPMG Al Fozan & Partners
Certified Public Accountants



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

Opinion

We have audited the consolidated financial statements of The Saudi Investment Bank (the "Bank") and its subsidiaries (collectively referred to as the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated income statement; and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes from 1 to 41.

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

- present fairly, in all material respects, the consolidated financial position of the Group 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 Authority ("SAMA") and with International Financial Reporting Standards ("IFRS"); and
- comply with 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 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 Group 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.



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Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of the 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:

The key audit matters	How the matters were addressed in our audit
<p>Loan impairment</p> <p>At 31 December 2016, the gross loans and advances were Saudi Riyals (SAR) 61.2 billion against which impairment provisions of SAR 995 million were recorded. These include impairment against specific loans and collective impairment recorded on a portfolio basis through the use of models.</p> <p>We considered this as a key audit matter as the Group makes complex and subjective judgments and makes assumptions to determine the impairment against credit losses as at each reporting date.</p> <p>In particular, the determination of impairment provisions 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 loans and advances; ○ The use of assumptions underlying the calculation of collective impairment for portfolios of loans and advances, and the use of models to make those calculations; and ○ An assessment of the Group’s exposure to certain industries affected by economic conditions. <p><i>Refer to the following notes to the consolidated financial statements: summary of significant accounting policies note 3(k) for loans and advances and note 2(d)(i) which contains the disclosure of significant accounting estimates relating to impairment of loans and advances, note 7(b) which contains the disclosure of impairment against loans and advances and note 3(l)(i) which explains the</i></p>	<p>We assessed the design and implementation, and tested the operating effectiveness of the key controls over management’s processes for establishing and monitoring both specific and collective impairment.</p> <p>We tested a sample of 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 on a timely basis.</p> <p>Where impairment was individually calculated, we tested the assumptions underlying the impairment identification including forecasted future cash flows, discount rates and estimated recovery from any underlying collateral. For individually assessed loans, we also selected a sample of loans for industries adversely affected by the economic conditions to evaluate management’s impairment assessment for such loans.</p> <p>For the collective impairment model, we tested the appropriateness of assumptions and the calculations within the model.</p>



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<p><i>impairment assessment methodology used by the Group.</i></p>	
<p>Fee income from banking services, net</p> <p>The Group charges loan-processing fees upfront to the customers and recognizes the same within fee income to the extent of certain thresholds. Such fees are an integral part of generating an involvement with the resulting financial instrument and therefore, should be an adjustment to the effective yield of loan financing. However, due to a large volume of transactions with mostly insignificant fee amounts, adjustments to the effective yield is made by the management based on certain thresholds and assumptions.</p> <p>We considered this as a key audit matter since the use of thresholds and assumptions could result in material over / under-statement of fee income and special commission income.</p> <p><i>Refer to the summary of significant accounting policies note 3(h) to the consolidated financial statements.</i></p>	<p>We assessed the design and implementation and tested the operating effectiveness of the key controls over the consistent application of the threshold.</p> <p>We evaluated the assumptions used and threshold established by the Group to record the fee income on financing.</p> <p>We obtained management's assessment of the impact of the use of thresholds and assumptions on fee income, and:</p> <ul style="list-style-type: none"> o traced the historical and current year data used by management to source documents on a sample basis; and o considered management's estimation of the impact of the use of thresholds and assumptions on the recognition of fee income.
<p>Valuation of investments held as available for sale</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 recognized in other comprehensive income. The fair value of certain available for sale investments, which are not traded in an active market, is determined through the application of valuation techniques. These techniques often involve the exercise of judgment by the 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 use:</p> <ul style="list-style-type: none"> o significant observable valuation inputs (i.e. level 2 instruments); and 	<p>We assessed the design and implementation and tested the operating effectiveness of the key controls over management's processes for performing valuations of investments classified as available for sale which are not traded in an active market.</p> <p>We performed an assessment of the methodology and the appropriateness of the valuation models and inputs used to value available for sale investments.</p> <p>We tested the valuation of a sample of these investments and assessed the key inputs used in the valuation such as the expected cash flows, risk free rates and credit spreads by benchmarking them with external data.</p>



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<ul style="list-style-type: none"> ○ significant unobservable valuation inputs (i.e. level 3 instruments) <p>Estimation uncertainty is particularly high for level 3 instruments.</p> <p>The valuation of the Group's available for sale investments in level 2 and level 3 categories was considered a key audit matter given the degree of complexity involved in valuing these financial instruments and the significance of the judgments and estimates made by the management. In the Group's accounting policies, the management has described the key sources of estimation involved in determining the fair value of level 2 and level 3 financial instruments and in particular when the fair value is established using a valuation technique due to the complexity of the instruments or due to the lack of availability of market based data.</p> <p><i>Refer to the following notes to the consolidated financial statements: summary of significant accounting policies note 3(j)(i), note 33 which explains the investment valuation methodology used by the Group and note 2(d)(ii) which explains critical judgments and estimates for fair value measurement.</i></p>	
<p>Impairment of investments held as available for sale</p> <p>As at 31 December 2016, the Group had investments held as available for sale of SAR 21.45 billion. These investments are comprised of equities, corporate and sovereign bonds and Sukuk, which are subject to the risk of impairment in value due to either adverse market situations and / or liquidity or other constraints faced by the issuers.</p> <p>For assessing the impairment of equities, management monitors the volatility of share prices and uses the criteria of significant or prolonged decline in fair values below their costs as the basis for determining impairment. A significant or prolonged decline in fair value below its cost represents objective evidence of impairment. The determination</p>	<p>We assessed the design and implementation and tested the operating effectiveness of the key controls over management's processes for identifying a significant or prolonged decline in the fair value of equities and/or any impairment indications for corporate and sovereign bonds / Sukuk.</p> <p>For equity investments, we assessed the appropriateness of the management's criteria for determining a significant or prolonged decline in the value of investments and on a sample basis;</p> <ul style="list-style-type: none"> ○ Evaluated the basis for determining the costs and fair value of investments;



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<p>of what is significant and prolonged requires judgment.</p> <p>In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the equity instrument at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the equity instrument has been below its original cost at initial recognition.</p> <p>For debt instruments such as corporate and sovereign bonds / Sukuk, the management considers them to be impaired when there is evidence of a deterioration in the financial health of the investee, industry 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 the following notes to the financial statements: summary of significant accounting policies note 3(l) for the accounting policy relating to the impairment of financial assets, note 2(d)(iii) for impairment of available-for-sale equity and debt investments, and notes 29 and 31 for the disclosures of credit and market risks respectively.</i></p>	<ul style="list-style-type: none"> o Tested the costs and valuations of investments; and o Considered the price fluctuations / movements during the holding period to determine if the investment meets the significant or prolonged criteria. <p>For corporate and sovereign bonds / Sukuk, on a sample basis, we assessed the creditworthiness of counter parties and cash flows from the instrument to consider any defaults based on the terms and conditions of the issuance of these bonds / Sukuk.</p>
<p>Valuation of derivatives</p> <p>The Group has entered into commission rate swaps, foreign exchange forward contracts and foreign exchange options which are over the counter (OTC) derivatives and hence, the valuation of these derivatives is subjective as it takes into account a number of assumptions.</p> <p>The Group utilizes these derivatives for trading and fair value hedge accounting purposes. An inappropriate valuation of derivatives could have a</p>	<p>We assessed the design and implementation, and tested the operating effectiveness of the key controls over management's processes for valuations of derivatives including the testing of relevant automated controls covering the fair valuation processes for derivatives.</p> <p>We selected a sample of derivatives and:</p>



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<p>material impact on the consolidated financial statements.</p> <p>We considered this as a key audit matter as there is complexity and subjectivity involved in determining the valuation where modelling techniques are used.</p> <p><i>Refer to the following notes to the consolidated financial statements: summary of significant accounting policies note 3(e) which explains derivative financial instruments and hedge accounting, note 11 which discloses the derivative positions and note 33 which explains the fair values of financial assets and liabilities.</i></p>	<ul style="list-style-type: none"> ○ Tested the accuracy of the particulars of derivatives by comparing the terms and conditions with relevant agreements and deal confirmations; ○ Checked the accuracy and appropriateness of the key inputs to the valuation models; and ○ Involved our valuation specialists to perform an independent valuation of the derivatives and compared the results with management's valuation.
<p>Valuation of associated company put option</p> <p>The Group's derivatives as at 31 December 2016 includes a put option with a positive fair value of SAR 386 million (2015: SAR 299 million) (note 11). This put option is embedded within the agreement (the Agreement) with the shareholder of an associated company and gives the Group an option to sell its associated company investment to its other shareholder based on a strike price determined in accordance with the Agreement.</p> <p>In accordance with the Group's accounting policy, this put option is segregated from the Agreement and is measured at its fair value.</p> <p>The Group uses an option pricing model to fair value the put option which requires certain inputs which are not observable in the current market place. These inputs include historical results of the associated company and other inputs which require management's judgement including estimations about the future results of the associated company, the detrimental effects on the operating results of the associated company which may arise from an exercise of the option, and an estimate of the fair value of the underlying investment.</p> <p>This is considered as a key audit matter as the valuation of this put option, as mentioned above,</p>	<p>We inspected the agreement to obtain an understanding of the principal terms of the put option.</p> <p>We considered the put option valuation performed by independent consultants engaged by management and discussed the methodology and key assumptions with the independent consultants.</p> <p>We also assessed the above valuation of the put option and used our internal valuation specialists to consider:</p> <ul style="list-style-type: none"> ○ the basis for determining the strike price and whether it complies with the terms of the Agreement; ○ the appropriateness of the assumptions used in the option pricing model; ○ the unobservable inputs used in the model and the basis for determining these inputs; and ○ the arithmetical accuracy of the option pricing model.



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<p>requires management to exercise judgment in determining the fair value of the put option.</p> <p><i>Refer to the following notes to the consolidated financial statements: summary of significant accounting policies note 3(e) which explains the accounting policy for derivative financial instruments and hedge accounting, note 11 which explains the put option positions and note 33 to the consolidated financial statements which explains the valuation methodology used by the Group.</i></p>	
<p>Zakat</p> <p>The Bank has received claims from the General Authority of Zakat and Tax (GAZT) for the years from 2003 to 2011 and 2013 raising additional demands aggregating to SAR 573 million. These additional demands arose, as the GAZT considered certain assets as non-deductible for the purpose of the computation of the Zakat base which consequently would increase the Zakat liability.</p> <p>The Bank, in consultation with its professional Zakat and Income Tax advisor, has filed appeals for the above assessments with the GAZT. The appeal proceedings are underway at various levels of the appellate forums available to the Bank and hence the ultimate outcome of the matter cannot be determined at this stage.</p> <p>The treatment of certain items in the Zakat calculation (resulting in additional demands) is uncertain until resolved with the GAZT. Consequently, the management makes judgments about the incidence and quantum of Zakat liabilities which are subject to the future outcome of assessments by the GAZT. The Bank recognizes provisions when a reliable estimate can be made for a present legal or constructive obligation as a result of past events and it is more likely than not that an outflow of resources embodying economic benefits will be required to settle the obligation. The Group currently considers that the outflow of resources is remote and has</p>	<p>We reviewed the correspondence between the Bank and the GAZT and the Bank's Zakat and Income Tax advisor.</p> <p>We held meetings with those charged with governance and executive management of the Group to obtain updates on the Zakat matter and the results of their interactions with the GAZT.</p> <p>We also assessed the appropriateness of the disclosures, in light of the facts and circumstances of the Bank.</p>



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accordingly not provided for the additional liability and has disclosed the related contingency in note 26 to the consolidated financial statements.

We considered this as a key audit matter as this matter is subjective and the amounts claimed by the GAZT are material.

Refer to the following notes to the consolidated financials: summary of significant accounting policies note 3(v) for the accounting policy relating to Zakat and income taxes and note 26 for the related disclosures for Zakat and Income Tax.

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 the 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 Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using



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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.

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.

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 controls 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 controls.
- 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 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 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



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

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.

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 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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