

**Audit Report on Consolidated Financial Statements  
issued by an Independent Auditor**

**INSTITUTO DE CRÉDITO OFICIAL AND SUBSIDIARIES  
Consolidated Financial Statements and  
Consolidated Management Report  
for the year ended December 31, 2017**

*Translation of a report and consolidated financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails.*

## AUDIT REPORT ON CONSOLIDATED FINANCIAL STATEMENTS ISSUED BY AN INDEPENDENT AUDITOR

To the General Board of INSTITUTO DE CRÉDITO OFICIAL:

### **Opinion**

We have audited the consolidated financial statements of INSTITUTO DE CRÉDITO OFICIAL (the Parent Company or the Institute) and its subsidiaries (the Group), which comprise consolidated balance sheet at December 31, 2017, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated cash flow statement, and the notes thereto for the year then ended.

In our opinion, the accompanying consolidated financial statements give a true and fair view, in all material respects, of the consolidated equity and the consolidated financial position of the Group at December 31, 2017 and of its financial performance and its consolidated cash flows, for the year then ended in accordance with International Financial Reporting Standards, as adopted by the European Union (IFRS-EU), and other provisions in the regulatory framework applicable in Spain.

### **Basis for opinion**

We conducted our audit in accordance with prevailing audit regulations in Spain. 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 ethical requirements, including those related to independence, that are relevant to our audit of the consolidated financial statements in Spain as required by prevailing audit regulations. In this regard, we have not provided non-audit services nor have any situations or circumstances arisen that might have compromised our mandatory independence in a manner prohibited by the aforementioned requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## **Most relevant audit issues**

Most relevant audit issues are those matters that, in our professional judgment, were the most significant assessed risks of material misstatements in our audit of the consolidated financial statements of the current period. These risks were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon, and we do not provide a separate opinion on these risks.

### **Estimate of credit impairment losses from loans and advances to customers**

#### **Description**

Estimating the credit risk impairment losses is one of the most significant and complex elements of Group's financial reporting process. Note 2.7 to the accompanying consolidated financial statements explains the main principles and criteria applied by the Group.

On a general basis, the Group estimates that an objective evidence of impairment exists when, after the initial recognition, an event or a combination of events takes place which impacts negatively in the future expected cash-flows of loans and advances to customers. Objective evidences of impairment are determined individually for the debt instruments that the Group has determined as significant, and collectively for the rest. In the collective evaluation, the Group bundles debt instruments with similar credit risk characteristics, indicative of the borrowers' financial capability to return interest and principle amounts, the nature of the instrument, the sector, the kind of collateral and the days past due, among others.

To determine the specific and generic impairment losses, the Group has used the parameters established by the Bank of Spain, based on the experience and information on the sector.

#### **Audit response**

Among the audit procedures carried out in this respect, we assessed and evaluated internal control and performed substantive tests on impairment losses assessed both individually and collectively.

Regarding internal control, our tests focused on:

- Evaluating whether the policies and procedures established by the Group comply with applicable regulatory requirements and are applied effectively.
- Reviewing, in the authorisation process, the procedures established by the Group for assessing collection of transactions based on an analysis of the borrower's future cash flows and financial information.
- Evaluating that the regular review process of borrowers' files, mainly those related to updates of financial information and identification of objective impairment evidences, as well as those related to underlying data such as the risk characteristics of the borrower, the nature of the instrument, the sector, the kind of collateral and the days past due.

We also performed substantive procedures, consisting mainly of:

- Audit procedures on a sample of transactions, targeted to evaluating the assumptions used by management to identify and estimate impairment losses, including the risk characteristics of the borrower, the nature of the instrument, the sector, the kind of collateral and the days past due.
- For credit losses determined collectively, we have evaluated, among others, the use of parameters based on the experience and information on the banking sector, and we have performed tests of details directed to assess the classification of credit risk exposures, the sector, the days past due, the collateral value and the exposure value.
- We have re-calculated the credit risk impairment losses.

### **Other matters**

Article 168 of the General Budgetary Law 47/2003 gives the General Intervention Board of the State Administration (IGAE) the attribution to conduct the audit of the consolidated financial statements of Instituto de Crédito Oficial, and the subsequent issuance of the auditor's report, according to the Audit Standards of the Public Sector in Spain. The contract signed between Ernst & Young, S.L. and the Ministry of Finance and Public Administrations to collaborate with IGAE in conducting the audit of the consolidated financial statements of the Institute addresses the issuance of this auditor's report using the generally accepted auditing standards in Spain, and the provisions included therein.

### **Other information: consolidated management report**

Other information refers exclusively to the 2017 consolidated management report, the preparation of which is the responsibility of the President of the Institute and is not an integral part of the consolidated financial statements.

Our audit opinion on the consolidated financial statements does not cover the consolidated management report. In conformity with prevailing audit regulations in Spain, our responsibility in terms of the consolidated management report is to assess and report on the consistency of the consolidated management report with the consolidated financial statements based on the knowledge of the entity we obtained while auditing the consolidated financial statements, and not including any information not obtained as evidence during the course of the audit. In addition, our responsibility is to assess and report on whether the content and presentation of the consolidated management report are in conformity with applicable regulations. If, based on the work carried out, we conclude that there are material misstatements, we are required to disclose them.

Based on the work performed, as described in the above paragraph, the information contained in the consolidated management report is consistent with that provided in the 2017 consolidated financial statements and their content and presentation are in conformity with applicable regulations.

### **Responsibilities of the President of the Institute for the consolidated financial statements**

The President of the Institute is responsible for the preparation of the accompanying consolidated financial statements so that they give a true and fair view of the equity, financial position and results of the Group, in accordance with IFRS-EU, and other provisions in the regulatory framework applicable to the Group in Spain, and for such internal control as they determine 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, the President of the Institute 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 the President of the Institute either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

### **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 prevailing audit regulations in Spain 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 prevailing audit regulations in Spain, we exercise professional judgement 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 the use of the going concern basis of accounting by the President of the Institute 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 the President of the Institute 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.

From the significant risks communicated with the President of the Institute, we determine those that were of most significance in the audit of the financial statements of the current period and are therefore the most significant assessed risks.

We describe those risks in our auditor's report unless law or regulation precludes public disclosure about the matter.

ERNST & YOUNG, S.L.

*(Signature on the original report in Spanish)*

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José Carlos Hernández Barrasús

April 3, 2018