Independent auditor's report

to the members of Arbuthnot Banking Group PLC

1. Our opinion is unmodified

We have audited the financial statements of Arbuthnot Banking Group PLC ("the Company") for the year ended 31 December 2017 which comprise the consolidated statement of comprehensive income, consolidated statement of financial position, company statement of financial position, consolidated statement of changes in equity, company statement of changes in equity, consolidated statement of cashflows, company statement of cashflows, and the related notes, including the accounting policies in notes 2 & 3.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Overview		
Materiality: group financial statements as a whole	£570,000 (2016:£526,000) 8% (2016: based on an aggregation of individual component materialities) of Group Profit Before Tax	
Coverage	100% (2016:100%) of Group Profit Before Tax.	
Risks of material misstatement		**vs 2016**
Recurring risks	Loan Impairment Provisioning	◄►
	Effective Interest Rate Accounting	◄►
	Investment Property	◄►
New risks	Fair value of net assets acquired as part of business combination	▲
	Valuation of Investment in Associate	▲

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

	The risk	Our response
Loan Impairment Provisioning Consolidated allowance for impairment of loans and advances: £1,362,000 (2016: £973,000) Consolidated net impairment loss on financial assets: £394,000 (2016: £474,000) *Refer to page 20 (Audit Committee Report), page 47 (accounting policy) and pages 56, 97 & 99 (financial disclosures).*	**Subjective estimate** The impairment provision relating to the Group's loans and advances requires the directors to make significant judgements in relation to the recoverability of loans and advances. Impairment provisions are assessed on an individual and collective basis. *Individual impairment:* Individual impairment provisions are determined by assessing the quantum and timing of future cashflows on loans identified as impaired on the watchlist. The directors judge individual impairments by reference to loans where the borrower has experienced cash flow difficulties, there has been delinquency in contractual payments of principal or interest or the account is under forbearance. *Collective impairment:* Collective impairment is assessed by applying judgement in the light of the Group's historical experience and other wider market factors due to there being limited loss experience.	Our procedures included: • **Controls:** We tested the controls over the acceptance, monitoring and reporting of credit risk; • **Independent re-performance:** We re-performed the calculations of impairment assessments and agreed the key data inputs to third party documentation; namely projected selling price and discount rates to the effective interest rate of the loan; • **Our sector experience:** We challenged and assessed the reasonableness of the key judgemental areas of the calculation, being forecast sale value of the collateral and the time to sale of the property, through stress testing by applying our own expectations based on our knowledge of the Group and experience of the industry in which it operates; • **Assessing valuers' credentials:** We evaluated the competence of the valuers engaged by the directors to support the valuation of collateral. This included consideration of their qualifications and expertise. • **Historical comparisons:** We critically assessed the Group's assumptions on past payment behaviour, collateral valuations and timing of realisation of cashflows by comparing them to the Group's historical experience; • **Sensitivity analysis:** We performed sensitivity analysis over the Group's collateral valuations based up our findings from the above procedures; and • **Test of details:** We performed credit reviews on a risk-based sample of loans; • **Assessing transparency:** We critically assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the balance and sensitivity of the impairment of loans and advances to changes in key assumptions reflected in the inherent risk. **Our results** We found the resulting estimate of the allowance for impairment of loans and advances to be acceptable.

	The risk	Our response
Effective Interest Rate Accounting Consolidated interest income: £47,427,000 (2016: £38,071,000) *Refer to page 20 (Audit Committee Report), page 45 (accounting policy) and pages 56 & 83 (financial disclosures).*	**Subjective estimate** The recognition of revenue (interest receivable) on loans and advances to customers under the effective interest rate (‘EIR’) method requires the directors to apply judgement, with the most critical estimate being the loans’ expected behavioural life. *Originated assets:* The expected life assumptions utilise repayment profiles which represent when customers are expected to repay based on past customer behaviour. *Acquired loan portfolios:* For the Group’s acquired loan portfolios, the risk is that future cash collections estimated at acquisition are not reflected in actual cash receipts. Given the nature of the acquired loan portfolios, estimation of future cash collections requires significant estimation with regard to the value and timing of expected future cash flows.	Our procedures included: *Originated assets:* • **Historical comparison:** We critically assessed the Group’s analysis and key assumptions for the repayment profiles by comparing them to the Group’s historical trends and actual portfolio behaviour; • **Our sector experience:** We challenged the Group’s repayment profiles by applying our own expectations based on our knowledge of the Group and experience of the industry in which it operates; *Acquired loan portfolios:* • **Historical comparison:** We critically assessed the Group’s cash flow forecasts by comparing them to current and past performance of the Group’s portfolios, including recent cash collections. • **Our sector experience:** We compared the profile of future cashflows to our own expectations based on our knowledge of the Group and experience of the industry in which it operates; *Both portfolios:* • **Assessing transparency:** We critically assessed the adequacy of the Group’s disclosures about the sensitivity of the revenue recognition on loans and advances to changes in key assumptions reflected in the inherent risk. **Our results** We found the resulting estimate of the revenue recognition on loans and advances to be acceptable.

	The risk	Our response
Investment Property Group Investment Property: £59,439,000 (2016: £53,339,000) *Refer to page 20 (Audit Committee Report), page 49 (accounting policy) and pages 57 & 110 (financial disclosures).*	**Subjective valuation** The investment property requires the directors to apply significant judgments and estimates to its fair value assessment. The directors have prepared a model with input from professional advisors to calculate the fair value of the investment property. As a result there is an inherent risk that the data and assumptions used in the calculation are not complete or accurate.	Our procedures included: • **Assessing valuer's credentials**: We evaluated the competence of the expert engaged by the directors to support the valuation methodology and key assumptions. This included consideration of their qualifications and expertise. • **Tests of detail:** We performed testing of source documentation provided by the Group. This included agreeing a sample of this documentation back to underlying lease data. • **Our property valuation expertise:** We included property valuation specialists in our audit team who challenged the valuation approach and assumptions determined by the directors. • **Benchmarking assumptions:** Our property valuation specialists compared the yields applied to an expected range of yields taking into account market data and asset-specific considerations. They also considered whether the other assumptions applied by the directors, such as the estimated rental values, voids, tenant incentives and refurbishment costs were reasonable and supported by available market data such as recent lettings and occupancy levels. • **Sensitivity analysis:** We have undertaken sensitivity analysis over the key valuation assumptions (i.e. yields, renovation costs & post renovation rental uplift). • **Historical comparisons:** We carried out analytical procedures by comparing assumptions used for the valuation of the property on a year-on-year basis, by reference to our understanding of the UK commercial real estate market and external market data to evaluate the appropriateness of the valuations adopted by the directors. • **Assessing transparency:** We assessed the adequacy of the investment property disclosures by reference to the requirements in IAS 40. **Our results** The results of our testing were satisfactory and we considered the valuation of investment property to be acceptable.

	The risk	Our response
Fair value of net assets acquired as part of business combination 2017: £4,420,000 (2016: £nil) *Refer to page 21 (Audit Committee Report), page 43 (accounting policy) and pages 57 & 107 (financial disclosures).*	**Subjective estimate** The Company acquired Renaissance Asset Finance Limited during the year. The Group prepared the acquisition balance sheet based on estimates of the fair value of assets and liabilities acquired. In particular, the Group prepared discounted cash flow models to arrive at estimates of the acquired intangible assets including customer relationships, broker relationships and brand. This required the directors to exercise judgement in determining the expected cash flows from the assets and the discount rates to be applied.	Our procedures included: • **Assessing valuer's credentials**: We evaluated the competence of the expert engaged by the directors to support the valuation methodology and key assumptions. This included consideration of their qualifications and expertise. • **Our sector experience:** We challenged the assumptions, including value, probability and timing of cash flows, made in calculating the fair value assigned to the acquired loan portfolio and intangibles with reference to the business plan, existing customer contracts and actual performance achieved. • **Benchmarking assumptions:** We assessed whether the discount rate used in calculating the fair value of the acquired intangibles reflected market conditions based on our knowledge of the industry. • **Test of details:** We tested the prospective financial information utilised in the valuation calculations by reference to our knowledge of the business. • **Assessing transparency:** We assessed the adequacy of the business combination disclosures by reference to the requirements in IFRS 3. **Our results** The results of our testing were satisfactory and we considered the RAF acquisition purchase price allocation to be acceptable.

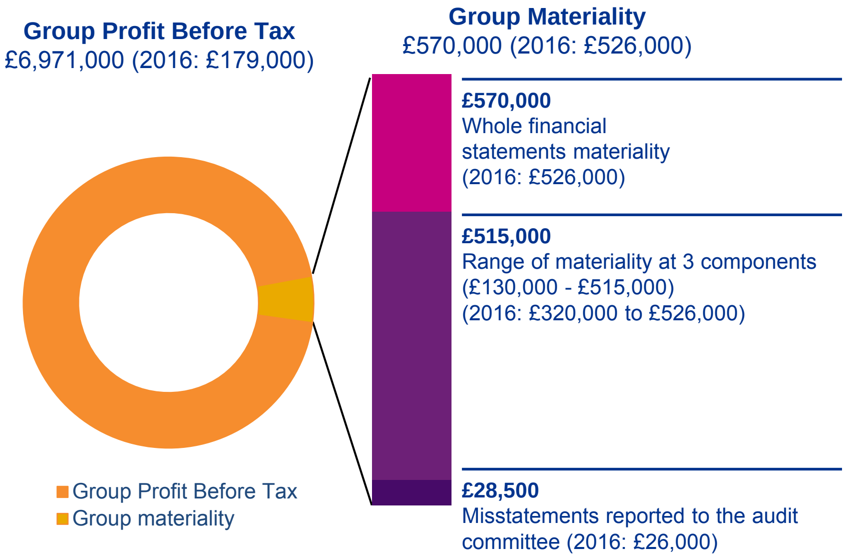
	The risk	Our response
Carrying Value of Investment in Associate Investment in Associate: £83,804,000 (2016: £82,574,000) *Refer to page 20 (Audit Committee Report), page 44 (accounting policy) and pages 58 & 102 (financial disclosures).*	**Subjective Estimate** The Group has an investment in Secure Trust Bank PLC ("STB") which is accounted for as an associate. The directors have assessed whether there is any impairment of the investment in light of the level of STB's share price. They have determined that the recoverable amount of the investment would be more appropriately determined through a 'value in use' calculation by reference to the expected dividend stream. The directors have prepared a bespoke model with input from professional advisors to calculate the value in use of the investment. As a result there is an inherent risk that the data and assumptions used in the calculation are not complete or accurate.	Our procedures included: • **Assessing valuer's credentials**: We evaluated the competence of the expert engaged by the directors to support the valuation methodology and key assumptions. This included consideration of their qualifications and expertise. • **Our corporate finance expertise:** We included corporate finance specialists in our audit team who challenged the valuation approach and assumptions determined by the directors. • **Our sector experience:** We challenged and assessed the reasonableness of the key judgemental areas of the calculation such as earnings and dividend growth based on our knowledge of the Group and experience of the industry in which it operates; • **Sensitivity analysis:** We have undertaken sensitivity analysis over the key valuation assumptions (i.e. return on equity, cost of equity, earnings and dividend growth). • **Assessing transparency:** We critically assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the balance and sensitivity of the value in use calculation to changes in key assumptions. **Our results** The results of our testing were satisfactory and we considered the valuation of investment in associate to be acceptable.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £570,000 (2016: £526,000), determined with reference to a benchmark of Group profit before tax which it represents 8% (2016: based on an aggregation of individual component materialities).

Materiality for the parent Company financial statements as a whole was set at £406,000 (2016: £526,000), determined with reference to a benchmark of parent company profit before tax, of which it represents 5% (2016: 4.5% of parent Company profit before tax).

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £28,500 (2016: £26,000), in addition to other identified misstatements that warranted reporting on qualitative grounds.



How we scoped our audit:

Audits for group reporting purposes were performed on all three (2016: two) reporting components, which were:

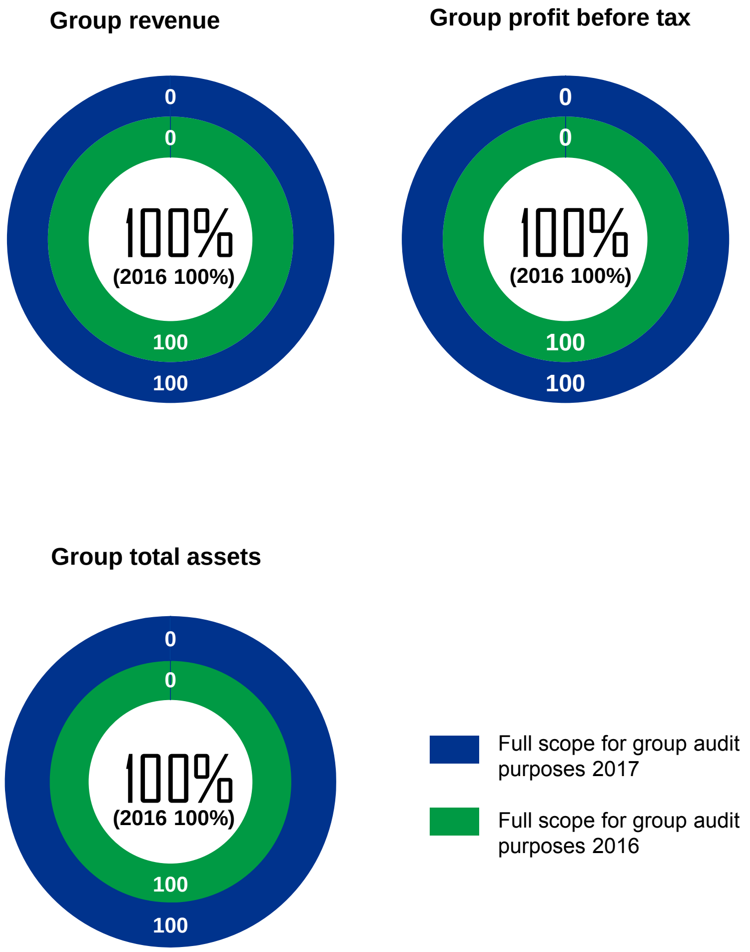
— Group holding company;
— Private banking subsidiary; and
— Asset finance subsidiary.

The components scoped in for Group reporting purposes accounted for 100% of Group revenue, 100% of Group profit before tax and 100% of Group total assets (2016: 100%).

The audit of the asset finance subsidiary was performed by a UK component audit team. The audit of the Group holding company, private banking subsidiary and consolidation was performed by the Group audit team.

The Group audit team managed and co-ordinated the component auditor in the following way:

- During the audit the Group audit team held regular telephone calls and face-to-face discussions with the component audit team to challenge audit risks and audit strategy. Through the calls and meetings, the findings and observations reported to the Group audit team were discussed in more detail and any further work required by the Group audit team was then performed by the component auditor.
- In addition, the Group audit team participated in the audit close out meeting with the component team to ensure all material issues affecting the Group were identified and communicated back to the parent company. We challenged and reviewed audit approaches to impairment provisioning and revenue recognition.



Scope – Disclosure of IFRS9 Effect

The Group is adopting IFRS 9 Financial Instruments from 1 January 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with *IAS 8 Changes in Accounting Estimates and Errors* as set out in note 3.27. This disclosure notes that the Group continues to refine its expected credit loss model and embed its operational processes which may change the actual impact on adoption. While further testing of the financial impact will be performed as part of our 2018 year end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

- Considered the appropriateness of key technical decisions, judgements, assumptions and elections made by management
- Considered key Classification and Measurement decisions, including Business Model Assessments and Solely Payment of Principal and Interest (SPPI) outcomes
- Considered credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios
- Considered transitional controls and governance processes related to the approval of the estimated transitional impact

4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

5. We have nothing to report on the strategic report and the directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- — we have not identified material misstatements in those reports;
- — in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and
- — in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion

- — adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- — the parent Company financial statements are not in agreement with the accounting records and returns; or
- — certain disclosures of directors' remuneration specified by law are not made; or
- — we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 23, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company'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 they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the group's regulatory correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statements items.

In addition we considered the impact of laws and regulations in the specific areas of regulatory capital & liquidity and conduct recognising the financial and regulated nature of the Groups activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related annual accounts items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
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27 March 2018