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 2018 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 2018 and of the Group's loss 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	£600,000 (2017:£570,000) 8.8% (2017: 8%) of Group profit before tax	
Coverage	100% (2017:100%) of group profit before tax	
Risks of material misstatement		**vs 2017**
Event driven	New: Brexit uncertainty	New matter
Recurring risks	Loan loss provisioning	▲
	Revenue recognition: effective interest rate	◀▶
	Investment property	▲
	Recoverability of parent company's investment in subsidiaries	◀▶

2. Key audit matters: including 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. The key audit matters in arriving at our audit opinion above were addressed in the context of, and solely for the purpose 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.

Brexit uncertainty

Refer to page 16 (strategic report)

The risk	Our response
Group and Parent **Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in loan loss provisioning, revenue recognition: effective interest rate and investment properties below and related disclosures and the appropriateness of the going concern basis of preparation of the annual accounts. All of these depend on assessments of the future economic environment and the Group's future prospects and performance. In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and to consider the directors' statement that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We have developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: — **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. — **Sensitivity analysis** – When addressing loan impairment, recognition of revenue: effective interest rate, investment properties and other areas that depend on forecasts, we compared the directors' sensitivity analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty. — **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on loan loss provisioning, revenue recognition: effective interest rate and investment properties we considered all the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. No audit should be expected to predict the unknowable factors or all possible future implications for a Group and this is particularly the case in relation to Brexit.

Loan loss provisioning

Group - £6.6 million; 2017: £1.4 million

Refer to page 26 (Audit Committee Report), note 3.10 (accounting policy) and note 23 (financial disclosures).

The risk

Group

Subjective estimate

IFRS 9 was implemented by the Group on 1 January 2018. This new standard requires the Group to recognise expected credit losses (ECL) on financial instruments which involves significant judgement and estimates to be made by the Group.

The most significant areas where we identified greater levels of management judgement are:

- Significant increase in credit risk (SICR) and the Group's definition of default – the criteria selected to identify a SICR and the Group's definition of default are judgmental and can materially impact the ECL by determining whether a 12 month (stage 1) or lifetime (stage 2 or 3) provision is recorded.
- Economic scenarios – IFRS 9 requires the Group to measure ECL on a forward-looking basis, incorporating future macro-economic variables reflecting a range of future conditions.
- Complex ECL model – inherently judgemental modelling techniques are used to estimate stage 1 ECLs which involves determining Probabilities of Default (PD) and Loss Given Default (LGD).
- Data capture - the ECL model uses a combination of static (e.g. original collateral valuation) and dynamic data (e.g. current balance/interest rates) about the Group's loans. Owing to the risk of associated with transferring system data to the impairment model (e.g. due to manual process) there is a risk that the data used in the ECL model is inaccurate.
- For loans classified as stage 2 or 3, these are individually assessed, an impairment assessment is required at an individual loan level, based on the probability of default and the estimated future cash flows discounted to present value at the loans effective interest rate ('EIR'). There are a number of data inputs and assumptions including the cost of obtaining and selling collateral and, probable sale proceeds.

The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. Note 4 of the financial statements discloses the sensitivities estimated by the Group.

Disclosure quality

The disclosures regarding the Group's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgments and material inputs to the IFRS 9 ECL results.

Our response

Our audit procedures over SICR and the Group's definition of default included:

— **Methodology implementation:** We compared the Group's SICR thresholds and definition of default with the relevant accounting standard.

— **Benchmarking assumptions:** We compared the Group's SICR thresholds and definition of default with other lenders.

Our audit procedures over the Group's economic scenarios included:

— **Sensitivity analysis**: We performed sensitivity analysis over the probability weightings attached to each economic scenario.

— **Benchmarking assumptions:** We compared the Group's probability weightings attached to each economic scenario to other lenders.

Our audit procedures over the Group's ECL model included:

— **Data comparison:** We checked a sample of the internal data used in the model back to the Group's and Bank's underlying source. We also checked the external inputs of collateral valuations to supporting documentation.

— **Methodology implementation:** We assessed whether the model, if applied as designed, would perform the impairment calculation as intended.

Our audit procedures over the Group's stage 2 and 3 loans where impairment indicators had been identified included:

— **Test of detail:** We tested the completeness of the Group's listing of loans classified as stage 2 or 3 by assessing the accuracy of arrears reporting.

— **Assessing valuers credential:** 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.

— **Sensitivity analysis:** We performed sensitivity analysis over the collateral valuation, time to sell and probability of default assumptions.

Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the expected credit losses. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear.

Revenue recognition: effective interest rate	

Group - *£65.3* million; 2017: £47.4 million
Refer to page 26 (Audit Committee Report), note 3.4 (accounting policy) and note 8 (financial disclosures).

The risk	Our response
Group **Subjective estimate** Using models, interest and fees earned and incurred on loans are recognised using the effective interest rate ('EIR') method that spreads directly attributable expected cash flows over the expected lives of the loans. The expected lives of loans are uncertain. The most significant areas where we identified greater levels of management judgement are: • Accounting implications - for originated loans, transaction costs are required to be spread over the EIR period. Given that transaction costs are often one-off costs, usually occurring either at the start or at the end of the contract, it is not uncommon for these to be overlooked when constructing EIR models. • Calculation error - the EIR model is complex and so open to the possibility of arithmetical errors and that modelling principles are not in accordance with accounting requirements. • Data capture - the EIR model uses data about the Group's loans that are sourced in other systems. The transfer of data from the underlying system to the EIR model is a manual process. There is a risk that the data used in the model is inaccurate. The effect of these matters is that, as part of our risk assessment, we determined that revenue recognition; effective interest rate has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. Note 4 discloses the sensitivities estimated by the Group.	Our procedures included: — **Methodology implementation:** We compared the application of the EIR methodology and the cash flows included in the models with the relevant accounting standard, checking that the model included the appropriate transaction costs. — **Tests of detail:** Through sample testing we assessed whether the model performs the EIR calculation as designed. — **Control operations:** We visited the servicer for the loan book not administered by the Group to test the relevant controls over the recording of loan balances and interest at these entities. — **Data capture:** We performed sample testing to assess the accuracy and consistency of the information provided by the servicer company to the Group; and that this is appropriately captured in the models. — **Sensitivity analysis:** We assessed the models for their sensitivity to changes in the key assumptions by considering different profiles to help us assess the reasonableness of the assumptions used and identify areas of potential additional focus. — **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. — **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the level of subjective estimation that exists when determining revenue recognition on the Group's loan portfolios. In addition, we challenged whether the disclosure of the key estimates and assumptions made was sufficiently clear.

Investment properties

Group - £67.1 million; 2017: £59.4 million

Refer to page 26 (Audit Committee Report), note 3.17 (accounting policy) and note 31 (financial disclosures).

The risk	Our response
Group **Subjective valuation** Investment property requires the directors to apply significant judgments and estimates to its fair value assessment. The directors have prepared models with input from professional advisors to calculate the fair value of the investment properties. As a result there is an inherent risk that the assumptions used in the calculations are not complete, accurate or appropriate. The effect of these matters is that, as part of our risk assessment, we determined that investment properties have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. Note 4 discloses the sensitivities estimated by the Group.	Our procedures included: — **Assessing valuers' credentials:** We evaluated the competence of the experts engaged by the Group to support the valuation methodologies and key assumptions. This included consideration of their qualifications and expertise. — **Our property valuation expertise:** With the assistance of our property valuation specialists, we challenged the valuation approaches and assumptions determined by the directors. — **Benchmarking assumptions:** We compared the Group's key assumptions on yields taking into account market data and asset-specific considerations. We also considered whether other key assumptions applied by the Group (i.e. estimated future rental value) were supported by available data. — **Sensitivity analysis:** We have undertaken sensitivity analysis over the key valuation assumptions (i.e. yields, renovation costs and future rental value). — **Assessing transparency:** We assessed the adequacy of the investment property disclosures by reference to the requirements in IAS 40.

Recoverability of parent company's investment in subsidiaries

Parent - *£134.6* million; 2017: *97.8* million

Refer to note 3.1a (accounting policy) and note 43 (financial disclosures).

The risk	Our response
Parent **Recoverability of investment** The carrying value of the parent Company's investment in subsidiaries represents 79% (2017: 70%) of the Company's total assets. Recoverability of the investment is not considered a high risk of significant misstatement or subject to significant judgement. However, due to the materiality of the investment in the context of the parent Company financial statements, this is considered to be the area that had the greatest focus of our overall parent Company audit.	Our procedures included: — **Tests of detail:** Compared the carrying amount of a sample of the highest value investments, representing 98% (2017: 98%) of the total investment balance with the relevant subsidiaries' balance sheet to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making. — **Assessing subsidiary audits:** Assessing the work performed during the subsidiary audits on that sample of those subsidiaries and considering the results of that work, on those subsidiaries' profits and net assets.

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

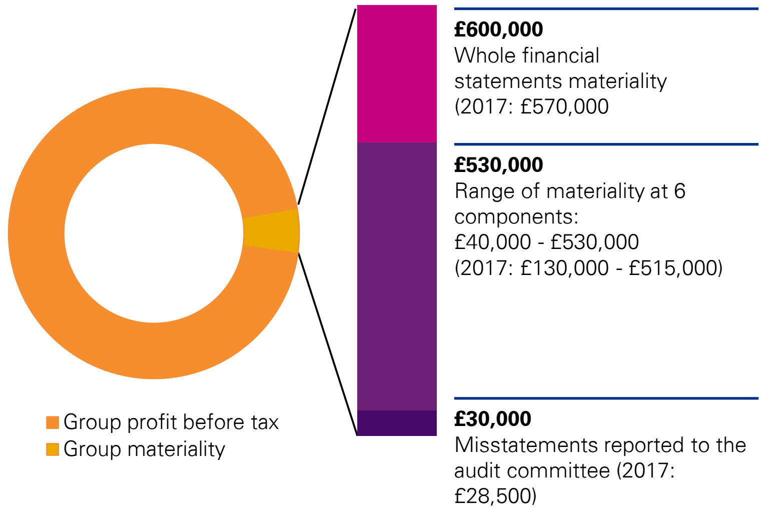
Materiality for the Group financial statements as a whole was set at £600,000 (2017: £570,000). This was determined with reference to the performance of the individual components within the Group, representing 8.8% (2017: 8%) of Group profit before tax.

Materiality for the parent Company financial statements as a whole was set at £386,000 (2017: £406,000), determined with reference to a benchmark of parent company profit before tax, of which it represents 4.5% (2017: 4.5% of parent Company profit before tax).

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £30,000 (2017: £28,500), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Group profit before tax
£6,780,000 (2017: £6,971,000)

Group Materiality
£600,000 (2017: £570,000)



How we scoped our audit:

Of the Group's 6 (2017: 3) components, we subjected 6 (2017: 3) to full scope audits for group purposes. The components within the scope of our work accounted for the 100% (2017: 100%) of Group revenue, 100% (2017: 100%) of Group profit before tax and 100% of Group total assets (2017: 100%).

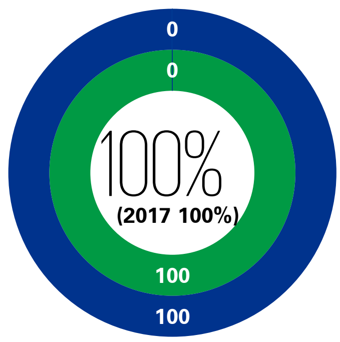
The Group team approved the component materialities which ranged from £40,000 to £530,000 (2017: £130,000 to £515,000), having regard to the mix of size and risk profile of the Group and components.

The audit of one (2017: one) component was performed by a UK component audit team. The audit of the remainder of the Group was performed by the Group audit team.

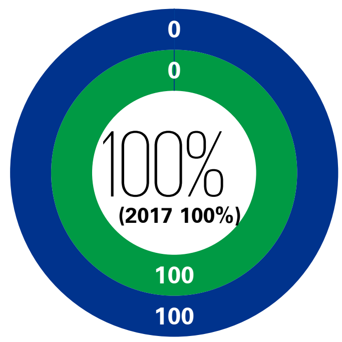
The Group team instructed the component auditor as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back.

Telephone conference meetings were held with the component auditor. At these meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

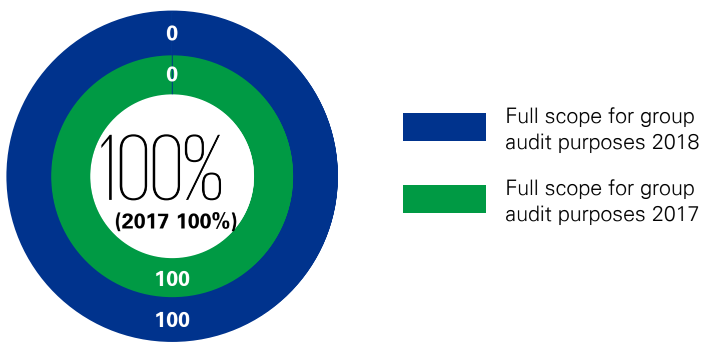
Group revenue



Group profit before tax



Group total assets



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4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the group or the company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period was the impact of Brexit on the Group and Company's liquidity and capital resources, in particular:

- availability of funding and liquidity in the event of a market wide stress scenario including the impact of Brexit, and
- impact on regulatory capital requirements and resources in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise.

Based on this work, we are required to report to you if:

— we have anything material to add or draw attention to in relation to the directors' statement in Note 2e to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least a year from the date of approval of the financial statements

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information 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 the other information.

Strategic report and directors' report

Based solely on our work on the other information:

— we have not identified material misstatements in the strategic report and the directors' report;

— in our opinion the information given in those reports 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.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

— the directors' confirmation within the director's report on page 19 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;

— the Risks and Uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and

— the directors' explanation in the Group Director's Report – Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

Corporate governance disclosures

We are required to report to you if:

— we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

— the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in these respects.

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 21, 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 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 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 annual accounts from our general commercial and sector experience, through discussion with the directors (as required by auditing standards), and from inspection of the Group's regulatory correspondence and discussed with the directors the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. The potential effect of these laws and regulations on the annual accounts varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the annual accounts including financial reporting legislation (including related companies legislation, distributable profits legislation and taxation legislation), and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the annual accounts, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity, conduct, financial crime including money laundering and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities.

Through these procedures we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items The actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the annual accounts, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statement , the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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.

Pamela McIntyre
(Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
March 2019

KPMG