

OakNorth Bank Limited

Independent auditor's report to the members of OakNorth Bank Limited

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of OakNorth Bank Limited (the 'company') which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the cash flow statement;
- the statement of accounting policies; and
- the related notes 1 to 30.



The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

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

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Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: <ul style="list-style-type: none">• Loan loss provisioning; and,• Revenue recognition
Materiality	The materiality that we used in the current year was £1.1 million which was determined on the basis of equity.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included 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.

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Loan loss provisioning

Key audit matter description



In accordance with Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" ('FRS102'), the bank has chosen to apply the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement*.

OakNorth Bank Limited ('OakNorth', 'the bank') holds an incurred but not reported ('IBNR') provision of £2.3 million at year end (2016: £937K) against loans and advances to customers of £607 million (2016: £225.5 million).

For further details please refer to the critical accounting judgements and key sources of estimation uncertainty note and note 9 on page 51 in the financial statements.

The IBNR involves management judgements in respect of the emergence period, probability of default and loss given default.

Given the significant level of management judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.

How the scope of our audit responded to the key audit matter



We updated our understanding of the business rationale for the IBNR provision and we assessed the design and implementation of controls around the IBNR methodology.

We evaluated the IBNR approach to determine whether it is appropriate based on IAS 39 and our knowledge of the business. We also tested the inputs and assumptions for the provision to assess whether they are consistent with our understanding of current market conditions and the bank's portfolio.

We also re-performed the calculation of the IBNR provision to verify arithmetic accuracy and traced inputs to supporting documentation.

To evidence the challenge of the estimate by management and directors, we reviewed board and committee minutes and papers.

Key observations



Overall, we found that the IBNR provisioning methodology used by the bank is in line with IAS 39 and is reasonable given the size of the bank and its stage of early development.

The bank's provision model was found to be working as intended and the underlying assumptions are reasonable.

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Revenue recognition

Key audit matter description



The main revenue stream within OakNorth is interest income of £31.2 million (2016: £8.7 million) which should be recognised based on the effective interest rate method in accordance with IAS 39. Additional revenues are earned from fees and commissions totalling £3.4 million (2016: £480K) charged to customers for transactions. Revenue has increased significantly in 2017 due to growth in the loan book.

For further details please refer to the profit and loss statement on page 34 and the accounting policy note in the financial statements for revenue recognition.

The application of the effective interest rate method in deriving the interest income recognised involves management judgement, specifically around the interest rates. In addition, the calculation and booking of fees and commissions are manual and therefore there is potential for error and fraud through possible manipulation of this balance.

How the scope of our audit responded to the key audit matter



We reviewed the bank's revenue recognition policies and discussed these with management to verify their appropriateness to the bank's specific circumstances, that they are compliant with applicable accounting standards and that they have been applied consistently throughout the year.

We evaluated the design and tested the implementation of controls related to the recognition of fee income and the methodology of the fee amortisation calculation.

We considered all types of fees and commissions charged by OakNorth to its customers and assessed the accounting treatment adopted for each type by reference to the relevant contractual arrangements.

For a sample of loan facilities we recalculated the commission and fee income due based on the facility terms and checked that the income had been recognised in the correct accounting period.

Key observations



We found the application of the effective interest rate method in deriving the interest income recognised to be appropriate and in accordance with IAS 39.

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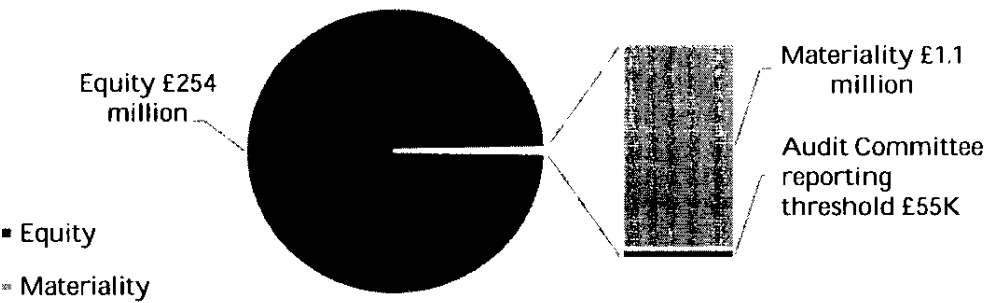
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Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£1.1 million
Basis for determining materiality	Materiality has been determined on the basis of 1% of equity.
Rationale for the benchmark applied	Equity has been used as the basis for materiality to reflect what we believe to be the key external metric; regulatory capital, which is proxied by the equity balance.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £55K, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the company and its environment, including internal controls, and assessing the risks of material misstatement. Audit work

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to respond to the risks of material misstatement was performed directly by the audit engagement team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

We have nothing to report in respect of these matters.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the 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 the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.