the tipton
& coseley building society

2018

Annual Report and Accounts

Contents

Directors' Report
for the year ended 31 December 2018

The Board is pleased to present its annual report and accounts and annual business statement for the year ended 31 December 2018.

Business Objectives and Activities

Purpose
Our principal purpose is 'enabling people to own their home at all stages of life' through the provision of residential mortgages. This is true to our founding principles and is supported through us raising funds from savings members and in doing so providing them with a safe and secure home for their savings.

Being a mutual building society means we do not have to maximise profits, but we do have to find an appropriate balance between rewarding members with competitively priced products and investing for the future benefit of members, whilst maintaining our financial strength.

We passionately believe in treating members as individuals and providing quality personal service. This is demonstrated in our approach to mortgage processing where we individually assess every new mortgage application on its merits and our mortgage team spend quality time engaging with potential borrowers to clearly understand their individual circumstances. For savings members, the personal service we provide, both in branch and over the telephone, is overlaid with our approach to ensuring our more vulnerable members remain safe.

Business Review

The Economy and Market Place
The year has been dominated by the negotiations over the UK's withdrawal arrangements from the European Union (EU), Brexit. This has resulted in many challenges for the UK economy, not least the continuing uncertainty of a no deal scenario and the implications for any future trading relationship post 29 March 2019.

This continuing uncertainty has fed through to the housing market where activity has reduced and annual transaction levels have fallen below 1.2m for the first time since 2013. It has also been reflected in house price movements with the Nationwide House Price Index reporting a year on year increase of just 0.5% at 31 December 2018 and some market commentators forecasting future reductions in house prices. UK economic growth has been subdued and is expected to remain so whilst market uncertainty exists.

In August, on the back of rising inflationary pressures, the Bank of England (the Bank) increased base rate to 0.75%, the second increase in less than 12 months, and the first time base rate has been higher than 0.50% since early 2009. The Bank also signalled its intention for further base rate rises on a slow and steady trajectory over the next three years although the timing of further changes remains uncertain.

Against this background the mortgage market continues to be extremely competitive and has seen larger volume lenders seek increased returns by entering market segments traditionally occupied by building societies. This has continued to suppress mortgage rates to historical lows despite the increase in bank base rate. It has also impacted savers who have once again seen little change in interest rates in many segments of the market.

Our Performance
In spite of the ongoing economic uncertainty we have delivered a strong financial performance culminating in a record year for gross mortgage advances of over £84m. The growth in our mortgage book was partially offset by a purposeful reduction in liquid assets resulting in total asset growth of 1.9%.

Directors' Report
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As noted last year, we continue to develop our systems and processes and to make strategic investment decisions to ensure the Society is successfully positioned to adapt to the increasing pace of change in our marketplace, which is being disrupted by both technology and new entrants. We have also continued to invest in our people, during 2018 we further strengthened our Senior Leadership Team with the appointment of a new Director of Sales & Marketing and a new Director of Information Technology. It is pleasing to note that our increased capabilities did not go unnoticed with the Society receiving an industry award for 'Best use of Technology' and being highly commended for its new Retirement Interest Only (RIO) mortgage product.

David Cox, Sally Wrigglesworth and Richard Newton (CEO) collecting our 'Best use of Technology' Award

As we implement change to promote mortgage book growth it is important that we are able to offer a range of products that retain existing borrowers, and also attract new borrowers. While striving to gain new business in a highly competitive marketplace we endeavor to offer long-term value to existing borrowers by combining the best products we can offer with great customer service.

We remain acutely conscious of the need to balance the conflicting needs of savers and borrowers, given our size and scale differences to the high street names, we are naturally a market follower. Consequently in the current market conditions with base rate at a mere 0.75% we are not able to go against market trends or to continually offer market leading rates. Nevertheless we keep our range of saving products under continuous review and aim to launch products that offer sustainable good value to our saving members.

Key Performance Indicators

Society	2015	2016	2017	2018
Gross Mortgage Lending	£52.1m	£66.6m	£57.7m	£84.6m
Savings Balances	£319m	£331m	£323m	£313m
Profit before Taxation	£2.9m	£2.1m	£1.7m[1]	£1.7m
Net Interest Margin	1.69%	1.59%	1.66%	1.79%
Management Expenses	1.06%	1.15%	1.32%	1.38%
Liquidity ratio	24.88%	24.90%	23.28%	20.88%
Tier 1 Capital ratio	29.22%	28.11%	29.44%	30.56%

[1] 2017 excludes a one-off dividend of £232k received from the winding up of our subsidiary company, Tipton & Coseley Financial Services Ltd.

Mortgages

Our achievement of record gross mortgage lending of over £84m, an increase of 46% over 2017, has resulted in mortgage book growth of 5%. This increase in lending has been the result of a number of factors including a fresh approach to the development of our mortgage intermediary offering and our tailored and personal approach to underwriting. Our underwriters fully assess each mortgage application on its own merit (we do not operate automated credit scoring) which ensures that each customer's unique circumstances and affordability requirements are considered from the outset.

We are committed to providing mortgage products to customers at all stages of life as demonstrated by our diverse product offering. This includes products for First Time Buyers with or without family assistance, products for older borrowers with our Later Life lending range which includes our new RIO mortgage, products for those who aspire to build their own home, and products for second homes and for Buy to Let. Our diverse product range ensures that we do not become over exposed to any one area of the market and are well positioned to combat future market changes.

Directors' Report
for the year ended 31 December 2018

It is pleasing to report that performance of our mortgage book remains strong reflecting our robust underwriting processes, and the combined effect of the low interest rate environment and historical house price inflation. The average loan to value (LTV) of the mortgage book is 47.8% (2017: 47.5%). Overall arrears levels have remained at historically low levels and at the year-end there were no mortgages 12 months or more in arrears (2017: none).

Savings

Following the Bank base rate rise in August we increased rates on all accounts from October having taken into consideration a number of factors including market conditions and comparable accounts from other providers. We consider our current rates to be comparable to equivalent account types in the market place. During the year we also continued to restrict the availability of our savings accounts for new customers so that we could carefully control inflows of new funds. The total of shares and deposit balances at the end of the year was £313m.

Profitability and Capital

Operating profit for the year reduced slightly from £1.74m to £1.67m. The increase in net interest income of £0.5m to £6.6m was offset by increased expenditure for the long-term benefit of the Society, and a lower level of release of provisions for bad and doubtful debts than in the prior year.

The profit after tax ratio remained healthy at 0.37%; sufficient to increase our capital reserves to over £39m and our Tier 1 ratio to 30.5%. Our reserves form the majority of our capital and arise from our retained profit. For most smaller building societies this is the only realistic source of capital. We have a particularly strong capital position and at the end of 2018 after transferring £1.3m to general reserves our gross capital (total reserves) increased to £39.8m, 12.06% (2017: 11.84%) of shares and borrowings, and free capital (aggregate of gross capital and collective loss provisions less total fixed assets) to £39.3m, 11.92% (2017: 11.74%) of shares and borrowings.

Management Expenses

Management expenses increased by 4.3% to £5.1m in 2018 and reflects our investment in our people, processes and technology during the year. Our ongoing investment will ensure we have the long-term capability to deliver sustainable balance sheet growth whilst remaining operationally resilient and improving customer access to our products. We are also continuing to maintain and strengthen our defences against cyber security risk. Whilst cost control remains an important focus, as we continue to invest in these areas and to keep abreast of new and changing market and regulatory conditions, we expect continued pressure on our management expenses ratio during 2019.

Assets

Mortgage book growth of £14m was funded by a combination of a controlled and purposeful reduction in our liquid assets and through accessing funding from the Bank's Term Funding Scheme (TFS). Overall net balance sheet growth was 1.9%, with total assets increasing to £370.7m (2017: £363.9m).

Liquid Assets

We maintain a prudent level of liquid assets with 'on-balance sheet' liquidity in the form of cash in hand and deposits with credit institutions. Liquidity comfortably exceeded the minimum regulatory requirements, with the Liquidity Coverage Ratio (LCR) at the 31 December 2018 being 345%; the liquidity ratio was 20.72% (2017: 23.28%).

We are now able to operate at a more efficient level of liquidity as we gained access to the various Bank of England facilities under the Sterling Monetary Framework during 2018; these are supported by pre-positioned collateral. When this is taken into account, the total liquid resources available to the Society at the year-end was 25.2% of shares and borrowings.

Directors' Report
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Review of Events

The mortgage market remained extremely competitive with many lenders reducing rates and relaxing underwriting criteria in order to attract volume. Our approach continues to focus on the individual needs of customers with tailored and personal underwriting. This approach enabled us to be one of the first building societies to offer RIO mortgages and also bring to market our innovative holiday let mortgage that allows AirBnB rentals, both of these products have seen a good level of interest and demand.

As part of our Board succession plan we had a number of changes at Board level in 2018. David Bassett retired at the conclusion of the AGM in April and Marcus Daly retired from the Board in June. Both had provided long and committed service to the Society. The Board would like to express its thanks for their significant contributions and wishes them both well for the future. Sara Shepherd resigned from the Board in July to allow her to spend more time on her commercial activities. The Board would like to express its appreciation of her contribution and to wish her well for the future. We welcomed Sally Veitch to the Board in June and we appointed Conrad Almond in February 2019.

Supporting and engaging with our local community is one of our core principles. During the year we donated £10,678 all of which went to our charitable foundation which in turn made or promised donations to 15 local charitable causes.

Members and staff helped us exceed our fundraising target for the Midlands Air Ambulance Charity raising over £6,000, this is a fabulous cause which receives no Government or National Lottery funding.

Supporting Midlands Air Ambulance Charity

Staff support included various fundraising events including a sponsored tandem sky dive, sponsored cycle ride and dress down days. Staff also donated an amazing 140kg of food and 26kg of non-food items to the Black Country Food Bank during December. For 2019 our staff have decided to continue our support of the Midlands Air Ambulance Charity.

Our charitable foundation supporting local charities

Zoe Bond, Finance Technician, mid-air during her sponsored tandem sky dive

Outlook

At the time of writing it appears that 2019 will be dominated by the continuing Brexit negotiations and the transition, if any, that can be agreed with the EU. Whilst it remains to be seen what impact this will have on the housing market and wider UK economy we are confident that the Society is well positioned to withstand the impact of these matters.

This year will see us continuing to develop our product proposition and to build on the strong performance of 2018. We recently launched a new range of saving accounts which are specifically focussed on supporting our local community, paying a competitive rate of interest to members and also a contribution, based on average balance, to our Charitable Foundation. This will enable the Foundation to assist a greater number of local good causes each year. In addition, we will continue developing our digital offering so ensuring members are better able to transact with us in a way and at a time that is more convenient for them in the future.

Above all, we are committed to remaining an independent mutual building society, treating our members as individuals and providing them with a great personal service.

Our Staff

On behalf of the Board, I would like to thank our staff for the vital part they play in our continuing success. They are the key element in the quality of what we do and the great service that members receive.

Creditor Payment Policy

It is our normal policy to agree the terms of payment at the commencement of trading with each supplier, to ensure that they are aware of those terms and to abide by them. Where terms of payment have not been agreed we settle the supplier's invoice on being satisfied that the supplier has fully conformed with the terms and conditions of purchase. The creditor days were 11 at 31 December 2018 (2017: 8 days).

Going Concern

The directors have considered the risk and uncertainties discussed on page 7, including the possible impact of a no deal Brexit scenario and the extent to which they might affect the preparation of the Annual Report and Accounts on a going concern basis.

The Society's business activities and future plans are set out on page 2. The directors have prepared forecasts which take account of current and possible future operating conditions, including stress testing and scenario analysis. These indicate that the Society has sufficient operating liquidity and capital for the foreseeable future.

As such the directors are satisfied that the Society has adequate resources to continue in business for the foreseeable future. For this reason, the accounts continue to be prepared on the going concern basis.

Financial Risk Management Objectives and Policies

The Society operates in an environment where financial risks arise as a natural consequence of its business activities. To mitigate these risks the Society operates a formal structure for managing risk which is closely monitored and controlled by the Board, supported by the Audit & Compliance, Risk, Nominations and Remuneration Committees. In addition, the Society operates four executive management sub committees which actively measure and monitor risk; the Executive Assets & Liabilities Committee (ALCO), the Executive Retail Credit Risk Committee (RCRC) and the Executive Operations Committee report into the Risk Committee; the Executive Compliance Committee reports into the Audit & Compliance Committee.

Risk Management Approach

The Board has overall responsibility for risk management process and for ensuring that the approach is aligned to business strategy and objectives. The Board has put in place a formal risk management framework, which includes a Risk Committee comprising three Non-Executive Directors, risk policy statements, exposure limits, mandates and reporting lines, and an active risk review process. Risks are monitored, assessed and are the subject of strategic policies approved by the Board.

As part of the Capital Requirements Directive (CRD), the Board has conducted an assessment of the adequacy of the Society's capital resources, and information about the Society's Pillar 3 disclosures, which are a requirement of the CRD, together with the disclosures to comply with the requirements of Article 89 of the Capital Requirements Directive IV (CRD IV), are provided on the Society's website.

The Society uses financial instruments for risk management purposes, the nature of these instruments and details of the financial risks are set out in note 27.

Principle Risks and Uncertainties

Managing risk is an inevitable part of running any successful business, and many of the risks the Society faces are those normally associated with any business striving to prosper in a competitive market: margin pressures, regulatory and statutory developments, reputation, staff recruitment and retention as well as the challenges presented by cyclical changes in the economy. The Society has a risk management framework that ensures it carefully manages the principal risks and uncertainties arising from its activities, and therefore helps to protect members' interests.

The principal risks and uncertainties are set out below:

Business Risk

Business risk is the risk of loss or reduction in profitability which arises from changes in business or economic conditions, including the failure to deliver business objectives within the corporate plan or implement the required strategy. The Society manages this with a long-term focus on ensuring a sustainable business model, encompassing carefully developed and detailed business plans and policies, which include maintaining a diverse product portfolio. The key business risks and uncertainties include:

Reducing mortgage yield – increasing competition within the mortgage market puts pressure on the Society's interest margin through reducing mortgage yields. The Society has a clear risk adjusted pricing mechanism to monitor the mortgage yield being generated by new lending with growth plans being adjusted accordingly should yield move outside of acceptable tolerances;

Retail savings competition – with all Bank of England funding stimulus now ended there is a risk that competition to acquire new retail savings increases the cost beyond that included within the corporate plan. Market conditions are monitored closely to ensure product mix and cost is aligned to the corporate plan, with growth plans being adjusted accordingly should they move outside of acceptable tolerances;

Management expenses – are expected to increase over the short-term due to continued investment in our people, processes and technology. There is a risk that they continue to increase after this period beyond corporate plan expectations. Management expenses are monitored closely against the corporate plan and if necessary the Society will adjust its future plans to ensure management expenses remain at acceptable levels; and

Business Change – investment in processes and technology is important for the growth of the Society and for enhancing the ways in which customers do business with us. As the strategic investment programme evolves it is important that risks are managed and resources prioritised to ensure maximum benefit whilst protecting member interests. This risk is controlled through an Executive Management programme board overseen by the Risk Committee.

The Board has formal oversight and monitoring of business performance.

Credit Risk

Credit risk is the risk that customers or counterparties will not meet their financial obligations to the Society as they fall due. This risk is most likely to arise in the potential inability of customers to make repayments on their mortgage, and of treasury counterparties to repay loan commitments. The Board has established a treasury policy framework which limits treasury exposures to only those institutions considered highly credit worthy along with limits in place to restrict the amount of exposure that can be taken in relation to any one counterparty, industry sector and geographic region. Monitoring and oversight of treasury positions is performed by ALCO with further oversight provided by the Risk Committee.

Mortgage Credit risk is managed through the Society's underwriting process which seeks to ensure that customers only assume a debt that they can afford to repay. All mortgage applications are rigorously assessed with reference to the Society's lending policy; changes to policy are approved by the Board and the approval of mortgage applications is mandated. No matter how prudent our lending policy is, a change in circumstances may lead to some customers getting into financial difficulties. The Society is highly proactive in providing support which can include working with customers to clear arrears, making arrangements, or forbearance. Exposure to mortgage credit risk is monitored by the RCRC with further oversight provided by the Risk Committee.

Interest Rate Risk

Interest rate risk is the risk that the income and expenditure arising from the Society's assets and liabilities may change adversely as a result of changes in interest rates. One particular type of interest rate risk is basis risk, this is the risk that assets and liabilities that are linked to different variable indices (such as Base Rate or LIBOR) may not move in accordance with each other.

The Society is exposed to movements in interest rates and manages this exposure on a continuous basis, within limits set by the Board. Monitoring and oversight of interest rate risk is performed by ALCO with further oversight provided by the Risk Committee. The interest rate sensitivity of the Society is set out in note 27.

Liquidity and Cash Flow Risk

Liquidity and Cash Flow risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only do so at excessive cost. The Board approved liquidity policy is to maintain sufficient liquid resources both as to amount and quality to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its financial obligations as they fall due. In addition, regular stress testing is performed to confirm the level of liquid resources is adequate under adverse scenarios.

The Society maintains a level of liquid assets in line with the Board approved treasury policy. Adherence to these limits is monitored by the Finance Director on a day to day basis with further oversight provided by ALCO and the Risk Committee.

Operational Risk (including Cyber Risk)

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. The Society mitigates this risk through having a strong and effective internal control environment in which risks are monitored and controlled on a regular and timely basis by the Risk and Compliance team. In addition, insurance is used to transfer some risks. Controls have been established and are maintained which appropriately address the risks identified and ensure prudent conduct of the business in accordance with Society policies and risk appetite, and compliance with relevant laws, regulations and rules.

The threat of cyber risk continues to increase with a number of high profile attacks reported in the media during the year. Protecting our systems against potential cyber attacks remains an ongoing focus of our risk management with further investment made during 2018 on additional safeguarding measures to increase resilience.

Exposure to operational risk is monitored by the Executive Operations Committee with further oversight provided by the Risk Committee.

Conduct Risk

Conduct risk is the risk that the Society's behaviour leads to poor customer outcomes. Our Conduct Risk Policy sets out in detail the manner in which the Society should conduct business with its customers to ensure this does not lead to poor outcomes for them. On a day-to-day basis the Compliance team are responsible for monitoring conduct risk and assessing the controls in place to manage the risk. Further monitoring of conduct risk is carried out by the Executive Compliance Committee with further oversight provided by the Audit & Compliance Committee.

Financial Services Compensation Scheme (FSCS)

In common with all regulated UK deposit takers the Society pays levies to enable claims on the FSCS to be met. Uncertainty therefore exists that the Society may be required to pay an increased amount of levies if claims on the FSCS increase. The Board monitors this requirement closely to ensure that the Society is well placed to meet any increases in levy requirement. Full details of the Society's financial commitment to the FSCS are set out in Note 23.

Brexit

The Society is unlikely to be directly affected by the UK leaving the EU as it operates entirely in the UK. However, there is significant uncertainty around the indirect impact and potential risks for the wider UK economy. In November 2018 the Bank of England published a report ('EU withdrawal scenarios and monetary financial stability') setting out the possible impacts arising from various Brexit scenarios. The report, amongst other risks, considers the possible impact to bank base rate, mortgage rates, house price inflation, unemployment and inflation, all of which can have an impact on the financial performance of the Society to some degree.

The Board, as part of its corporate planning process, have considered the results of various scenario and sensitivity analysis, including that of a no deal scenario, to help inform and quantify the possible risks to the Society arising from Brexit. Economic conditions will be monitored closely and mitigating actions have been identified to adjust the corporate plan should the need arise.

Directors' Report
for the year ended 31 December 2018

Directors' Responsibilities in respect of the Annual Report and Accounts, the Annual Business Statement, and the Directors' Report

The directors are responsible for preparing the Annual Report and Accounts, Annual Business Statement and the Directors' Report in accordance with applicable law and regulations.

The Building Societies Act 1986 ("the Act") requires the directors to prepare annual accounts for each financial year. Under that law they have elected to prepare the annual accounts in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

The annual accounts are required by law to give a true and fair view of the state of affairs of the Society as at the end of the financial year and of the income and expenditure of the Society for the financial year.

In preparing the annual accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the annual accounts;
- assess the Society's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

In addition to the annual accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society.

Directors' Responsibilities for Accounting Records and Internal Controls

The directors are responsible for ensuring that the Society:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Society, in accordance with the Act; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors are responsible for 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, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Society and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of annual accounts may differ from legislation in other jurisdictions.

Directors

The following served as Directors of the Society during the year:

Non-Executive Directors

D G Bassett ACII, Cert PFS (retired 16 April 2018)
M H P Daly FCA (retired 28 June 2018)
A J Higgins MA, FCA (Chairman)
M Hrycyk MBA
G E Loynes MRICS, FAAV
K A Rolfe BSc (Hons) (Vice Chairman and Senior Independent Director)
S J Shepherd BA (resigned 26 July 2018)
S J Veitch MA, ACA (appointed 28 June 2018)

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Executive Directors

A J Lumby FCA (Finance Director – appointed 29 January 2018)
R J Newton FCCA, ACIB (Chief Executive)

No director has any beneficial interest in the shares of any connected undertaking of the Society.

Post Balance Sheet Events

There are no post balance sheet events to report.

Auditor

The external auditor, KPMG LLP, has indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are aware, there is no relevant audit information of which the Society's auditor is unaware; and each Director has taken all steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

A J Higgins, Chairman
5 March 2019

Corporate Governance Report

The purpose of the UK Corporate Governance Code (the Code) is to facilitate effective, entrepreneurial and prudent management to deliver long-term success of a company. The Board support the principles of the Code (April 2016) and has regard for the requirements when developing its governance policies and practices.

The Society will be reviewing its corporate governance practices in 2019 in line with the revised code issued by the Financial Reporting Council (FRC) in July 2018 applicable for accounting periods beginning on or after 1 January 2019.

The Society's regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) also require the Board to have regard for the Code.

Leadership

The Role of the Board

Code Principle A1: Every company should be headed by an effective Board, which is collectively responsible for the long-term success of the company.

Board Comment: The Board directs the business of the Society by developing and monitoring strategic matters such as the corporate plan and business objectives. The Board is also responsible for reviewing the performance of the Executive Directors, ensuring that risk management is effective, overseeing compliance with regulations and statutory requirements, confirming that adequate financial resources are in place and that the right people with the right skills and experience are employed by the Society. At its heart is safeguarding the members by ensuring the Executive Directors act in line with the best interest of the Society consistent with their statutory duties. The Society maintains liability insurance cover for Directors and Officers.

The Senior Leadership Team (SLT) carry out the day to day duties resulting from the corporate plan, other Board policies and regulatory and statutory matters. A transparent culture and constructive challenge is encouraged to deliver further improvements for the benefit of the Society's members.

The Board's focus continues to be on strategy and risk management and it holds regular meetings. It is advised by, and delegates certain matters to Board sub-committees, Audit & Compliance, Remuneration, Risk, and Nominations Committees. This included the Assets & Liabilities Committee (ALCO) until October 2018, when it was replaced by an Executive ALCO, with the Risk Committee assuming responsibility for Board delegated matters. A brief description of the work of these Committees is given below and detailed terms of reference are available from the Secretary. The Board meets at least twice a year without the Executive Directors being present. An annual strategy day is also held at which the Board and SLT focus on the Society's future strategy.

Audit & Compliance Committee

The Audit & Compliance Committee meet at least four times a year and comprises three Non-Executive Directors, Sally Veitch (Chair), Myron Hrycyk and Gavin Loynes.

The Board is satisfied that at least one member of the Committee has recent and relevant financial experience. The Committee oversees the adequacy of internal controls, and ensures an effective system of inspection and report. It reviews the annual accounts prior to approval by the Board; monitors and assesses the external auditors, including their effectiveness and independence; approves and monitors the policy for non-audit services; and approves and monitors the internal audit plan and findings. The Committee oversees the compliance function and ensures that the Society complies with the law, requirements and standards of the regulatory system including anti-money laundering regulations and voluntary codes of practice. It also approves the Compliance Policy and annual Compliance Monitoring Plan.

Remuneration Committee

The Report of the Remuneration Committee on page 16 contains details of the Committee, its composition and duties.

Assets & Liabilities Committee (ALCO)

The Board Assets & Liabilities Committee met three times until October 2018 and comprised Non-Executive Directors, Andrew Higgins (until 29 June 2018), and Keith Rolfe; and Executive Directors, Richard Newton (Chief Executive and Committee Chairman) and Andrew Lumby (Finance Director). The Committee developed treasury management policies relating to liquidity, wholesale funding and financial risk management; monitored assets and liabilities structure and risk, and reviewed mortgage and savings products.

Nominations Committee

The Nominations Committee meets at least twice a year and consists of Andrew Higgins (Chairman), Richard Newton (Chief Executive) and Keith Rolfe, Vice-Chairman of the Board and the Senior Independent Director, who is a contact point for the members.

The Committee regularly reviews the Society's succession plans and considers carefully the skills and attributes necessary for Board appointments. It leads the process for Board appointments and assesses Directors' independence.

Risk Committee

The Risk Committee meets four times a year. The Committee comprises three Non-Executive Directors, Keith Rolfe (Committee Chairman), Myron Hrycyk and Sally Veitch, and is responsible for developing and reviewing the Society's risk management framework; ensuring there is a comprehensive understanding of the risks facing the Society, the potential likelihood and impact of occurrence and how such risks are being mitigated.

The Committee monitors the Society's Risk Register ensuring that all principal risks are identified and adequately mitigated against. It also conducts an annual review of the effectiveness of the Society's risk governance arrangements.

Division of Responsibilities

Code Principle A2: There should be a clear division of responsibilities at the head of the company between the running of the Board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

Board Comment: The offices of Chairman and Chief Executive are distinct, separate and held by different people. The Chairman is responsible for leading the Board and ensuring that Directors receive clear, timely and accurate information. The Chief Executive's role is to lead the Society in an efficient and effective manner and to achieve the objectives set by the Board in accordance with its policies.

The Chairman

Code Principle A3: The Chairman is responsible for leadership of the Board and ensuring its effectiveness on all aspects of its role.

Board Comment: The Chairman sets the culture and direction of the Board, facilitating and encouraging effective contribution and challenge from Directors. The Chairman is responsible for maintaining constructive relations between the Non-Executive and Executive Directors and ensuring that Directors receive accurate, timely and clear advice and information. The Chairman was appointed in June 2018 as a result of his experience, commitment and capability demonstrated during his service to the Society. The Board considers that the Chairman met the criteria of independence on his appointment.

Non-Executive Directors

Code Principle A4: As part of their role as members of a unitary Board, Non-Executive Directors should constructively challenge and help develop proposals on strategy.

Board Comment: The Society's Non-Executive Directors are recruited from a wide range of backgrounds to ensure they have the necessary breadth of skills, knowledge and experience to monitor and challenge performance of the Society in a constructive manner whilst providing an appropriate level of support to the SLT. Non-Executive Directors regularly debate strategy and long-term sustainability at Board and Committee meetings.

Effectiveness

The Composition of the Board

Code Principle B1: The Board and its Committees should have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively.

Board Comment: The Society's Nominations Committee ensures that the Board has the necessary skills and knowledge to enable the Society to compete effectively in the current challenging economic climate.

The Board currently has six Non-Executive Directors and two Executive Directors who provide a balance of skills and experience across a wide range of disciplines.

All Non-Executive Directors are considered by the Board to be independent in character and judgement. The Vice Chairman is the Senior Independent Director. He provides support to the Chairman and is an alternative route for communication from members and staff. His main responsibilities are to chair the Board if the Chairman is absent and to facilitate the annual appraisal of the Chairman.

Appointments to the Board

Code Principle B2: There should be a formal, rigorous and transparent procedure for the appointment of new directors to the Board.

Board Comment: As noted earlier, the Nominations Committee leads the process for Board appointments. The Society values diversity but always makes appointments on merit, based on the specific skills and experience required to complement existing skills under the succession plan. All vacancies are openly advertised. The Board as a whole makes the final decision. Care is taken to ensure that new directors can devote sufficient time to the position. All Directors must meet stringent fitness and propriety standards in order to fulfil their senior management function responsibilities and if required be approved by the Regulators.

Commitment

Code Principle B3: All Directors should be able to allocate sufficient time to the Company to discharge their responsibilities effectively.

Board Comment: As part of the recruitment process the Nominations Committee evaluates the ability of Non-Executive Directors to commit the time required for their role. The formal appraisal process carried out annually by the Chairman also assesses whether Directors have demonstrated this ability throughout the year. Evidence of Board and Committee attendance throughout the year is shown on page 14.

Development

Code Principle B4: All Directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge.

Board Comment: The Society provides a formal induction programme for all newly appointed Directors which is tailored to their needs. This includes Directors' responsibilities and duties; the management information they will receive and how to interpret it; detailed information about the Society including its Risk Management Framework; an overview of regulatory requirements; and details of current significant challenges facing the industry.

The Chairman ensures that Non-Executive Directors continually update their skills and knowledge in order that they may continue to fulfil their role on the Board and any Committees. Training and development needs are identified as part of the annual appraisal process. These needs are usually met by internal briefings, external specialist advisors, and via attendance at industry seminars and conferences. The Society maintains a formal training record for each Director.

Information and Support

Code Principle B5: The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

Board Comment: The Chairman ensures that the Board receives accurate, timely and clear information sufficient to enable them to discharge their responsibilities. The Board and each Committee is responsible for evaluating the effectiveness of the information received and to ensure improvements are made where necessary. The SLT ensures that information is delivered in accordance with Board requirements.

Evaluation

Code Principle B6: The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors.

Board Comment: The Board appraises the performance of the Executive Directors. Each Non-Executive Director has an annual appraisal which is carried out by the Chairman. The Chairman is appraised by the Non-Executive Directors facilitated by the Senior Independent Director. In addition, there is an annual appraisal of the Board as a whole and also of the performance of Board Committees. As part of this evaluation the Board considers the balance of skills, experience, independence and knowledge of Board members.

Re-election

Code Principle B7: All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Board Comment: Directors have to be elected by members at the first opportunity following appointment to the Board. Each Non-Executive Director is appointed to the Board for an initial term of up to three years, subject to satisfactory performance. Non-Executive Directors may serve an additional term of three years.

The Nominations Committee considers whether Directors are independent in character and judgement, are able to commit sufficient time and demonstrate capability and knowledge. The Committee will recommend to the Board whether or not a Non-Executive Director should be submitted for re-election.

Accountability

Financial and Business Reporting

Code Principle C1: The Board should present a fair, balanced and understandable assessment of the company's position and prospects.

Board Comment: The Board considers that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the necessary information for members to assess performance, strategy and the business model of the Society, and that there are no significant matters to report. The responsibilities of the Directors in relation to the preparation of the Society's accounts and the statement that the Society's business is a going concern are contained on pages 9 and 6 respectively.

Risk Management and Internal Control

Code Principle C2: The Board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The Board should maintain sound risk management and internal control systems.

Board Comment: The Board is collectively responsible for determining the strategies for risk management and control as described in the Society's Risk Management Framework. The SLT is responsible for designing, operating and monitoring risk management systems and controls. Further details on the assessment and mitigation of risk can be found in the Directors' Report on pages 6 to 8.

Each Board Committee is responsible for the risks and controls which fall under its remit. The Risk Committee assesses the adequacy of this process and reports to the Board. The Society's internal auditors provide independent and objective assurance that the systems are appropriate and controls effectively applied.

The Society is committed to a strong and prudent risk management framework and process of continuous improvement to all aspects of risk management. The Board is satisfied that the systems and controls are effective and appropriate to the scale and complexity of the business and to protect the interests of the members.

Audit Committee and Auditors

Code Principle C3: The Board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Board Comment: Please refer to page 11 for details of the Audit & Compliance Committee. The Committee meets at least four times a year where the Society's internal and external auditors and the Executive Directors attend by invitation. All meetings conclude with the Committee meeting with the internal and external auditors without the Executive Directors present. The minutes of the Committee

are circulated to all Board members and the Chairman of the Audit & Compliance Committee reports to the Board at the next Board meeting.

Audit firms often have specialist skills and expertise and can provide non-audit services competitively. The Society has a policy on the provision of non-audit services. Material non-audit services provided by the auditors require Audit & Compliance Committee approval to ensure that auditor objectivity and independence is safeguarded. The Committee carries out an annual appraisal to ensure that the effectiveness of the external auditor is maintained.

Remuneration

The Report of the Remuneration Committee on page 15 explains how the Society complies with the Code Principles relating to remuneration.

Relations with Shareholders

Dialogue with Shareholders

Code Principle E1: There should be a dialogue with shareholders based on the mutual understanding of objectives. The Board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

Board Comment: As a mutual organisation, the Society's membership consists of individuals who are also its customers. There are a number of different ways of communicating with and receiving information from members. These include regular newsletters, questionnaires, surveys, suggestion boxes and an informal meeting at which members can meet and discuss issues face to face with all directors. The purpose of the communication is to understand the needs of our members and improve the service provided to them.

Constructive use of the Annual General Meeting (AGM)

Code Principle E2: The Board should use the AGM to communicate with investors and to encourage their participation.

Board Comment: Each year the Society sends details of the AGM to members including the Summary Financial Statement and a newsletter which outlines the Society's work in the community as well as addressing topical product and service issues. The voting pack encourages members to use their vote and attend the AGM. Additional donations to charity are made based on the number of votes cast. The Society uses postal and electronic voting options to provide ease of access for members. The counting of votes is conducted by an independent scrutineer.

At the AGM, a poll is called in relation to the resolutions and the proxy votes cast are added to the votes at the meeting so that the opinions of all members can be considered. The results are subsequently disclosed on the Society's website.

All directors attend the AGM (unless their absence is unavoidable) and the Chairs of the Board, the Audit & Compliance and Remuneration Committees are available to answer questions. There is an informal session at the end of each AGM giving further opportunity for members to speak to the Society's Directors and SLT.

Board and Committee attendance record

Director	Board	Audit & Compliance	ALCO	Remuneration	Nominations	Risk
D G Bassett	3 (3)	-	-	2 (2)	2 (2)	-
M H P Daly	6 (6)	-	-	-	3 (3)	-
A J Higgins	11 (12)	2 (2)	1 (1)	-	5 (5)	2 (2)
M Hrycyk	12 (12)	1 (1)	-	1 (1)	-	4 (4)
G E Loynes	12 (12)	4 (4)	-	3 (3)	-	-
A J Lumby	12 (12)	-	3 (3)	-	-	-
R J Newton	12 (12)	-	3 (3)	-	5 (5)	-
K A Rolfe	12 (12)	-	3 (3)	-	2 (2)	4 (4)
S J Shepherd	7 (7)	3 (3)	-	2 (2)	-	-
S J Veitch	7 (7)	2 (2)	-	1 (1)	-	3 (3)

The figures in brackets represent the maximum number of meetings each Director could have attended.

Report of the Remuneration Committee

This report explains how the Society has regard for the principles in the UK Corporate Governance Code relating to remuneration, as applicable to a mutual organisation of its size. The Society has a Remuneration Policy which complies with the relevant elements of the regulators' remuneration codes. The remuneration of individual Directors is detailed on pages 16 and 17.

The Level and Components of Remuneration

Code Principle D1: Executive Directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Committee Comment: The Society's policy is to reward Executive Directors according to their expertise, experience and overall contribution to the successful performance of the business. The Executive Directors' benefit package is designed to motivate decision making in the interests of members as a whole. A performance related pay scheme operated during the year for Executive Directors. It is carefully designed to encourage achievement of targets that maintain the security and financial strength of the Society, to recognise corporate and individual performance in accordance with good risk management, to treat customers fairly, uphold excellent customer service, conduct and quality of work standards.

Executive Directors

The remuneration for Executive Directors reflects their responsibilities and roles within the Society. This year it comprised basic salary, an executive performance related pay scheme, and various benefits. Performance related payments are non-contractual and non-pensionable. The Society does not have a share option scheme and none of the Directors has any beneficial interest in, or any rights to subscribe for shares in or debentures of, any commercial undertaking of the Society.

Basic Salaries

Each year the Executive Directors are appraised by the Non-Executive Directors in respect of their performance as members of the Board and by the Chief Executive in respect of their executive duties. The Remuneration Committee considers appropriate terms and conditions in the light of these appraisals, the performance of the Society as a whole and information from external sources including comparable market and building society data. This included for 2018, a formal independent review of Executive Directors remuneration. It then makes recommendations to the Board regarding levels of salary, benefits, and performance related pay. The Executive Directors who hold outside Directorships do not receive any remuneration from those organisations. The Remuneration Committee also make recommendations to the Board regarding levels of salary, benefits, and performance related pay in respect of the appointment of Executive Directors, which is considered in light of information from external sources including comparable market and building society data.

Annual Performance Related Pay Scheme

The scheme has regard for best practice by emphasising the need for sustainable performance. The scheme recognises that ensuring effective risk management and a sustainable business model are vital requirements for the well-being of the Society.

The scheme has been designed to provide testing objectives, giving an incentive to perform at the highest level in a manner consistent with the long term interests of members. In particular, it requires substantial over-performance resulting in outstanding performance across a range of measures, before the maximum award of 20% of base annual salary can be achieved.

The Remuneration Committee recommends to the Non-Executive members of the Board the measures that should be achieved. These include a high level of conduct and quality of performance in accordance with good risk management, together with profitability, control of costs, and controlled commercial asset growth. In assessing performance against these measures, the Remuneration Committee will ensure performance is aligned with the Society's business objectives and activities and have regard for the overall regulatory conduct of the Society, member satisfaction and the effect of general market conditions. The Non-Executive Directors of the Board have sole discretion on awards made under this scheme.

Benefits

Executive Directors are members of the Society's Defined Contribution Pension Scheme details of which can be found on page 49. They also receive other benefits including a car allowance and private health care scheme (covering only the Directors themselves). The Society does not provide subsidised mortgages.

Contractual Terms

The Executive Directors have service contracts. Mr Newton's is dated 19 December 2013 and requires 12 months' notice by the Society and 6 months by Mr Newton. Mr Lumby's is dated 5 January 2018 and requires 6 months' notice by the Society and 6 months by Mr Lumby. There are no special terms in the event of amalgamation, transfer of engagements or transfer of business where the Executive Director's employment is to be terminated.

Report of the Remuneration Committee

Non-Executive Directors

The level of fees payable to Non-Executive Directors is assessed using information from comparable organisations.

Remuneration comprises a basic fee with a supplementary payment for the Chair of the Board, the Chair of Audit & Compliance Committee and the Chair of Risk Committee to reflect the additional responsibilities and workloads of these posts.

Fees for Non-Executive Directors are non-pensionable and Non-Executive Directors do not participate in any incentive schemes or receive any other benefits. Non-Executive Directors have letters of appointment rather than service contracts.

The Procedure for Determining Remuneration

Code Principle D2: There should be a formal and transparent procedure for developing policy on Executive remuneration and for fixing the remuneration packages of individual Directors. No Director should be responsible for setting his or her own remuneration.

Committee Comment: The Remuneration Committee consists of three Non-Executive Directors, Gavin Loynes (Chairman), Myron Hrycyk and Sally Veitch. The Chief Executive attends by invitation but takes no part in the discussion of his own salary. The Committee is responsible for the remuneration policy for all Executive Directors and it makes recommendations to the Board regarding remuneration and contractual arrangements. The Committee has responsibility for ensuring that the Society complies with the relevant aspects of the regulators' remuneration codes and also has the responsibility to consider the Society's Remuneration Policy Statement and recommend its approval to the Board.

The Committee meets at least three times per year and reviews supporting evidence, including external professional advice if appropriate, on comparable remuneration packages. The minutes of the Committee are circulated to all Board members and the Chairman of the Committee reports to the Board at the next Board meeting.

Fees relating to Non-Executive Directors are considered by the Chief Executive and Finance Director, with the Board Chairman in attendance, having consideration for the amount permissible under the Society's Rules. No Director is involved in setting their own fees.

Directors' Remuneration

Non-Executive Directors (audited)	2018 Total Fees £'000	2017 Total Fees £'000
D G Bassett (retired 16 April 2018)	9	29
M H P Daly (retired 28 June 2018)	22	45
A J Higgins (Chairman)	40	38
M Hrycyk	30	4
G E Loynes	30	29
K A Rolfe	35	31
S J Shepherd (resigned 26 July 2018)	17	29
S J Veitch (appointed 28 June 2018)	20	-
Total	**203**	**205**

Report of the Remuneration Committee

Executive Directors (audited)	Salary	Performance related pay	Benefits	Sub-total	Pension contributions	Total
2018	£'000	£'000	£'000	£'000	£'000	£'000
R J Newton	155	22	11	188	22	210
A J Lumby (appointed 29/01/18)	118	15	8	141	17	158
	273	**37**	**19**	**329**	**39**	**368**

Mr Newton and Mr Lumby are members of the Society's defined contribution pension scheme. During 2018 Mr Newton elected with agreement from the Society to take a proportion of his pension contributions as a cash allowance.

Executive Directors (audited)	Salary	Performance related pay	Benefits	Sub-total	Pension contributions	Total
2017	£'000	£'000	£'000	£'000	£'000	£'000
R J Newton	141	10	10	161	21	182
S J Costley (resigned 13/04/17)	104	-	2	106	4	110
	245	**10**	**12**	**267**	**25**	**292**

Board of Directors

Andrew Higgins
Chairman
Andrew was appointed to the Board in May 2012 and appointed Chairman in June 2018. He is also Chairman of the Nominations Committee. He is a chartered accountant with a background in audit and advisory services, with a career spanning 33 years in the UK and overseas. Andrew is currently also a non-executive director of an acute NHS Foundation trust, where he chairs the Quality and Safety Committee and is a member of the Audit Committee.

Richard Newton
Chief Executive
Richard joined the Society in 1991 as an administrative assistant. Following his appointment as Finance Manager he qualified as a Chartered Certified Accountant in 2001. He was appointed to the Board in July 2011 and is a former Finance Director of the Society. He was appointed Chief Executive in December 2013 and is a member of the Nominations Committee.

Conrad Almond
Non-Executive Director
Conrad was appointed to the Board in February 2019. He has had a career in prudential risk matters having worked full time for NatWest and then RBS for nearly 30 years in prudential risk and capital management roles, and more latterly in a consultancy capacity for HSBC and Co-operative Bank. He is currently a Trustee of Age Concern, St Albans. Conrad will be a member of the Audit & Compliance and Risk Committees.

Myron Hrycyk
Non-Executive Director
Myron was appointed to the Board in November 2017. He has an MBA from Birmingham University, is a chartered member of the British Computer Society and has sat on the Midlands CBI Council. During his career he has been Group Chief Information Officer (CIO) and Digital Director at Severn Trent plc, IT Director at Unipart Advanced Logistics and he is currently a Cabinet Office Crown Representative working with the UK Government's strategic digital technology suppliers. He is a member of the Audit & Compliance, Risk and Remuneration Committees.

Gavin Loynes
Non-Executive Director
Gavin was appointed to the Board in May 2011. He is a consultant Chartered Surveyor with Bruton Knowles, a national firm of property consultants of which he was an equity partner for over 10 years. Gavin is also a director of Charles Edwards Property Consultants Ltd, a RICS registered valuer and a member of the Royal Institution of Chartered Surveyors. Having worked in the West Midlands since qualifying, he has gained a detailed understanding of property matters within the area. He is Chairman of the Remuneration Committee and is a member of the Audit & Compliance Committee.

Andrew Lumby
Finance Director
Andrew was appointed to the Board as Finance Director upon joining the Society in January 2018. He is a Chartered Accountant, qualifying in 2002 whilst working at PwC. Prior to joining the Society Andrew gained 14 years' experience at a large regional building society, most recently as a member of the Senior Leadership Team where he was responsible for the Finance, Treasury Risk and Credit Risk teams.

Board of Directors

Keith Rolfe

Vice-Chairman and Senior Independent Director

Keith was appointed to the Board in June 2015. He has extensive risk management experience gained from front line risk roles in leading global financial institutions, latterly in an executive role within Barclays Corporate as Chief Credit Officer. He has also worked for UBS AG in roles including Director, Risk Management, and at Credit Suisse in roles including Credit Risk Manager. He is a Board Member and Vice Chairman of Rooftop Housing Group. He is Chairman of the Risk Committee and is a member of the Nominations Committee.

Sally Veitch

Non-Executive Director

Sally was appointed to the Board in June 2018. Sally is a Chartered Accountant, qualifying in 1997 whilst working for Coopers & Lybrand. She is a Non-Executive Director/Chair of Audit at Redwood Bank; and formerly Chair of Audit and a Member of the Risk Committee at an East Midlands Building Society, and Chair of Audit with Amicus Finance. In her executive career, Sally was a senior executive at Home Retail Group PLC, as the Finance Director for their Financial Services business. Sally is Chair of the Audit & Compliance Committee and a member of the Risk and Remuneration Committees.

KPMG

Independent auditor's report

to the members of Tipton and Coseley Building Society

1. Our opinion is unmodified

We have audited the annual accounts of Tipton and Coseley Building Society ("the Society") for the year ended 31 December 2018 which comprise the Income Statement, Statement of Financial Position, Statement of Changes in Members' Interests, Statement of Cash Flows and the related notes, including the accounting policies in Note 1.

In our opinion the annual accounts:

— give a true and fair view of the state of the Society's affairs as at 31 December 2018 and of the Society's profit for the year then ended;

— have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and

— have been prepared in accordance with the requirements of the Building Society Act 1986 and the regulations made under it.

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 believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were appointed as auditor by the members in June 2006. We were reappointed in February 2017 following a competitive tender process. The period of total uninterrupted engagement is for the thirteen financial years ended 31 December 2018.

We have fulfilled our ethical responsibilities under, and we remain independent of the Society in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview	
Materiality: Annual accounts as a whole	£80,000 (2017:£87,000) 4.8% (2017: 5.0%) of Profit before tax and dividends

Key audit matters		vs 2017
Other matter	The impact of uncertainties due to Britain exiting the European Union on our audit	▲
Recurring risks	Impairment of loans and advances to customers	◀▶
	Interest receivable on loans and advances to customers – effective interest rate adjustment	◀▶

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 annual accounts 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. We summarise below the key audit matters, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the annual accounts as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	The risk	Our response
The impact of uncertainties due to Britain exiting the European Union on our audit *Refer to page 2, (Business Review), page 7 (Principal Risks and Uncertainties), and page 30 (Accounting Policies).*	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in impairment of loans and advances to customers, interest receivable on loans and advances to customers – effective interest rate adjustment, 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 Society's future prospects and performance.	We 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 Society'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 impairment of loans and advances to customers, interest receivable on loans and advances to customers – effective interest rate adjustment and other areas that depend on forecasts, we compared the directors' sensitivity analysis to our assessment of the worst reasonably possible, known adverse scenario resulting from Brexit uncertainty. – **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on impairment of loans and advances to customers, and interest receivable on loans and advances to customers – effective interest rate adjustment, we considered all of the Brexit related disclosures together, including those in the directors' report, comparing the overall picture against our understanding of the risks. **Our results** As reported under impairment of loans and advances to customers and interest receivable on loans and advances to customers – effective interest rate adjustment, we found the resulting estimates and related disclosures of sensitivity and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Society and this is particularly the case in relation to Brexit.

2. Key audit matters: including our assessment of risks of material misstatement (continued)

Key audit matter	The risk	Our response
Impairment of loans and advances to customers (£1,469,000; 2017: £1,573,000) *Refer to note 1.6 (accounting policy), note 1.13 (Accounting Estimates and Judgements) and notes 13, 14 and 27 (Financial disclosures).*	**Subjective estimate:** The impairment provision relating to the Society's loan portfolio requires the directors to make significant judgements and estimates in order to determine incurred losses on loans and advances to customers. Individual impairment provisions cover loans specifically identified as impaired and a collective impairment provision is held for all other loans for those impairments incurred but not yet specifically identified. The Directors assess individual impairments by reference to loans that have suffered significant financial difficulty of the borrower, the restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise, indications that a borrower or issuer will enter bankruptcy, and observable data relating to a group of assets such as adverse changes in payment status of borrowers. The collective impairment provision is derived from a model that uses a combination of the Society's historical experience, segmentation of the high risk loans and, due to the Society's limited loss experience, external data, adjusted for current conditions including the impact of the UK exiting the European Union. In particular, judgement is required on the key assumptions of probability of defaults, future house price movements and forced sale discounts against collateral. The impairment model is most sensitive to movements in future house price movement. The effect of these matters is that, as part of our risk assessment, we determined that the collective impairment provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the annual accounts as a whole. The annual accounts (note 1.13) disclose the sensitivity estimated by the Society.	Our procedures included: – **Controls testing:** We tested controls over the identification and monitoring of impaired and forborne accounts, and the lending processes that capture certain static data used in the impairment model; – **Historical experience:** We challenged the key assumptions used in the collective impairment provision model, being the forced sale discount, sales costs and probability of default, by comparing with recent actual historical experience of the Society; – **Challenge of assumptions:** For the collective impairment provision, we challenged the manual overlays made by management to indexed house price values, historic forced sale discounts and probability of default, to reflect management's current expectation of how losses will crystallise; – **Benchmarking :** We compared certain key assumptions used in the impairment provisions and the resultant collective impairment coverage with those of peer organisations; – **Sensitivity analysis:** We assessed the provision model for its sensitivity to changes in key assumptions by using alternative assumptions to help us assess the reasonableness of the assumptions and identify areas of potential additional focus; – **Tests of detail:** We challenged the key assumptions over the recoverability of individually impaired loans, including the realisable value of the individual properties held as security; – **Assessing transparency**: We assessed the adequacy of the Society's disclosures in respect of the degree of estimation involved in arriving at the provision. **Our results** – We found the resulting estimate of impairment of loans and advances to customers to be acceptable (2017: result acceptable).

2. Key audit matters: including our assessment of risks of material misstatement (continued)

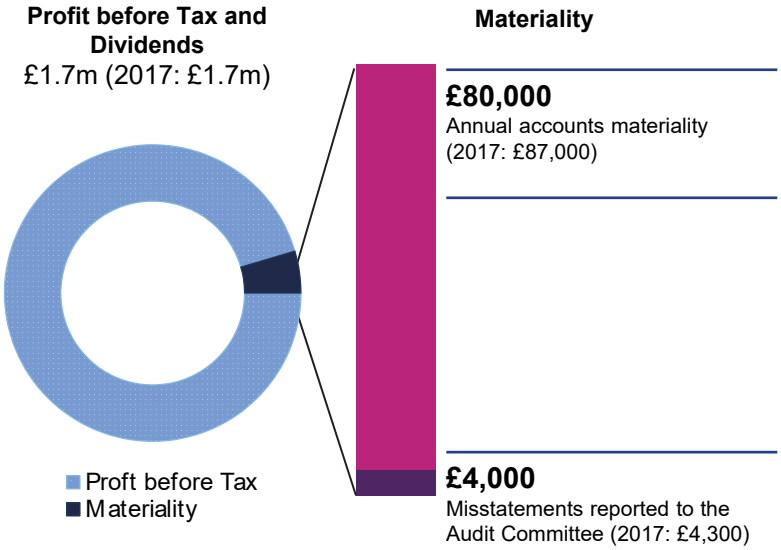
Key audit matter	The risk	Our response
Interest receivable on loans and advances to customers – effective interest rate adjustment (Balance sheet asset £475,000; 2017: £606,000) *Refer to note 1.6 (accounting policy), note 1.13 (Accounting Estimates and Judgements).*	**Subjective estimate** Accounting standards require interest receivable on loans and advances to customers to be recognised using the effective interest rate ('EIR') method. This results in all directly attributable interest, fees and costs being recognised on an even yield basis over the expected life of the loans. The recognition of interest receivable on loans and advances to customers under the effective interest rate method requires the directors to make significant judgements and estimates, with the most critical estimate being the loans' expected behavioural life. The directors have determined this estimate with reference to historical customer behaviour, the impact of the Society's current approach to contacting customers shortly before the end of their initial term to offer them a new product, and the competitive nature of the remortgage market. In addition, the directors apply judgement in determining whether or not fees and costs, including early redemption charges, should be included in the methodology.	Our procedures included: – **Controls testing:** We tested controls over the lending processes that capture certain static data used in the EIR models; – **Historical comparison:** We assessed the reasonableness of the model's expected repayment profile assumptions against recent historical experience of loan lives and whether any adjustments to recent historical redemption profiles used in the EIR model are necessary to reflect expected changes in future redemption profiles; – **Challenge of assumptions:** We challenged whether any adjustments to recent historical redemption profiles used in the EIR model are necessary to reflect expected changes in future redemption profiles – **Our sector experience:** Using our knowledge of EIR methodologies in peer organisations, and by inspecting the Society's product literature and general ledger, we challenged the fees and costs included or excluded from the EIR estimates, including early redemption charges; – **Sensitivity analysis:** We assessed the models for their sensitivities to changes in the key assumptions by considering alternative behavioural lives to help us assess the criticality of the assumptions used and identify areas for potential additional focus; and – **Assessing transparency:** We assessed the adequacy of the Society's disclosures about the degree of estimation involved in arriving at the interest income recognised. **Our results** – We found the resulting estimate of interest receivable on loans and advances to customers recognised under the EIR method to be acceptable (2017: acceptable).

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

Materiality for the annual accounts as a whole was set at £80,000 (2017: £87,000), determined with reference to a benchmark of Profit before Tax and Dividends of £1,673,000 (2017: £1,740,000), of which it represents 4.8% (2017: 5.0%).

We agreed to report to the Audit & Compliance Committee any corrected or uncorrected identified misstatements exceeding £4,000 (2017: £4,300), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Society was undertaken to the materiality level specified above and was performed at the Society's head office in Tipton.



4. We have nothing to report on going concern

The directors have prepared the annual accounts on the going concern basis as they do not intend to liquidate the Society or to cease its operations, and as they have concluded that the Society'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 its ability to continue as a going concern for at least a year from the date of approval of the annual accounts ("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 judgements 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 Society will continue in operation.

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

As these were risks that could potentially cast significant doubt on the Society's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Society'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 1 to the annual accounts on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Society's use of that basis for a period of at least twelve months from the date of approval of the annual accounts.

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 annual accounts. Our opinion on the annual accounts 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 annual accounts audit work, the information therein is materially misstated or inconsistent with the annual accounts or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Annual Business Statement and Directors' Report

In our opinion:

— the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations thereunder;

— the information given in the Directors' Report for the financial year is consistent with the accounting records and the annual accounts; and

— the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

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

Under the Building Societies Act 1986, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society,
- the annual accounts are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations and access to documents 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 9, the directors are responsible for: the preparation of the annual accounts including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error; assessing the Society'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 Society 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 annual accounts as a whole are free from material misstatement, whether due to fraud, 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 annual accounts.

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 Society'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 Society is subject to laws and regulations that directly affect the annual accounts including financial reporting legislation (including related Building Society legislation) and taxation legislation, and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related annual account items.

Secondly, the Society 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 Society's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the Society's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any.

These limited procedures did not identify actual or suspected non-compliance.

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 annual accounts, 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 Society's members, as a body, in accordance with Section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society'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 Society and the Society's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Andrew Walker (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill

Snow Hill Queensway

Birmingham

B4 6GH

5 March 2019

KPMG

Income Statement
for the year ended 31 December 2018

	Notes	2018 £'000	2017 £'000
Interest receivable and similar income	2	**9,245**	8,818
Interest payable and similar charges	3	**(2,653)**	(2,725)
Net interest income		**6,592**	6,093
Fee and commissions receivable		**579**	672
Fees and commissions payable		**(473)**	(350)
Net gains from derivative financial instruments	4	**4**	3
Total net income		**6,702**	6,418
Administrative expenses	5	**(4,930)**	(4,715)
Depreciation and amortisation	15,16	**(147)**	(152)
Impairment credit on loans and advances	14	**98**	250
Provisions for liabilities	23	**(50)**	(61)
Operating Profit		**1,673**	1,740
Dividends Receivable		**-**	232
Profit Before Tax		**1,673**	1,972
Tax expense	8	**(325)**	(328)
Profit for the financial year	25	**1,348**	**1,644**

Profit for the financial year arises from continuing operations. Total comprehensive income is the same as the profit for the 2018 and 2017 financial years and is attributable to the members of the Society.

The notes on pages 30 to 68 form part of these accounts.

Statement of Financial Position
as at 31 December 2018

	Notes	2018 £'000	2017 £'000
Assets			
Liquid assets			
Cash in hand and balances with Bank of England	9	**58,565**	63,585
Loans and advances to credit institutions	10	**9,750**	9,953
Debt securities	11	**-**	2,016
Derivative financial instruments	12	**56**	55
Loans and advances to customers:	13		
Loans fully secured on residential property		**297,448**	282,730
Other loans		**2,493**	3,002
Prepayments and accrued income		**493**	639
Tangible fixed assets	15	**1,691**	1,730
Intangible fixed assets	16	**165**	98
Deferred tax assets	17	**53**	88
Total assets		**370,714**	**363,896**
Liabilities			
Shares	18	**312,610**	322,950
Amounts owed to credit institutions	19	**14,531**	-
Amounts owed to other customers	20	**2,579**	1,543
Derivative financial instruments	12	**121**	35
Other liabilities	21	**140**	215
Accruals and deferred income	22	**893**	673
Provisions for liabilities	23	**83**	71
Total liabilities		**330,952**	**325,487**
Reserves			
General reserves	25	**39,757**	38,409
Total liabilities and Equity (Members' Capital)		**370,714**	**363,896**

The notes on pages 30 to 68 form part of these accounts.

These accounts were approved by the Board of Directors on 5 March 2019 and signed on its behalf:

A J Higgins Chairman
R J Newton Chief Executive
A J Lumby Finance Director

Statement of Changes in Members' Interests
for the year ended 31 December 2018

	Notes	General reserves £'000	Total £'000
2018			
Balance as at 1 January 2018		**38,409**	**38,409**
Profit for the year		**1,348**	**1,348**
Balance as at 31 December 2018	25	**39,757**	**39,757**
2017			
Balance as at 1 January 2017		36,765	36,765
Profit for the year		1,644	1,644
Balance as at 31 December 2017	25	**38,409**	**38,409**

The notes on pages 30 to 68 form part of these accounts.

Statement of Cash Flows
for the year ended 31 December 2018

	Notes	2018 £'000	2017 £'000
Cash flows from operating activities			
Profit before tax		**1,673**	1,740
Depreciation and amortisation		**159**	144
Provisions for bad and doubtful debts		**(98)**	(250)
Loans and advances written off net of recoveries		**(6)**	(9)
Decrease/(increase) in prepayments and accrued income		**151**	(161)
Increase/(decrease) in accruals and deferred income		**237**	(283)
Increase/(decrease) in other liabilities		**11**	(20)
Net (increase)/decrease in loans and advances to customers		**(14,105)**	1,596
Net decrease/(increase) in loans and advances to credit institutions		**1,000**	(1,000)
Net increase in amounts owed to credit institutions		**14,531**	-
Net increase/(decrease) in amounts owed to other customers		**1,036**	(1,715)
Net (decrease) in shares		**(10,357)**	(7,832)
Movement in derivative financial instruments		**85**	(184)
Movement in fair value adjustments		**1**	8
Taxation paid		**(364)**	(280)
Net cash (outflow) from operating activities		**(6,046)**	**(8,246)**
Cash flows from investing activities			
Purchase of debt securities		**-**	(4,000)
Sales of debt securities		**2,016**	12,526
Purchase of tangible and intangible assets		**(234)**	(548)
Disposal of tangible and intangible assets		**59**	133
(Gain)/loss on disposal of tangible and intangible assets		**(12)**	8
Net cash inflow from investing activities		**1,829**	**8,119**
Net (decrease) in cash		**(4,217)**	(127)
Cash and cash equivalents at start of year		**67,512**	67,639
Cash and cash equivalents at end of year	26	**63,295**	**67,512**

The notes on pages 30 to 68 form part of these accounts.

Notes to the accounts

1 Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below.

Basis of preparation

Tipton and Coseley Building Society (the "Society") has prepared these Society annual accounts in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and Financial Reporting Standard 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102") as issued in September 2015. As permitted in Section 11 of FRS 102, the Society has also chosen to apply the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (as adopted for use in the EU). The presentation currency of these annual accounts is sterling. All amounts in the annual accounts have been rounded to the nearest £1,000.

The Society is considered to be a qualifying entity under FRS 102 paragraphs 1.8 to 1.12. The following exemptions available under FRS 102 in respect of certain disclosures for the Society annual accounts have been applied.

- Key Management Personnel compensation has not been included.

In 2017, the Society closed its subsidiary undertaking (Tipton & Coseley Financial Services Limited) and a final dividend was paid to the Society of £232k. As a result the accounts have been prepared on a Society only basis.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these annual accounts.

The accounts have been prepared on the going concern basis as outlined in the Directors report on page 6.

Judgments made by the directors, in the application of these accounting policies that have significant effect on the annual accounts and estimates with a significant risk of material adjustment in the next year are discussed in note 1.13.

Included within the notes and financial statements are references to the Income Statements and the profit and loss account. These terms are the same and refer to items included within the Society's Income Statement reported on page 26.

The Society has adopted the provisions of International Financial Reporting Interpretations Committee 'IFRIC' 21 in accordance with the transitional provisions contained therein, in respect of the Financial Services Compensation Scheme (FSCS) Levy. Although IFRIC 21 is not applicable to FRS 102 the Society adopted this approach to align treatment of the FSCS levy with larger societies who apply International Accounting Standards.

1.1 Measurement convention

The annual accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments classified at fair value through the profit or loss or available-for-sale, and investment property measured in accordance with the revaluation model.

1.2 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' (EIR) is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Society estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition of a financial asset or financial liability.

Interest income and expense presented in the income statement and other comprehensive income include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Fair value changes on financial assets and financial liabilities carried at fair value through profit or loss are presented in net income from other financial instruments at fair value, through profit or loss in the Income Statement and Other Comprehensive Income.

1.3 Fees and commission

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the measurement of the effective interest rate (see 1.2).

Other fees and commission income and expenses - including account servicing fees, sales commission and other fees are recognised as the related services are performed.

1.4 Expenses

Operating leases
Payments (excluding costs for services and insurance) made under operating leases are recognised in the profit and loss account on a straight-line basis over the term of the lease.

1.5 Taxation

Tax on the profit for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the year- end date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on timing differences which arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the annual accounts. The following timing difference is not provided for: differences between accumulated depreciation and tax allowances for the cost of a fixed asset if and when all conditions for retaining the tax allowances have been met, to the extent that it is not probable that they will reverse in the foreseeable future and the Society is able to control the reversal of the timing difference. Deferred tax is not recognised on permanent differences arising because certain types of income or expense are non-taxable or are disallowable for tax or because certain tax charges or allowances are greater or smaller than the corresponding income or expense.

Deferred tax is measured at the tax rate that is expected to apply to the reversal of the related difference, using tax rates enacted or substantively enacted at the year-end date. Deferred tax balances are not discounted.

1.6 Financial instruments

Recognition
The Society initially recognises loans and advances, deposits and debt securities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the settlement date, which is the date on which the Society transfers any consideration for an instrument. If any transactions were committed to at the year-end date these are included in contractual commitments. No adjustments to fair values are made for contractual commitments of financial instruments due to the short period between settlement and trade dates.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition.

Classification
Financial assets
The Society classifies its financial assets into one of the following categories:

- *Loans and receivables*

'Loans and advances' are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Society does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method (see 1.2). When the Society chooses to designate the loans and advances as measured at fair value through profit or loss, they are measured at fair value with fair value changes recognised immediately in profit or loss.

Should the Society purchase a financial asset and simultaneously enter into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement would be accounted for as a loan or advance, and the underlying asset would not be recognised in the annual accounts.

- *Available-for-sale*

Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprise of debt securities. All available-for-sale investments are measured at fair value after initial recognition. In 2018 and 2017 the available-for-sale reserve account balance was nil. This is due to the difference in book and fair value on the Society's financial instruments being immaterial and therefore nothing is disclosed on the face of the financial statements.

Interest income is recognised in profit or loss using the effective interest method (see 1.2). Impairment losses are recognised in profit or loss. Other fair value changes, other than impairment losses, are recognised in OCI and presented in the available for sale reserve within capital reserves. When the investment is sold, the gain or loss accumulated in capital reserves is reclassified to profit or loss.

- *At fair value through profit and loss*

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

Fair value hedges
On initial designation of the hedge, the Society formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. An assessment is made, both at inception of the hedge relationship and on an on- going basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80–125%.

Where a derivative financial instrument is designated as a hedge of the variability in fair value of a recognised asset or liability or an unrecognised firm commitment, all changes in the fair value of the derivative are recognised immediately in profit or loss. The carrying value of the hedged item is adjusted by the change in fair value that is attributable to the risk being hedged (even if it is normally carried at cost or amortised cost) and any gains or losses on remeasurement are recognised immediately in the income statement (even if those gains would normally be recognised directly in reserves). If hedge accounting is discontinued and the hedged financial asset or liability has not been derecognised, any adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged item.

Financial liabilities
The Society classifies its financial liabilities, other than loan commitments, as measured at amortised cost or fair value through profit or loss.

Derecognition
Financial assets or liabilities are derecognised when the contractual right to the cash flows from the financial asset or liability are discharged, cancelled or expire.

On derecognition of a financial asset or liability the difference between the carrying amount of the asset or liability (or the carrying amount allocated to the portion of the asset or liability derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss. The Society have not transferred the risks and rewards of ownership of any financial assets to another party during the year ended 31 December 2018.

Measurement
Amortised cost measurement
The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method, of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

Fair value measurement
'Fair value' is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

When available, the fair value of an instrument is measured using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis.

If there is no quoted price in an active market, then the Society uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If it is determined that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

Identification and measurement of impairment
At each reporting date, the Society assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:
- significant financial difficulty of the borrower or issuer;
- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise;
- indications that a borrower or issuer will enter bankruptcy;

- the disappearance of an active market for a security; or
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Evidence of impairment for loans and advances is considered at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

In assessing collective impairment, modelling is used, as well as the timing of recoveries and the amount of loss incurred, and an adjustment is made if current economic and credit conditions are such that the actual losses are likely to be greater or less than is suggested by historical trends.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

A range of forbearance options are available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on track. The main options offered by the Society include:

- Temporary transfer to an interest only mortgage;
- Reduced monthly payment;
- Product review;
- Capitalisation of arrears; and
- Extension of mortgage term.

Customers requesting a forbearance option will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank/credit card statements and payslips, in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with the Society's policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale debt securities are recognised by reclassifying the losses accumulated in the available for sale reserve. The cumulative loss that is reclassified from reserves to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through profit or loss; otherwise, any increase in fair value is recognised through OCI.

1.7 Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

1.8 Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Tangible fixed assets include investment property. Certain items of tangible fixed assets that had been revalued to fair value on or prior to the date of transition to FRS 102, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation.

Where parts of an item of tangible fixed assets have different useful lives, they are accounted for as separate items of tangible fixed assets, for example land is treated separately from buildings. All current leases are classified as operating leases. The Society assesses at each reporting date whether tangible fixed assets are impaired.

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Land is not depreciated. The estimated useful lives are as follows:

- Freehold premises – 50 years straight line
- Short leasehold premises - Straight line over the remaining years of the lease
- Motor vehicles - 25% reducing balance

- Equipment and fixtures - 10% and 20% straight line
- Computer hardware – 20% straight line.

Depreciation methods, useful lives and residual values are reviewed if there is an indication of a significant change since the last annual reporting date in the pattern by which the Society expects to consume an asset's future economic benefits.

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are recognised initially at cost.

Subsequent to initial recognition:

- investment properties whose fair value can be measured reliably without undue cost or effort are held at fair value. Any gains or losses arising from changes in the fair value are recognised in profit or loss in the period that they arise; and
- no depreciation is provided in respect of investment properties applying the fair value model.

If a reliable measure is not available without undue cost or effort for an item of investment property, this item is thereafter accounted for as tangible fixed assets in accordance with section 17 of FRS 102 until a reliable measure of fair value becomes available.

1.9 Intangible fixed assets

Computer Software

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Society which will generate future economic benefits and where costs can be reliably measured. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred.

Intangible assets are stated at cost less cumulative amortisation and impairment losses.

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is generally 3 to 7 years. The basis for choosing these useful lives is dependent on the software asset expected life. The Society reviews the amortisation period and method when events and circumstances indicate that the useful life may have changed since the last reporting date.

Intangible assets are tested for impairment in accordance with Section 27 of FRS 102 Impairment of assets when there is an indication that an intangible asset may be impaired.

Assets are reviewed for impairment at each Statement of Financial Position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

1.10 Impairment excluding financial assets and deferred tax assets

The carrying amounts of the Society's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. An impairment loss is reversed if the reasons for the impairment have ceased to apply.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

1.11 Employee benefits

Pensions

The Society operates a defined contribution scheme, with contributions charged to the Income Statements as they fall due.

Incentive Schemes

The costs of bonuses payable after the year end in which they are earned are recognised in the year in which the employees render the related service.

1.12 Provisions and contingent liabilities

A provision is recognised in the Statement of Financial Position when the Society has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are recognised at the best estimate of the amount required to settle the obligation at the reporting date.

The Society has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated and when the Society has an obligation in accordance with IFRIC 6 and specifically relating to Levies under IFRIC 21. The amount provided is based on information received from the FSCS, forecast future interest rates and the Society's historic share of industry protected deposits. Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised in the Statements of Financial Position.

1.13 Accounting estimates and judgements

The Society makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are described below:

a) Impairment losses on loans and advances to customers

The mortgage portfolio is reviewed on at least a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Society is required to exercise a degree of judgement. Specific impairment triggers are principally when an account has been in arrears in the 12 months preceding the Statement of Financial Position date, or when forbearance arrangements have been agreed. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and expected cashflows. Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The Society's estimate of collective impairment at 31 December 2018 assumes a deterioration in credit risk outcomes compared with recent historical experience. This is primarily represented by a decrease in expected recoveries on impaired accounts due to forecast decreases in house prices during 2019, together with an increase in the probability of default due to anticipated increases in base rate and a decline in the economic environment. These expectations are based on reports and commentaries from external agencies, including the Bank of England. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions. In the event that a fall in house prices was 5% less, the estimated impact would be to reduce the impairment provision by £545k. The directors believe that these assumptions adequately address the risk presented by a possible 'disorderly' Brexit.

b) Effective interest rate

Amounts related to the effective interest rate (EIR) included within the income statement is £130k (2017: £192k) with an EIR asset included in the balance sheet of £475k (2017: £606k). The effective interest rate will affect the carrying values of loans and receivables. One of the key components of the estimates within EIR is the expected mortgage life. In determining the expected life of mortgage assets, the Society uses historical and forecast redemption data as well as management judgement. During the year, the expected life of mortgage assets are reassessed for reasonableness. This year the expected average lives have reduced, reflecting the Society's proactive approach to contacting customers shortly before the end of their initial product term and the competitive nature of the remortgage market. Any variation in the expected life of mortgage assets will change the carrying value in the Statement of Financial Position and the timing of the recognition of interest income. A 10% change in the life profile of mortgage assets would result in a change in the value of loans on the Statement of Financial Position by approximately £12k.

c) Fair value of derivatives and financial assets

The following techniques are employed in determining the fair value of its derivatives and financial assets:

- Available for sale – measured at fair value using market prices or, where markets have become inactive or there is no readily available traded price, the present value of future cash flows is used.
- Derivative financial instruments - calculated by discounted cash flow models using yield curves that are based on observable market data, which is discussed further in note 4.

The impact of interest rate risk sensitivities can be found in Note 27 to the financial statements.

1.14 Segmental reporting

The Society operates entirely in the UK and so no Country by Country information has been presented.

Information for the years ended 31 December 2018 and 31 December 2017 has been prepared on the following basis:

- The number of employees has been calculated as the average number of full and part time employees, on a monthly basis, as disclosed in Note 6
- Turnover represents interest receivable and similar income as disclosed in the Income Statement
- Pre-tax profit represents the Society's profit before tax, as reported in the Income Statement
- Corporation Tax paid represents the cash amount of corporate income tax paid during the year, as disclosed in the Cash Flow Statement

Notes to the accounts

	2018 £'000	2017 £'000
2. Interest receivable and similar income		
On loans fully secured on residential property	**8,646**	8,550
On other loans	**205**	233
On liquid assets	**474**	258
Net interest expense on derivatives	**(80)**	(223)
	9,245	**8,818**

	2018 £'000	2017 £'000
3. Interest payable and similar charges		
On shares held by individuals	**2,560**	2,720
On deposits and other borrowings	**93**	5
	2,653	**2,725**

	2018 £'000	2017 £'000
4. Net gains/(losses) from derivative financial instruments		
Derivatives in designated fair value hedge relationships	**(82)**	190
Adjustments to hedged items in fair value hedge accounting relationships	**94**	(182)
Derivatives not in designated fair value hedge relationships	**(8)**	(5)
	4	**3**

The net gain from derivative financial instruments of £4k (2017: gain £3k) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering underlying performance.

Notes to the accounts

	2018 £'000	2017 £'000
5. Administrative expenses		
Staff costs		
Wages and salaries	**2,402**	2,176
Social security costs	**249**	206
Other pension costs	**217**	292
	2,868	2,674
Operating lease rentals	**25**	25
Other administrative costs	**2,037**	2,016
	4,930	**4,715**
Other administrative costs include:		
Remuneration of Auditor and its associates (excluding VAT):		
Audit of these financial statements	**65**	58
For other services	**13**	24

	2018 Number	2017 Number
6. Employees		
The average number of persons employed during the year was:		
Full time	**46**	47
Part time	**37**	37
	83	**84**
The average number of persons employed during the year was:		
Head office	**56**	54
Branch offices	**27**	30
	83	**84**

The average number of employees on a full time equivalent basis was 65 (2017: 68) and all of these are employed within the UK.

Notes to the accounts

7. Directors' loans and transactions

a) Directors' remuneration

Directors' remuneration totalling £571,000 for 2018 (2017: £497,000) is shown as part of the Report of the Remuneration Committee on pages 16 and 17.

b) Directors' loans

There were no loans granted or outstanding to directors or connected persons in the year (2017: nil).

A register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register will be available for inspection at the head office for a period of 15 days up to and including the date of the Annual General Meeting.

c) Other Directors' transactions

Directors and connected persons hold savings balances with the Society; all accounts have the same terms and conditions as available to customers of the Society. The savings balances are not detailed in the register unlike loans and transactions above, due to their sensitive nature. The aggregate amount of all savings balances at 31 December 2018 was £51,965 (2017: £159,268).

8. Taxation

	2018 £'000	2017 £'000
UK corporation tax at 19.00% (2017: 19.25%)	**287**	303
Under/(over) provision in previous year	**3**	(8)
Total current tax	**290**	295
Deferred tax (note 17)	**35**	33
Total tax expense	**325**	**328**

The total tax charge for the period differs from that calculated using the UK standard rate of corporation tax. The differences are explained below.

Profit before taxation	**1,673**	1,972
Expected tax at 19.25% (2017: 20.00%)	**318**	380
Effects of:		
Expenses not deductible for corporation tax purposes	**1**	4
Exempt distributions (dividends receivable)	**-**	(45)
Changes in tax rate	**(1)**	-
Short term timing difference	**(2)**	(7)
Fixed asset differences	**6**	4
Adjustment for prior years	**3**	(8)
Tax expense for the year	**325**	**328**

Reductions in the UK corporation tax rate from 19% to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015. This will reduce the Society's future current tax charge accordingly.

The deferred tax asset at 31 December 2018 has been calculated based on the prevailing tax rate when the timing differences are expected to reverse.

	2018 £'000	2017 £'000
9. Cash in hand and balances with Bank of England		
Cash in hand	**414**	347
Bank of England Reserve Account	**58,151**	63,238
Included in cash and cash equivalents (note 26)	**58,565**	**63,585**

	2018 £'000	2017 £'000
10. Loans and advances to credit institutions		
Accrued interest	**20**	26
Repayable on demand (note 26)	**4,730**	3,927
In not more than three months	**5,000**	1,000
In more than three months but not more than one year	-	5,000
	9,750	**9,953**

	2018 £'000	2017 £'000
11. Debt securities		
Securities available-for-sale		
Certificates of deposit	-	2,016
	-	2,016

The Society holds no listed debt securities at 31 December 2018 (2017: nil).

	2018 £'000	2017 £'000
Movements on debt securities during the year are analysed as follows:		
At 1 January	**2,016**	10,549
Additions	**-**	4,000
Disposals and maturities	**(2,000)**	(12,554)
Movement in interest and amortisation	**(16)**	21
At 31 December	**-**	**2,016**

12. Derivative financial instruments

At 31 December 2018	Contract/notional	Fair values	
	Amount	Assets	Liabilities
	£'000	£'000	£'000
a) Unmatched derivatives			
Interest rate swaps	**17,324**	**2**	**(17)**
b) Derivatives designated as fair value hedges			
Interest rate swaps	**82,026**	**54**	**(104)**
Total recognised derivative assets/(liabilities)	**99,350**	**56**	**(121)**

At 31 December 2017	Contract/notional	Fair values	
	Amount	Assets	Liabilities
	£'000	**£'000**	**£'000**
a) Unmatched derivatives			
Interest rate swaps	14,750	-	(7)
b) Derivatives designated as fair value hedges			
Interest rate swaps	63,150	55	(28)
Total recognised derivative assets/(liabilities)	**77,900**	**55**	**(35)**

Typically unmatched derivatives arise during the final 3 months of an interest rate swap's life where the derivative's change in fair value are immaterial, or where a new interest rate swap contract has been agreed but the corresponding asset or liability is still to be realised on the Statement of Financial Position.

At 31 December 2018 no cash collateral has been received or paid by the Society against derivative contracts (2017: nil). No collateral was provided to any other parties during the year including collateral secured against loans and advances to credit institutions or customers (2017: nil).

	2018 £'000	2017 £'000
13. Loans and advances to customers		
Loans fully secured on residential property	**298,810**	284,178
Other loans – loans fully secured on land	**2,538**	3,163
	301,348	287,341
Provision for impairment losses on loans and advances (note 14)	**(1,469)**	(1,573)
Fair value adjustment for hedged risk	**62**	(36)
	299,941	**285,732**

Maturity analysis

The remaining maturity of loans and advances to customers including fair value adjustment for hedged risk at the reporting date is as follows:

In not more than three months	**3,672**	3,554
In more than three months but not more than one year	**8,474**	8,940
In more than one year but not more than five years	**50,735**	49,566
In more than five years	**238,529**	225,245
	301,410	287,305
Provision for impairment losses on loans and advances (note 14)	**(1,469)**	(1,573)
	299,941	**285,732**

The maturity analysis above is based on contractual maturity and not expected redemption levels.

Certain residential mortgages have been utilised as mortgage loan pools for the Bank of England's Term Funding Scheme. The scheme has enabled the Society to obtain secured funding.

Bank of England Funding

The table below summarises the mortgages pledged and encumbered:

Bank of England Funding	Mortgages pledged		Drawn	
	2018	2017	2018	2017
	£'000	£'000	£'000	£'000
Other whole mortgage schemes	**24,467**	-	**-**	-
Term funding schemes	**26,933**	-	**14,500**	-
Total	**51,400**	**-**	**14,500**	**-**

14. Provision for bad and doubtful debts

	Loans fully secured on residential property	Other loans fully secured on land	Total
	£'000	£'000	£'000
Individual provision			
At 1 January 2018	**14**	**39**	**53**
Amounts written off	-	-	-
Charge/(Release) for the year	60	(39)	21
At 31 December 2018	**74**	**-**	**74**
Collective provision			
At 1 January 2018	**1,283**	**237**	**1,520**
Amounts written off	(13)	-	(13)
Charge/(Release) for the year	80	(192)	(112)
At 31 December 2018	**1,350**	**45**	**1,395**
Individual provision			
At 1 January 2017	156	46	202
Amounts written off	(17)	-	(17)
(Release) for the year	(125)	(7)	(132)
At 31 December 2017	**14**	**39**	**53**
Collective provision			
At 1 January 2017	1,438	192	1,630
Amounts written off	-	-	-
(Release)/Charge for the year	(155)	45	(110)
At 31 December 2017	**1,283**	**237**	**1,520**

The credit to the income statement comprises:

Net credit for the year (above)	(104)
Amounts written off less recoveries	6
Credit to the income statement in 2018	**(98)**
Credit to the income statement in 2017	**(250)**

Notes to the accounts

15. Tangible fixed assets

	Freehold Land & buildings	Short leasehold	Equipment, fixtures, fittings and vehicles	Total
	£'000	£'000	£'000	£'000
2018				
Cost				
At 1 January 2018	**1,566**	**101**	**1,458**	**3,125**
Additions	-	-	114	114
Disposals	-	-	(122)	(122)
At 31 December 2018	**1,566**	**101**	**1,450**	**3,117**
Depreciation				
At 1 January 2018	**163**	**50**	**1,182**	**1,395**
Charge for the year	23	6	77	106
On disposals	-	-	(75)	(75)
At 31 December 2018	**186**	**56**	**1,184**	**1,426**
Net Book Value				
At 31 December 2018	**1,380**	**45**	**266**	**1,691**
2017				
Cost				
At 1 January 2017	1,272	101	1,419	2,792
Additions	419	-	79	498
Disposals	(125)	-	(40)	(165)
At 31 December 2017	**1,566**	**101**	**1,458**	**3,125**
Depreciation				
At 1 January 2017	140	43	1,121	1,304
Charge for the year	23	7	85	115
On disposals	-	-	(24)	(24)
At 31 December 2017	**163**	**50**	**1,182**	**1,395**
Net Book Value				
At 31 December 2017	**1,403**	**51**	**276**	**1,730**

Land and buildings

The net book value of freehold land and buildings occupied for own use at 31 December 2018 was £1,308,000 (2017: £1,331,000). Land and buildings includes investment properties held at fair value at 31 December 2018 of £72,000 (2017: £72,000); no gains or losses have been recognised in 2018 (2017: nil).

Depreciation and amortisation

The Income Statements 'Depreciation and amortisation' includes profit on sale of tangible fixed assets in 2018 of £12,467 (2017:loss £8,332).

16. Intangible fixed assets

	Purchased Software £'000
2018	
Cost	
At 1 January 2018	**828**
Additions	120
At 31 December 2018	**948**
Amortisation	
At 1 January 2018	**730**
Charge for the year	53
At 31 December 2018	**783**
Net Book Value	
At 31 December 2018	**165**
2017	
Cost	
At 1 January 2017	778
Additions	50
At 31 December 2017	**828**
Amortisation	
At 1 January 2017	701
Charge for the year	29
At 31 December 2017	**730**
Net Book Value	
At 31 December 2017	**98**

	2018 £'000	2017 £'000
17. Deferred tax		
At 1 January	**88**	121
Decrease in asset for the year (note 8)	**(35)**	(33)
At 31 December	**53**	**88**
Tax effect of timing differences due to:		
FRS102 transitional adjustments	**(19)**	(19)
Accelerated capital allowances	**(53)**	(38)
Collective loss provision	**125**	145
	53	**88**

Reductions in the UK corporation tax rate from 19% to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015. This will reduce the Society's future current tax charge accordingly. The deferred tax asset at 31 December 2018 has been calculated based on the prevailing tax rate when the timing differences are expected to reverse.

	2018 £'000	2017 £'000
18. Shares		
Held by individuals	**312,600**	322,943
Other shares	**12**	12
Fair value adjustment for hedged risk	**(2)**	(5)
	312,610	**322,950**
Shares are repayable from the date of the Statement of Financial Position in the ordinary course of business as follows:		
Accrued interest	**578**	561
Repayable on demand	**209,864**	211,272
In not more than three months	**77,514**	86,128
In more than three months but not more than one year	**18,665**	17,231
In more than one year but not more than five years	**5,991**	7,763
Fair value adjustment for hedged risk	**(2)**	(5)
	312,610	**322,950**

	2018 £'000	2017 £'000

19. Amounts owed to credit institutions

Amounts owed to credit institutions are repayable at the reporting date in the ordinary course of business as follows:

Accrued interest	31	-
In more than one year but not more than five years	14,500	-
	14,531	-

Amounts owed to credit institutions include £14,500k (2017: £nil) secured against certain loans and advances to customers.

	2018 £'000	2017 £'000

20. Amounts owed to other customers

Amounts owed to other customers are repayable at the reporting date in the ordinary course of business as follows:

Repayable on demand	1,579	1,543
In not more than three months	1,000	-
	2,579	1,543

	2018 £'000	2017 £'000

21. Other liabilities

Falling due within one year		
Income tax	-	1
Corporation tax	140	214
	140	215

Notes to the accounts

	2018 £'000	2017 £'000
22. Accruals and deferred income		
Accruals	**893**	673

A reclassification from the prior year comparative of £25k has been made between Accruals and Provisions for liabilities (note 23).

	2018 FSCS £'000	2018 Other Provisions £'000	2018 Total £'000	2017 FSCS £'000	2017 Other Provisions £'000	2017 Total £'000
23. Provision for liabilities						
At 1 January	**46**	**25***	**71**	67	-	67
Charge for the year	**(27)**	**77**	**50**	36	25	61
Provision utilised	**(13)**	**(25)**	**(38)**	(57)	-	(57)
At 31 December	**6**	**77**	**83**	**46**	**25**	**71**

* Opening balance restated as per note 22

Financial Services Compensation Scheme

The FSCS levy represents the estimated amount payable under the FSCS for the 2018/19 scheme year, which ran from April 2018 to March 2019 and is calculated with reference to the protected deposits held at 31 December 2017.

Other Provisions

Other provisions have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance. It is expected that the liability will predominantly crystallise over the next 12 months.

24. Retirement benefit obligations

Defined contribution scheme

The Society operates a defined contribution scheme, the assets of which are held separately from those of the Society. The total cost was £217,000 (2017: £292,000). There were no outstanding or prepaid contributions at either the beginning or end of the year.

25. General reserves

	2018 £'000	2017 £'000
At 1 January	**38,409**	36,765
Profit for the financial year	**1,348**	1,644
At 31 December	**39,757**	**38,409**

26. Cash and cash equivalents

	Notes	2018 £'000	2017 £'000
Cash in hand and balances with the Bank of England	9	**58,565**	63,585
Loans and advances to credit institutions repayable on demand	10	**4,730**	3,927
		63,295	**67,512**

27. Financial instruments

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The Society is a retailer of financial instruments in the form of mortgage and savings products, and also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and to manage the risks arising from its operations.

The Society has a formal structure for managing financial risk, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Society's Executive Assets & Liabilities Committee (ALCO), which is charged with the responsibility for managing and controlling balance sheet exposures. Instruments used for risk management purposes include derivative financial instruments (derivatives), which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates.

Derivatives are only used by the Society in accordance with the Building Societies Act 1986, to limit the extent to which the Society will be affected by changes in interest rates. Derivatives are not used in trading activity or for speculative purposes and all derivatives are, therefore, designated as hedging instruments. The principal derivatives used in the balance sheet risk management are interest rate swaps which are used to hedge balance sheet exposures arising from fixed rate mortgage lending and from fixed rate savings accounts.

The Society applies fair value hedging techniques to reduce its exposure to interest rate risk as follows:

Activity	Risk	Fair value interest rate hedge
Fixed rate mortgages	Increase in interest rates	Society pays fixed, receives variable
Fixed rate savings accounts	Decrease in interest rates	Society receives fixed, pays variable

The fair values of these hedges at 31 December 2018 and 31 December 2017 are shown in note 12.

27. Financial instruments (continued)

Summary terms and conditions and accounting policies of financial instruments

Financial instrument	Terms and conditions	Accounting policy
Loans and advances to credit institutions	Fixed interest rate Fixed term Short to medium term maturity	Loans and receivables at amortised cost Accounted for at settlement date
Debt securities	Fixed interest rate Fixed term Short to medium term maturity	Available-for-sale at fair value Accounted for at settlement date
Loans and advances to customers	Secured on property or land Standard contractual term of 25 years Fixed or variable rate interest	Loans and receivables at amortised cost Accounted for at settlement date
Shares	Fixed or variable term Fixed or variable interest rates	Amortised cost Accounted for at settlement date
Amounts owed to credit institutions	Fixed interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Amounts owed to other customers	Fixed or variable term Fixed or variable interest rates Short to medium term maturity	Amortised cost Accounted for at settlement date
Derivative financial instruments	Fixed interest received/paid converted to variable interest paid/received Based on notional value of the derivative	Fair value through profit and loss

27. Financial instruments (continued)

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1: 'Accounting policies' describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The tables below analyse the Society's assets and liabilities by financial classification:

Carrying values by category 31 December 2018	Held at amortised cost		Held at fair value			
	Loans and receivables	Financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	**Total**
	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets						
Cash in hand and balances with Bank of England	-	**58,565**	-	-	-	**58,565**
Loans and advances to credit institutions	-	**9,750**	-	-	-	**9,750**
Derivative financial instruments	-	-	-	**54**	**2**	**56**
Loans and advances to customers	**299,879**	-	-	**62**	-	**299,941**
Other assets	-	**2,402**	-	-	-	**2,402**
	299,879	**70,717**	**-**	**116**	**2**	**370,714**
Financial liabilities						
Shares	-	**312,612**	-	**(2)**	-	**312,610**
Amounts owed to credit institutions	-	**14,531**	-	-	-	**14,531**
Amounts owed to other customers	-	**2,579**	-	-	-	**2,579**
Derivative financial instruments	-	-	-	**104**	**17**	**121**
Other liabilities	-	**1,116**	-	-	-	**1,116**
	-	**330,838**	**-**	**102**	**17**	**330,957**

27. Financial instruments (continued)

Carrying values by category 31 December 2017	Held at amortised cost		Held at fair value			
	Loans and receivables	Financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets						
Cash in hand and balances with Bank of England	-	63,585	-	-	-	63,585
Loans and advances to credit institutions	-	9,953	-	-	-	9,953
Debt securities	-	-	2,016	-	-	2,016
Derivative financial instruments	-	-	-	55	-	55
Loans and advances to customers	285,768	-	-	(36)	-	285,732
Other assets	-	2,555	-	-	-	2,555
	285,768	**76,093**	**2,016**	**9**	**-**	**363,896**
Financial liabilities						
Shares	-	322,955	-	(5)	-	322,950
Amounts owed to other customers	-	1,543	-	-	-	1,543
Derivative financial instruments	-	-	-	28	7	35
Other liabilities	-	959	-	-	-	959
	-	**325,457**	**-**	**23**	**7**	**325,487**

There have been no reclassifications during either year.

27. Financial instruments (continued)

Fair values of financial assets and liabilities

The table below analyses the book and fair values of the financial instruments held at amortised cost at 31 December:

		2018 Book value £'000	2018 Fair value £'000	2017 Book value £'000	2017 Fair value £'000
Financial assets					
Cash in hand and balances with Bank of England	a	58,565	58,565	63,585	63,585
Loans and advances to credit institutions	b	9,750	9,750	9,953	9,954
Loans and advances to customers	c	299,941	304,710	285,732	289,475
Other assets		2,402	2,402	2,555	2,555
		370,658	375,427	361,825	365,569
Financial liabilities					
Shares	d	312,610	312,651	322,950	323,052
Amounts owed to credit institutions	e	14,531	14,531	-	-
Amounts owed to other customers	e	2,579	2,579	1,543	1,543
Other liabilities		1,116	1,116	959	959
		330,836	330,877	325,452	325,554

Fair value is the value for which an asset or liability could be exchanged or settled between knowledgeable willing parties in an arm's length transaction. The estimated fair value of the financial assets and liabilities above has been calculated using the following valuation methodology:

The fair value hierarchy when deriving fair values is split into three levels, as follows:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly
- Level 3 - inputs for the asset or liability that are not based on observable market data

a) Cash in hand and balances with Bank of England - Level 1
The fair value of cash in hand and deposits with central banks is the amount repayable on demand.

b) Loans and advances to credit institutions - Level 2
The fair value of overnight deposits is the amount repayable on demand. The estimated fair value of loans and advances to credit institutions is calculated based on discounted expected future cash flows.

c) Loans and advances to customers - Level 3
Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IAS39. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received taking account of expected prepayment rates.

Estimated cash flows are discounted at prevailing market rates for items of similar remaining maturity. The fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

d) Shares - Level 3
The fair value of shares with no stated maturity is the amount repayable on demand. The estimated fair value of fixed share accounts are based on expected future cash flows determined by the contractual terms and conditions discounted at prevailing market rates for items of similar remaining maturity.

e) Amounts owed to other customers - Level 2
The fair value of fixed interest bearing deposits and other borrowings without a quoted market price is based on expected future cash flows determined by the contractual terms and conditions discounted at prevailing market rates for items of similar remaining maturity.

27. Financial instruments (continued)

Fair values of financial assets and liabilities

The table below summarises the fair values of the Society's financial assets and liabilities that are accounted for at fair value, analysed by the valuation methodology used by the Society to derive the financial instruments fair value:

	Notes	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
31 December 2018					
Financial assets					
Derivative financial instruments					
Interest rate swaps	12	-	56	-	56
		-	56	-	56
Financial Liabilities					
Derivative financial instruments					
Interest rate swaps	12	-	121	-	121
		-	121	-	121
31 December 2017					
Financial assets					
Available-for-sale					
Debt securities	11	-	2,016	-	2,016
Derivative financial instruments					
Interest rate swaps	12	-	55	-	55
		-	2,071	-	2,071
Financial Liabilities					
Derivative financial instruments					
Interest rate swaps	12	-	35	-	35
		-	35	-	35

Valuation techniques

The main valuation techniques employed to establish fair value of the financial instruments disclosed above are set out below:

- **Debt securities**
  Level 1 - Market prices have been used to determine the fair value of listed debt securities
  Level 2 - Debt securities for which there is no readily available traded price are valued based on the 'present value' method. This requires expected future principal and interest cash flows to be discounted using prevailing yield curves. The yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the cash flows and maturities of the instruments.

- **Interest rate swaps** - the valuation of interest rate swaps is based on the 'present value' method. Expected interest cash flows are discounted using the prevailing yield curves. The yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments. The Society's swaps are not collateralised.

27. Financial instruments (continued)

Credit risk

Credit risk is the risk that the Society incurs a financial loss arising from the failure of a customer or counterparty to meet their contractual obligations. The Society structures the level of credit risk it undertakes, by maintaining a governance framework involving delegated approval authority levels and credit procedures, the objective of which is to build and maintain asset port folios of high quality.

The Society's maximum credit risk exposure is detailed in the table below:

	2018 £'000	2017 £'000
Credit Risk Exposure		
Cash in hand and balances with Bank of England	**58,565**	63,585
Loans and advances to credit institutions	**9,750**	9,953
Debt securities	**-**	2,016
Derivative financial instruments	**56**	55
Loans and advances to customers	**299,941**	285,732
Total statement of financial position exposure	**368,312**	**361,341**
Off balance sheet exposure – mortgage commitments	**17,215**	13,004
Total	**385,527**	**374,345**

27. Financial instruments (continued)

a) Loans and advances to credit institutions, debt securities and derivative financial instruments

The Board is responsible for approving treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to a single counterparty, or group of counterparties, and to industry sectors. This is monitored daily by the Finance Director and reviewed monthly by the ALCO.

Policy only permits lending to central government (which includes the Bank of England), banks with a high credit rating and building societies. The Finance Director performs regular analysis of counterparty credit risk and monitoring of publicly available information to highlight possible indirect exposures.

An analysis of the treasury asset concentration is shown in the tables below:

	2018 £'000	2018 %	2017 £'000	2017 %
Industry sector				
Banks	**4,744**	**6.94**	5,959	7.89
Building Societies	**5,006**	**7.33**	6,010	7.95
Central Bank	**58,565**	**85.73**	63,601	84.16
Total	**68,315**	**100.00**	**75,570**	**100.00**

	2018 £'000	AA %	A %	Other %	2017 £'000
Geographic region					
United Kingdom	**68,315**	**85.75**	**6.92**	**7.33**	75,570

'Other' relates to investments in unrated Building Societies.

There is no exposure to foreign exchange risk. All instruments are denominated in Sterling.

The derivative financial instruments are analysed in the table below:

	2018 £'000	AA %	A %	Other %	2017 £'000
Geographic region					
United Kingdom	**99,350**	**57.67**	**42.33**	**-**	77,900

There are no impairment charges against any of the Society's treasury assets at 31 December 2018 (2017: £nil).

27. Financial instruments (continued)

b) Loans and advances to customers

All mortgage loan applications are assessed with reference to the Society's credit risk appetite statement and lending policy which are approved by the Board. When deciding on the overall risk appetite that is to be adopted, both numerical and non- numerical considerations are taken into account, along with data on the current UK economic climate and competitor activity. The lending policy must comply with all the prevailing regulatory requirements. The lending portfolio as originated is monitored by the Board to ensure that it remains in line with the stated risk appetite, including adherence to the lending principles, policies and lending limits.

For new customers the first assessment of credit risk is achieved through individual case underwriting, which assesses the credit quality of potential customers prior to making loan offers. The customers' credit assessment combines demographic and financial information. A second element is lending policy rules which are applied to new applications to ensure that they meet the risk appetite of the Society. All mortgage applications are overseen by the Mortgage department who ensure that lending criteria are applied and that all information submitted within the application is validated.

To ensure good customer outcomes and responsible lending the Society ensures at the outset that the customer can meet the mortgage repayments. This is achieved by obtaining specific information from the customer concerning income and expenditure but also with reference to external credit reference agency data. The maximum credit risk exposure is disclosed in the table on page 56.

Loans and advances to customers are predominately made up of retail loans fully secured against UK residential property (£299m), split between primarily residential loans and a small portfolio of buy-to-let loans with the remaining £3m being secured on commercial property.

The Society operates throughout England & Wales and an analysis of the geographical concentration is shown in the table below:

	2018	2017
	%	%
Geographical analysis		
West Midlands	**62.13**	68.82
East Midlands	**8.00**	8.09
London	**8.78**	6.68
South West	**5.93**	4.12
North West	**3.80**	3.41
South East	**3.80**	3.40
Yorkshire and Humberside	**3.67**	3.17
East Anglia	**1.87**	1.11
Wales	**1.18**	0.67
North	**0.84**	0.53

27. Financial instruments (continued)

The average loan to value (LTV) is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held and adjusted by a house price index (HPI) for loans which are on residential property.

The average LTV of mortgage loans is 47.83% (2017: 47.50%). Mortgage Indemnity Insurance is taken out for all residential loans above 80% LTV at origination for a five year period from inception with a Lloyds of London insurance firm. Further LTV information on the mortgage portfolio is shown below:

	2018	2017
	%	%
LTV analysis		
>0% - 50%	**25.90**	24.54
>50% - 60%	**15.76**	15.29
>60% - 70%	**15.08**	19.98
>70% - 80%	**17.85**	18.31
>80% - 90%	**18.24**	16.88
>90% +	**7.17**	5.00
Average loan to value of mortgage loans	**47.83**	**47.50**

27. Financial instruments (continued)

The table below provides information on loans by payment due status net of provision:

	2018 £'000	2018 %	2017 £'000	2017 %
Arrears analysis				
Not impaired:				
Neither past due or impaired	**297,888**	**99.31**	283,186	99.11
Past due up to 3 months but not impaired	**1,342**	**0.45**	2,036	0.71
Past due over 3 months but not impaired	**210**	**0.07**	371	0.13
Possessions	**-**	**-**	-	-
Impaired:				
Not past due	**-**	**-**	95	0.03
Past due up to 3 months	**356**	**0.12**	-	-
Past due 3 to 6 months	**145**	**0.05**	44	0.02
Past due 6 to 12 months	**-**	**-**	-	-
Past due over 12 months	**-**	**-**	-	-
Possessions	**-**	**-**	-	-

	Indexed £'000	Unindexed £'000	Indexed £'000	Unindexed £'000
Value of Collateral held:				
Neither past due or impaired	**615,557**	**525,192**	590,176	492,746
Past due but not impaired	**8,921**	**6,870**	9,276	7,371
Impaired	**222**	**181**	263	218
	624,700	**532,243**	**599,715**	**500,335**

The Society uses HPI indexing to update the property values of its residential and buy-to-let portfolios on a quarterly basis. Collateral values are adjusted by the Nationwide house price index to derive the indexed valuation at 31 December. This is a UK house price index and takes into account regional data from the 12 standard planning regions of the UK. The collateral consists of UK property and land.

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'past due but not impaired' at 31 December 2018 is £4,131,484 (2017: £4,734,933) against an outstanding debt of £4,131,484 (2017: £4,734,933). In addition, the value of collateral held against 'Impaired' assets at 31 December 2018 is £159,682 (2017: £58,518) against outstanding debt of £159,682 (2017: £58,518).

Mortgage indemnity insurance acts as additional security. It is taken out for all residential loans where the borrowing exceeds 80% of the value of the total security at the point of origination.

The status 'past due up to three months but not impaired' and 'past due over three months but not impaired' includes any asset where a payment due is received late or missed but no individual provision has been allocated. The amount included is the entire loan amount rather than just the overdue amount.

Possession balances represent those loans where the Society has taken action to realise the underlying security. Various forbearance options are available to support customers who may find themselves in financial difficulty.

27. Financial instruments (continued)

Forbearance

Temporary transfer to an interest only concession is offered for a set period for customers in financial difficulty. The concession allows customers to reduce monthly payments to cover interest only, and if made, the arrears status will not increase.

Reduced monthly payment concessions allow a customer to make an agreed underpayment for a specific period of time. The monthly underpaid amount accrues as arrears and agreement is reached at the end of the concession period on how the arrears will be repaid. Payment plans are agreed to enable customers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment.

Product reviews for mortgages are undertaken if a change of product is appropriate, this could be due to a customer not switching product on the maturity of their fixed or discount term. All customers are contacted by the Society on maturity of their discount or fixed product rate.

Capitalisations occur where arrears are incorporated into the capital balance outstanding for the purposes of re-structuring the loan.

The term of the mortgage can be extended in order to reduce payments to a level which is affordable to the customer based on their current financial circumstances.

All forbearance arrangements are formally discussed with the customer and reviewed by management prior to acceptance of the forbearance arrangement. By offering customers in financial difficulty the option of forbearance the Society potentially exposes itself to an increased level of risk through prolonging the period of non-contractual payment and/or potentially placing the customer into a detrimental position at the end of the forbearance period.

The level and different types of forbearance activity is reported to the Board on a monthly basis. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

The table below details the number of forbearance cases within the 'not impaired' category:

Type of Forbearance	2018 Number	2017 Number
Interest only concessions at year end	**15**	20
Reduced payment concessions at year end	**-**	1
Total	**15**	**21**

These are included as part of the collective impairment provision of £1.395m (2017: £1.52m). Total loans in forbearance represent £1.52m (2017: £2.11m).

27. Financial instruments (continued)

Liquidity risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. A significant amount of liquid assets are carried in the form of cash and other readily realisable assets in order to:

i) meet day-to-day business needs;
ii) meet any unexpected cash needs;
iii) maintain public confidence; and
iv) ensure maturity mismatches are provided for.

Monitoring of liquidity, in line with the Society's Internal Liquidity Adequacy Assessment Process (ILAAP) document is performed daily. Compliance with the policy is reported to ALCO and to the Board monthly.

The ILAAP is designed to ensure the Society has sufficient liquid resources to withstand a range of stressed scenarios. A series of liquidity stress tests have been developed as part of liquidity risk assessment process. They include scenarios that fulfil the specific requirements of the PRA (the idiosyncratic, market-wide and combination stress tests). The stress tests are performed monthly and reported to the Board.

The Society's liquid resources comprise high quality liquid assets, including a Bank of England reserves account and time deposits, supplemented from time to time by UK Government Treasury bills. At the end of the year the ratio of liquid assets to shares and deposits was 20.72% compared to 23.28% for 2017.

The table below analyses the Society's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the Statement of Financial Position date. This is not representative of the Society's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example, most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

27. Financial instruments (continued)

Residual maturity as at 31 December 2018	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	No specific maturity and loss provision	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets							
Liquid assets							
Cash in hand and balances with Bank of England	58,565	-	-	-	-	-	58,565
Loans and advances to credit institutions	4,750	5,000	-	-	-	-	9,750
Total liquid assets	63,315	5,000	-	-	-	-	68,315
Loans and advances to customers	-	3,088	8,484	50,862	238,976	(1,469)	299,941
Derivative financial instruments	-	3	44	9	-	-	56
Tangible assets	-	-	-	-	-	1,691	1,691
Intangible assets	-	-	-	-	-	165	165
Other assets	-	-	-	-	-	546	546
	63,315	8,091	8,528	50,871	238,976	933	370,714
Financial liabilities and reserves							
Shares	210,442	77,555	18,622	5,991	-	-	312,610
Amounts owed to credit institutions	31	-	-	14,500	-	-	14,531
Amounts owed to other customers	1,579	1,000	-	-	-	-	2,579
Derivative financial instruments	-	-	1	120	-	-	121
Other liabilities	-	-	-	-	-	1,033	1,033
Provisions for liabilities	-	-	-	-	-	83	83
Reserves	-	-	-	-	-	39,757	39,757
	212,052	78,555	18,623	20,611	-	40,873	370,714
Net liquidity gap	(148,737)	(70,464)	(10,095)	30,260	238,976	(39,940)	-

27. Financial instruments (continued)

Residual maturity as at 31 December 2017	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	No specific maturity and loss provision	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets							
Liquid assets							
Cash in hand and balances with Bank of England	63,585	-	-	-	-	-	63,585
Loans and advances to credit institutions	3,943	1,002	5,008	-	-	-	9,953
Debt securities	-	2,016	-	-	-	-	2,016
Total liquid assets	67,528	3,018	5,008	-		-	75,554
Loans and advances to customers	-	3,026	8,950	49,549	225,780	(1,573)	285,732
Derivative financial instruments	-	-	16	39	-	-	55
Tangible assets	-	-	-	-	-	1,730	1,730
Intangible assets	-	-	-	-	-	98	98
Other assets	-	-	-	-	-	727	727
	67,528	6,044	13,974	49,588	225,780	982	363,896
Financial liabilities and reserves							
Shares	211,833	86,128	17,231	7,758	-	-	322,950
Amounts owed to other customers	1,543	-	-	-	-	-	1,543
Derivative financial instruments	-	5	10	20	-	-	35
Other liabilities	-	-	-	-	-	888	888
Provisions for liabilities	-	-	-	-	-	71	71
Reserves	-	-	-	-	-	38,409	38,409
	213,376	86,133	17,241	7,778	-	39,368	363,896
Net liquidity gap	(145,848)	(80,089)	(3,267)	41,810	225,780	(38,386)	-

All liquid assets are unencumbered as at the balance sheet date (2017: nil).

27. Financial instruments (continued)

The following is an analysis of gross cash flows payable under financial liabilities.

31 December 2018	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	Non interest bearing	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Financial liabilities and reserves						
Shares	210,442	77,516	18,704	6,208	-	312,870
Amounts owed to credit institutions	-	-	-	14,842	-	14,842
Amounts owed to other customers	1,579	1,002	-	-	-	2,581
Derivative financial instruments	-	233	612	1,043	-	1,888
Other liabilities	-	-	-	-	1,033	1,033
Provisions for liabilities	-	-	-	-	83	83
Total liabilities	212,021	78,751	19,316	22,093	1,116	333,297

31 December 2017	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	Non interest bearing	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Financial liabilities and reserves						
Shares	211,833	86,179	17,553	7,978	-	323,543
Amounts owed to other customers	1,543	-	-	-	-	1,543
Derivative financial instruments	-	108	205	93	-	406
Other liabilities	-	-	-	-	888	888
Provisions for liabilities	-	-	-	-	71	71
Total liabilities	213,376	86,287	17,758	8,071	959	326,451

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the Statement of Financial Position date. The derivative financial instrument cash flows include the payable leg of all interest rate swap derivatives held by the Society at the Statement of Financial Position date.

27. Financial instruments (continued)

Market risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk).

The Society has adopted the 'Matched' approach to interest rate risk, as defined by the PRA. Societies adopting the Matched approach should have a balance sheet where assets and liabilities are entirely in sterling and use hedging contracts (or internal matching of assets and liabilities with similar interest rate and maturity features) to neutralise the risk arising from loans or funding other than at administered rates, on a tranche by tranche, product by product basis. By implication, societies adopting this approach should not be taking an interest rate view for the purposes of determining a hedging strategy.

The management of interest rate risk is based on a full Statement of Financial Position gap analysis. The Statement of Financial Position is subjected to a stress test of a 2% rise in interest rates on a monthly basis and the results are reported to the Board monthly. In addition management review interest rate basis risk which is reported to the Board monthly. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum level of capital. These are in turn reviewed by the ALCO and reported to the Board.

The table below summarises the exposure to interest rate risk. Included in the table are assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by repricing date.

Interest rate risk as at 31 December 2018	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non interest bearing	Total
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Financial assets						
Liquid assets	67,879	-	-	-	436	68,315
Loans and advances to customers	193,779	34,301	72,792	-	(931)	299,941
Derivative financial instruments	-	-	-	-	56	56
Tangible assets	-	-	-	-	1,691	1,691
Intangible assets	-	-	-	-	165	165
Other assets	-	-	-	-	546	546
	261,658	34,301	72,792	-	1,963	370,714
Financial liabilities and reserves						
Shares	282,296	23,747	5,991	-	576	312,610
Amounts owed to credit institutions	14,500	-	-	-	31	14,531
Amounts owed to other customers	2,579	-	-	-	-	2,579
Derivative financial instruments	-	-	-	-	121	121
Other liabilities	-	-	-	-	1,033	1,033
Provisions for liabilities	-	-	-	-	83	83
Reserves	-	-	-	-	39,757	39,757
	299,375	23,747	5,991	-	41,601	370,714
Impact of derivative instruments	70,914	(18,099)	(52,915)	100	-	-
Interest rate sensitivity gap	31,727	(7,545)	13,886	100	(38,169)	-
Sensitivity to profit and reserves						
Parallel shift of 1%	(39.5)	48.9	(313.0)	(4.6)	-	(308.2)
Parallel shift of 2%	(79.1)	97.9	(626.1)	(9.2)	-	(616.5)

27. Financial instruments (continued)

Interest rate risk as at 31 December 2017	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	Non interest bearing	Total
	£'000	£'000	£'000	£'000	£'000
Financial assets					
Liquid assets	70,164	5,000	-	390	75,554
Loans and advances to customers	206,007	39,134	41,630	(1,039)	285,732
Derivative financial instruments	-	-	-	55	55
Tangible assets	-	-	-	1,730	1,730
Intangible assets	-	-	-	98	98
Other assets	-	-	-	727	727
	276,171	44,134	41,630	1,961	363,896
Financial liabilities and reserves					
Shares	291,374	23,257	7,763	556	322,950
Amounts owed to other customers	1,543	-	-	-	1,543
Derivative financial instruments	-	-	-	35	35
Other liabilities	-	-	-	913	913
Provisions for liabilities – FSCS Levy	-	-	-	46	46
Reserves	-	-	-	38,409	38,409
	292,917	23,257	7,763	39,959	363,896
Impact of derivative instruments	46,350	(19,600)	(26,750)	-	-
Interest rate sensitivity gap	29,604	1,277	7,117	(37,998)	-
Sensitivity to profit and reserves					
Parallel shift of 1%	(31.0)	0.1	(157.3)	-	(188.2)
Parallel shift of 2%	(62.0)	0.1	(314.5)	-	(376.4)

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the Statement of Financial Position as FRS 102 Section 11.38A requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society. All financial assets and liabilities are presented on a gross basis in the Statement of Financial Position.

The Society has Credit Support Annexes (CSA) for its derivative instruments which typically provides for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure. As at 31 December 2018 no exchange of collateral has taken place due to the trigger points within the CSA's not being exceeded.

The Society is not exposed to foreign currency risk.

Notes to the accounts

28. Guarantees and financial commitments

	2018 £'000	2017 £'000
a) Capital commitments		
Capital expenditure contracted for but not provided for in the accounts	-	-
b) Annual operating lease commitments at the year end		
Leases which expire in more than 5 years	25	25

29. Related Party Transactions

During the year ended 31 December 2018 a total of £3,230 (2017: £6,023) was paid to Higgs & Sons for professional advice relating to procurement contracts and property. Sara Shepherd, a Non-Executive Director, is a partner at Higgs & Sons, but was not party to the advice and the transactions were carried out on normal commercial terms.

At 31 December 2018 there was £1,260 of related party liabilities to Higgs & Sons in relation to invoices rendered for services as noted above (2017: nil).

Directors and connected persons hold savings balances with the Society; all accounts have the same terms and conditions as available to customers of the Society. The savings balances are not detailed in the register unlike loans and transactions, due to their sensitive nature. The aggregate amount of all savings balances at 31 December 2018 was £51,965 (2017: £159,268).

Annual Business Statement

1. Statutory percentages

	2018 %	Statutory limit %
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	**1.03**	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	**5.23**	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 and are based on the Statement of Financial Position.

Business assets are the total assets of the Society as shown in the Statement of Financial Position plus impairment for losses on loans and advances (note 14), less property, plant and equipment, intangible assets and liquid assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and interest accrued not yet payable.

Total ‘shares and borrowings’ are the aggregate of ‘shares’ and ‘amounts owed to other customers’ in the Statement of Financial Position. Shares held by individuals are set out in note 18.

Annual Business Statement

2. Other percentages

	2018 %	2017 %
As a percentage of shares and borrowings		
Gross capital	**12.06**	11.84
Free capital	**11.92**	11.74
Liquid assets	**20.72**	23.28
As a percentage of mean total assets		
Profit after taxation	**0.37**	0.45
Management expenses	**1.38**	1.32
As a percentage of year end assets		
Return on assets	**0.36**	0.45

The above percentages have been calculated from the accounts.

'Shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions' and 'amounts owed to other customers' in the Statement of Financial Position.

'Gross capital' are the reserves as shown in the Statement of Financial Position.

'Free capital' is gross capital plus collective impairment for losses on loans and advances (note 14) less property, plant and equipment and intangible assets in the Statement of Financial Position.

'Mean total assets' are calculated by halving the aggregate of total assets at the beginning and end of the financial year.

'Liquid assets' are the first three items on the asset side of the Statement of Financial Position.

'Management expenses' are the aggregate of administrative expenses, depreciation and amortisation taken from the Income Statement.

Annual Business Statement

3. Information relating to Directors as at 31 December 2018

Directors

Name and year of birth	Appointment date	Occupation	Other directorships
A J Higgins MA, FCA 1953	1 May 2012	Chartered Accountant	Countess of Chester Hospital NHS Foundation Trust Roseville Court Management Ltd
M Hrycyk MBA 1956	20 November 2017	Chief Information Officer	Maple Hawthorn Ltd Bookpoint Ltd
G E Loyne MRICS, FAAV 1960	26 May 2011	Consultant & Company Director – Chartered Surveyors and Property Consultants	Charles Edwards Property Consultants Ltd
A J Lumby FCA 1978	29 January 2018	Building Society Finance Director	None
R J Newton FCCA, ACIB 1970	1 July 2011	Building Society Chief Executive	Roseville Court Management Ltd
K A Rolfe BSc (Hons) 1961	1 June 2015	Retired banker	Rooftop Housing Group Ltd
S J Veitch MA, ACA 1973	28 June 2018	Non-Executive Director	Redwood Bank Ltd

Documents may be served on the above named directors c/o Higgs & Sons, Solicitors, 3 Waterfront Business Park, Brierley Hill, West Midlands, DY5 1LX. We do not accept service of documents by email.

Details of the Directors' service contracts are shown in the Report of the Remuneration Committee on page 15.

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Basel III	The Basel Committee on Banking Supervision issued the Basel III rules text in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. Basel III became effective from 1 January 2015 through CRD IV.
Buy to let loans	Buy to let loans are those loans which are offered to customers buying residential property specifically to let out.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2015 to implement Basel III. It has revised the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Deferred tax asset	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates or exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rates.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Financial Services Compensation Scheme	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
General reserves	The accumulation of the Society's historic and current year profit.
Gross capital	The aggregate of general reserves, and available for sale reserves.

Glossary

Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due.
Individually/collectively assessed impairment	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment, as part of CRD IV requirements, of the levels of liquidity that it needs to hold in respect of its regulatory requirements for risks it faces under a business as usual scenario including stress events.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Liquid assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans are past due when a loan payment that has not been made as of its due date.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK from the 1 April 2013. The PRA is a subsidiary of the Bank of England.
Residential loans	Loans that are loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions and amounts owed to other customers.

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