VERNON
BUILDING SOCIETY

ANNUAL Report & Accounts 2017

Helping Stockport own homes since 1924

VERNON

BUILDING SOCIETY

Contents

In 2017 we invested further in our Risk Management Framework and recruited new people where we needed additional depth or experience, resulting in the creation of six new jobs in the Stockport area. We are now well positioned to grow the business in line with our long term plans as we develop new products and services to meet the changing needs of our Members. In April 2017 Mike Hanson, our CEO for the last 22 years, signalled his intention to step down in 2018, and arrangements were put in place to secure a smooth transition. Following a robust recruitment process, the Board was able to appoint Steve Fletcher as the Society's new Chief Executive from early 2018. Mike and Steve have together worked well to safeguard continuity and stability. We thank Mike for his committed and loyal service, and successful stewardship of the Society through a period of unprecedented change.

Our 2017 financial performance saw a decrease in profit before tax to £769,000 reflecting the investment made in the business - costs which will continue into 2018. Our overall Tier 1 capital and liquidity ratios however have been maintained at very robust levels of 19.8% and 648%, respectively. A sustainable growth plan has been put in place for the next five years which will ensure our financial position will remain strong for the years to come.

Economy

Despite the uncertainties that exist following the decision to exit the EU, the UK economy proved relatively resilient through 2017. In November the Bank of England increased the base rate from 0.25% to 0.5%. The Board felt able to pass the majority of the increase on to savers on this occasion. Across the mortgage market, the trend has been towards a more restrained level of activity, reflecting a number of factors including affordability pressures and regulatory and tax changes impacting buy to let landlords. Government schemes such as Help to Buy have helped bolster first time buyer numbers. The recent reduction in stamp duty for first time buyers is also expected to provide a positive stimulus to those trying to get onto the housing ladder.

Members

As part of our long term plan, we are committed to maintaining our network of branches around Stockport in order to grow the Society's Membership. We know that in a range of areas, particularly financial planning advice and mortgage advice, Members value our personal approach and the opportunity for face-to-face interaction. This is something we intend to sustain.

A number of attractive mortgage products were launched by the Society in 2017 reflecting our commitment to providing borrowers with fair and attractive mortgages. We have a comprehensive range of products designed to meet a variety of customer circumstances, including contractors, self-employed, self-builders and buy to let landlords.

We continued with our commitment to helping first time buyers get a foot on the housing ladder with products designed to facilitate the increasing requirement for family support.
Our mortgage proposition has been further extended with the relaunch of the Retirement Mortgage which meets the needs of the developing later life mortgage market and allows mortgage payments of interest only from pension income with the amount borrowed being repaid from the sale of the house on death or moving to alternative accommodation.

On the savings front, we continued to provide a range of saving accounts to support our Members needs. During the year we were able to enhance our Help To Buy ISA product to further assist new home-owners.

We continue to support our local community through the Jubilee Fund which is distributed to good causes following a vote from the local community. This scheme is now in its 6th year and has donated a total of £60,000 to the community since its launch. We also took a decision to decommission our bouncy castle which was available for community groups to use for fundraising, replacing it with a free Vernon Bear costume hire scheme. This ties into our sponsorship of the Stockport County Football Club as Vernon Bear is the mascot of the club and a popular local figure with children and adults alike.

Our People

The Society employs 80 people across its branches and support functions. Evidence from our customer surveys and feedback shows how well they continue to serve Members and I thank them for their continued hard work and commitment. In 2017 we have invested in People Development and a Performance Management Framework which will ensure that everyone is equipped to help deliver the Society's long term plans. Our people were instrumental in reviewing and updating the Society values during 2017, thereby helping to ensure that everyone knows what is expected from them and what our Members can expect from us.

Our Board

I took over as Chair from Don Bailey in June and on behalf of the Board I thank him for his commitment and service to the Society over the last 11 years. Susan Jee has taken the position as Vice Chair where her extensive Boardroom knowledge and skill will be invaluable. The Board continues to review the skills, experience and capabilities required to oversee the Society's long term success, and to make sure that the Board has the right knowledge, experience and skills to do so.

Overview

The Society remains in a strong financial position which is demonstrated by its capital and liquidity. Investment across the Society will continue into 2018 as the Society seeks to consolidate its role as a key lender and employer - within and for the region. Facing anticipated economic challenges and increasingly competitive markets, the Society will continue to take a prudent approach at all times, but we remain positive about opportunities to grow further in the years ahead, and to attract new Members as well as retain existing ones.

Finally, as a community focused Building Society, the Board is clear about the central role played by our people in delivering great service to Members. We remain committed to investing in people, and ensuring that we have the right capabilities to win the long term trust and confidence of savers and borrowers alike.

John Hughes
Chair
7 March 2018

I am delighted to have taken over as Chief Executive on the 5th February 2018 and would like to thank Mike for all of his work over the last 22 years. I am taking over following a year when the Society has made good progress, in an unpredictable external environment. At the start of the year the Society set out an ambitious agenda including improving the Risk Management Framework, strengthening capability to deliver faster response times and ensure Member's money remains safe from an ever more sophisticated cyber threat.

It is very pleasing to report that the Society achieved the goals announced at the beginning of the year, while also adapting to the changing regulatory agenda and unforeseen events, both in the wider world and closer to home too.

A few of the highlights from 2017 include: relaunch of the retirement mortgage; Values and Coaching workshops; a focus on people development; supporting local communities through the Jubilee Fund; staff volunteering and the creation of six new full time jobs in Stockport.

Of course financial performance is also important and across 2017 profit, capital and liquidity ratios remained strong and record low arrears figures were achieved.

Financial Performance

Profit before tax was £769,000 for the year ended 31 December 2017 compared to £1,304,000 for 2016, due to the investment in capability for the future. Net interest margin has held at 1.74%, reflecting the stability of the Society's balance sheet.

In 2017 the Society invested significantly in IT systems and supporting processes, particularly around combatting cyber crime, enhancing resilience, reflecting the latest regulatory developments and improving functionality. All of this is essential to protect our customers and to further enhance the service we deliver.

The Society applies a prudent loan provisioning policy. During the year there has been a release in loan impairment provisioning of £76,000 reflecting reduced levels of arrears. The FSCS levy provision also decreased from £47,000 to £22,000 due to a reduction in the scheme's interest costs recharged to retail deposit takers by the FSCS. The Society's capital ratios continue to improve with the Common Equity Tier 1 improving from 18.7% to 19.8%. The leverage ratio increased from 7.0% to 7.2% reflecting the increase in capital reserves and is comfortably in excess of minimum requirements.

Despite the mortgage market being extremely competitive in 2017 the Society achieved a steady amount of new lending and due to the investment in the broker channel, 2018 starts with a healthy pipeline. Gross residential mortgage new lending was down 13% from £33.3m to £29.0m and net lending decreased from £233.7m to £225.5m reflecting the difficult start to 2017.

The percentage of mortgage loans in arrears by 2.5% or more of the loan balance, across our whole mortgage portfolio based on the number of loans, reduced again from 1.28% to 0.44%; lower than the industry average of 0.8%.

The Society's liquidity has increased slightly over the year, highlighted by key liquidity metrics. At the year end our liquidity assets represented 25.2% of our total funding (2016: 23.3%).

Our Liquidity Coverage Ratio ('LCR', the European measure introduced in 2015) has also increased, quite materially, to 648% (2016: 484%), following the opening of the Society's Bank of England Deposit Account. The minimum requirement for the LCR is 100% from 1st January 2018.

Supporting our Members

Mortgage borrowers have seen mortgage rates at record lows for most of this year, however, they did increase in December following the base rate increase announced by the Bank of England in November. As well as continuing to offer a great range of products for customers, the Society has expanded our range to relaunch the Retirement Product, tailored for customers who are in retirement and want to release equity without a build-up of further debt.

First time buyer lending was successful in 2017 with good value fixed rate products up to 95% Loan to Value (LTV) for those customers taking their first step onto the property ladder. The Society also extended support for first time buyers with the improvements in the Help to Buy ISA product.

Over the last 12 months the Society has engaged with our Members through Member surveys and most importantly responding to the feedback our Members give us. I was delighted to see the Society win 'Best Savings Provider 2017' at the British Banking Awards. This accolade is a direct result of our Member's feedback via Smart Money People.

Criminals are becoming increasingly sophisticated in their tactics to access and use information held online. During the year the Society has invested in strengthening its capability to tackle such cyber security risks. All staff have also been trained on cyber security and how to avoid the tricks that these perpetrators employ.

Supporting our People

The Society is conscious of its responsibilities as an employer in the region and continually searches for ways to make the Society an even better place to work and help people achieve their potential. The Society Values have therefore been developed, defining aspects of the Society that makes it so special to our people and its Members. All our people took part in workshops to help to craft the Values.

The Society continued to invest in recruitment and development of people across the business, and are very proud that this year's recruitment includes the first of our permanent appointments through the nationwide apprenticeship scheme. We have also demonstrated our ongoing commitment to create jobs in Stockport by recruiting a new apprentice during 2017. All leaders have developed coaching skills so they can encourage every member of their team to fulfill their full potential.

As well as increasing the number of employees at the Society (we now employ 80 people) over a quarter have at least ten years' service. One of our key goals is to continue to be an employer of choice in Stockport.

Summary

I would like to thank our people for their exceptional contribution in 2017. I look forward to the future and continuing to stay true to our purpose to provide straight forward, good value mortgage and savings products with individual personal service to meet the needs of Members and customers. Our Members and customers can rely on their local building society, like they have done in Stockport since 1924.

Steve Fletcher
Chief Executive
7 March 2018

The Directors present their Strategic Report on the Society for the year ended 31 December 2017

Purpose and Strategy

Vernon Building Society is a regional building society based in Stockport, in the North West of England. In recent years the Society has successfully followed a strategy which has seen innovation in product design to meet customers' requirements, provided by personal service and manual underwriting. This strategy is still relevant today and was reconfirmed by the Corporate Plan, along with new customer segments which require specialist support.

In 2017 we performed a complete review of our strategy to ensure our focus was on our purpose as a building society and defined a number of key metrics. Although financial strength underpins any successful business, we do not exist to make record profits, we exist to make a real positive difference to the communities in which we operate. The Society's purpose is:-

To provide straight forward, good value mortgage and savings products with individual personal service to meet the needs of our Members and customers.

The Purpose Statement encompasses two key strands of the strategy which are 'personal service' and 'individual underwriting'. These strands are the Society's main differentiators and are recognised as among its core strengths. These form the backbone of the plan as it is through these strengths, utilised across specialised segments that the Society can continue to provide its Members and employees with a stable Society.

This Purpose will not be delivered without enthusiastic and engaged people and we have also defined a set of Society Values which encompass what is different about the Vernon and what we all aspire to. The Society Values are:

We aim to exceed expectations
We want to impress our customers with how far we'll go to help them.

We care
More than just a 'team', we support and care for each other, our customers and our communities.

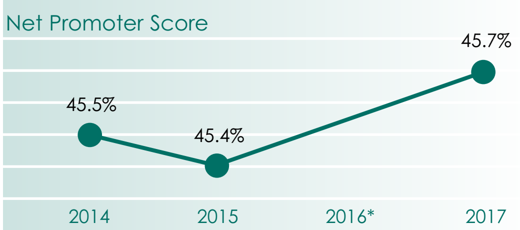
We embrace mutuality
With every decision we ask ourselves "is this fair and in the best long term interest of our Members?"

We rise to the challenge
We innovate and challenge ourselves to excel.

We support self-improvement
We encourage everyone to discover and fulfil their potential.

Customer Satisfaction

The current metrics are designed to reflect how well the Society is meeting Members' needs is the customer satisfaction survey which shows the proportion of our customers who say that they are pleased with the service they receive. The 2017 customer satisfaction survey showed overall satisfaction of 98.3% (2016: 98.0%), continuing the preceding years' trend of achieving or exceeding our target of 90%.



* 2016 data not available.

The 2017 survey highlighted improvements in many aspects of the service offered by the Society. This includes increases in scores for our friendliness and helpfulness of staff in branch and over the phone and a higher net promoter score (NPS) which measures the loyalty of our customer relationship. The NPS is an expression of how our customers rate us, with negative feedback deducting from the score and positive contributing to the score. For this reason a NPS can range between -100% to +100%. The Society is proud of its score, which is very strong in context to the wider industry, as it illustrates the excellent work the Society and it's people deliver.

We were particularly pleased to be awarded "Best Savings Provider" 2017, by the British Banking Association, beating many high street names, as this was voted for entirely by Members filling in the Smart Money People Reviews. We have also been shortlisted as finalists for this year's awards, the results of which we currently await with eager anticipation.

Other customer metrics in 2017 include the growth in customer numbers and mortgage balances for which the targets have not been achieved this year due to the concentration on process redesign and risk management.

For 2018 the customer metrics will include timeliness of response following a mortgage application as this is an area where we are able to improve on our customer experience still further.

The Society launched a new look website making it easier to find out about our products and services. The website also features helpful guides, tools and videos.

Further details of what the Society has been doing for Members and customers are included in the Chief Executive's Review on pages 5.

Leadership Team Balanced Scorecard Measures 2018

Our balanced scorecard is an important way of monitoring achievement of short-term objectives and progress against the Society Plan. The Society's balanced scorecard has four quadrants:

- Customer Satisfaction
- Financial Stewardship & Risk Management
- People
- Development and Process.

Metrics are set in each quadrant which help to focus on delivery of the plan for that year.

Customer & Community (20%)
People instinctively turn to and trust us for their financial needs.

- Attain a net promoter score higher than the Nationwide
- Surpass the average Building Society sector Customer Satisfaction Score
- Establish financial education relationships with local colleges and schools.

Financial Stewardship & Risk Management (40%)
Execute the growth strategy within our risk appetite & risk framework.

- Achieve all essential financial objectives - 20%
- Deliver key Risk Management objectives - 20%

People (20%)
Valued and proud to be an effective team member admired by all those who deal with us.

- Live and breathe our Values and behaviours
- Deliver and embed the People Plan
- Uplift our employee satisfaction score.

Process & Performance (20%)
Known for our creativity in product design and the speed and efficiency of our personalised service.

- Improve core mortgage process to industry standards.
- Streamline critical processes.
- Maintain core IT platforms and improve the digital agenda.

People Development

The Society needs to have the right people in the right jobs, with the right skills appropriately supported to achieve both personal and organisational potential.

In 2017 we set out our new People Plan and have delivered the initial elements of this which included the establishment of an in-house training team, development and implementation of a behavioural framework and the introduction of a new appraisal system, supported by coaching development sessions. Our People Plan focuses on providing an immediate, on-going and long term framework for engaging, developing and managing our people. This was informed by a staff survey from which the Society developed a 'You said, We did' list of items to update in the current employee package; including trialling flexible working for head office staff and more manager discretion and decision making closer to the customer.

Our People Plan is about creating an inspiring place for people to work and achieve their full potential whilst delivering the Society's ambitions.

The metrics in this segment reflect the start of engagement in the People Plan through various initiatives such as the new appraisal system, celebrating success through the new 'Standing Ovation' and engagement through employee survey participation. These will be updated as the People Plan develops.

Many of our people volunteer to help local charities and groups through participating in a wide variety of activities and events. Of particular note in 2017 were the sponsored walk for Christies which raised over £2,000 and the MacMillan Coffee Morning which raised £1,040. Further details are given in the Community Support Round-up Report on page 10.

An annual pay review takes place for all staff and a new Society wide discretionary Bonus Scheme has been set up, payable depending on the delivery of metrics linked to the Society Plan. The 2017 Society Bonus Scheme will pay all eligible staff an amount equal to 4.15% of salary.

The Society operates an Equal Opportunities Policy. It is the intention of the Society that no applicant or employee receives less favourable treatment on the grounds of disability, sex, transgender status, sexual orientation, marital status, civil partnership status, race, ethnic origin, colour, age, nationality, national origins, or political beliefs, or is disadvantaged by conditions or requirements that cannot be shown to be justifiable. The Board also has an approved Diversity Policy.

The gender diversity for the Society's staff at 31 December 2017 is as follows:

	FEMALE %		MALE %	
	2017	2016	2017	2016
Executives	17	33	83	67
Managers	53	55	47	45
Employees	89	89	11	11
Overall	**76**	**80**	**24**	**20**

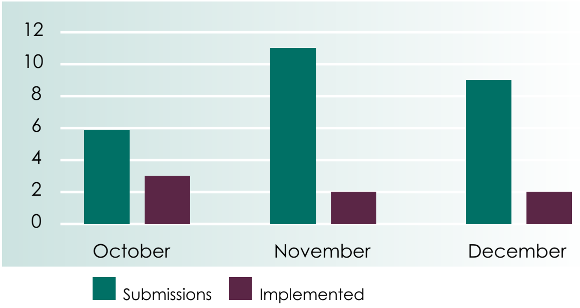
The Society has very low staff turnover which is why it is not included as one of the metrics, although this is monitored. The Society has a Health & Safety Policy and has had only one incident in the year.

Progress

The current metrics are designed to reflect the progress that the Society needs to make to deliver the Corporate Plan. As a small Society, we fully recognise that the Society relies on few people with different specialist skill sets and maintaining these skills is partly about cross training and development of our people. An active programme to increase resilience has been developed as part of the Risk Management Framework.

The Society recognises that to meet its Members' expectations, we need to continue to maintain a culture of right first time and taking ownership of resolving issues that do arise. As noted in the customer section there are various processes in the Society that are being reviewed to make sure they are as smooth as possible for the customer and to help with this improvement process a staff suggestions scheme called 'Inspiring Innovation' was launched to enable people to put forward suggestion that they have to improve the way the Society and it's people operate, such as improving efficiency or customer service.

Inspiring Innovation Submissions and number Implemented



Since its launch the number of submissions through the new Inspiring Innovations scheme has been very pleasing as it illustrates strong and positive engagement in the process and it is expected to yield many positive outcomes. The chart also illustrates the number of initiatives that the Society has been able to implement already whilst also having a healthy pipeline of ideas to be taken forward into the new year for consideration.

Financial Stewardship and Risk Management

Risk Management

The Society has continued to invest in its Risk Management capabilities during 2017. This will remain a focus throughout 2018 to ensure that the Society maintains a strong position and is able to continue to develop innovative products to meet our Members' and customers' needs.

The Risk Management investments during 2017 include the recruitment of additional resource including the appointment of a Chief Risk Officer and the implementation of an improved approach to managing Operational Risk through the development of a Risk and Control Self-Assessment (RCSA) process. This process empowers our people and staff Society-wide to identify and evaluate risks and the associated controls and in a consistent manner. The outcomes of the RCSA process provides the Society and its Board with a reasonable level of assurance that controls are effective and risks are well managed. During 2017 the RCSA process has been the driver for the implementation of process improvements.

The Society also recognises the importance of capturing data when things go wrong and ensuring that we learn from these experiences and take action to improve existing controls (Risk event and Near Miss reporting). Emphasis on embedding this activity will remain a focus to ensure that the Society's resilience to similar events improves over time.

The Society Balanced Scorecard for 2017 reflected the set-up, development, roll out and embedding of this major piece of work, while the Balanced Scorecard for 2018 reflects the ongoing need to ensure the Society continues to develop its risk management capabilities.

Profitability

Profitability is one of the key performance measures the Board monitors closely. The Society seeks to make sufficient profit in order to invest in and grow the business for the benefit of its current and future Members. A Building Society must be profitable to demonstrate it has a long term sustainable business model and show financial strength to savers, borrowers, regulators and business partners. 2017 has been a year of investment so the retained profit is lower; 2018 is expected to be similar.

INCOME STATEMENT	2017	2016
	£m	£m
Net interest income	5.2	5.2
Other income and charges	0.1	-
Total Income	**5.3**	**5.2**
Administrative expenses	(4.6)	(3.9)
Loan impairment provision release	0.1	0.1
Other provision adjustments	-	(0.1)
Profit before tax	**0.8**	**1.3**

Profit before tax decreased by £535,000 to £769,000 in 2017 from £1,304,000 in 2016 due to the investment the Society has made during the year in its capabilities.

Net interest margin

Net interest margin is a relative measure of the Society's net interest income (as disclosed in the Statement of comprehensive income on page 31) – the difference between interest received on assets and interest paid on liabilities – divided by the Society's average total assets during the year.

The Society's net interest margin held at 1.74% in 2017. The Society continued to manage the margin with a view to the long term future by balancing the risks and rewards from residential lending while offering consistent value to savers.

Other income and charges

The Society generated net other income of £76,000 in 2017, compared to net other charges of £43,000 in 2016. The change is primarily driven by residual fair value movements on hedging instruments held after applying hedge accounting.

Administrative expenses and depreciation

Administrative expenses and depreciation (together "management expenses") increased to £4.6m in 2017 from £3.9m in 2016, reflecting the Society's strategy of investing in people and processes to support expected growth in the business. Staff costs increased by £583,000 in 2017 compared to the prior year. The increase is mostly associated with the six new roles created during the year. Further details can be found in note 8 on page 40.

Non staff costs increased by £92,000 in 2017 compared to the prior year. The increase was driven in part by investments made in our information technology. The Society recognises that information technology is a cornerstone of any business and investment ensures our technology platform is at a leading level to provide security of its data and enhance resilience.

The ratio of management expenses to mean total assets increased to 1.54% in 2017 compared to 1.32% in 2016.

Impairment charges

The impairment provision for loans and advances to customers was further reduced by £76,000 (2016: £87,000). The Society has been successful in its personal underwriting approach which has resulted in such low provision levels.

Provisions for liabilities and charges

This year there was a net income recognsied in the Statement of comprehensive income of £23,000 relating to movements in the provisions for the Financial Services Compensation Scheme (FSCS) levy and the Pension Rights equalisation provision. The FSCS levy charge for the year was £20,000, this was more than offset by a partial release in the pension right equalisation of £43,000.

Taxation

The Society shows an effective corporation tax rate of 19.64% in 2017, compared to 19.25% in 2016. See note 10 on pages 40 and 41.

Balance Sheet

Liquid assets

The Society has continued to maintain a level of high quality liquid assets throughout 2017. The Society has opened a Bank of England Account during 2017 to supplement its range of liquid assets.

LIQUID RESOURCES YEAR ENDED:	2017	2016
Total liquid resources (£m)	69.2	64.7
BY ASSET CLASS	%	%
Cash in hand and balances with the Bank of England	26.5	0.4
Gilts	10.8	20.5
Other sovereign bonds	8.5	14.9
Loans & advances to credit institutions	54.2	64.2

The Society liquid assets increased slightly during the year with the statutory liquidity percentage reported at 31 December 2017 being 23.3% compared to 21.5% in 2016. The Society has no encumbered collateral.

The Liquidity Coverage Ratio (LCR) measures unencumbered high quality liquid assets as a percentage of net cash outflows over a 30 day stress period. The LCR as at 31 December 2017 was 648% (2016: 484%), comfortably in excess of the minimum regulatory limit set by the PRA of 100% from 1 January 2018. The further strengthening of the LCR during 2017 was driven by the opening of the Society's Bank of England deposit account during the year, and subsequent transfer of assets previously held with other institutions.

Loans and advances to customers

Loans and advances to customers decreased by £8m overall in 2017 as shown in the table below, which highlights the competitive market place during the year and the Society's emphasis on its strategy to build upon its capability in order to provide a broader product offering to its customers during 2018 and beyond.

LOAN PORTFOLIOS	2017		2016	
	£m	LTV %	£m	LTV %
Prime Residential	175.5	30.6	182.8	31.4
BTL	39.6	44.3	39.1	46.0
Commercial	10.5	35.1	11.8	35.1
Provisions	(0.3)	-	(0.4)	-
	225.3		**233.3**	**-**

The Society re-entered the retirement mortgage market in 2017, a strategic decision to strengthen our overall mortgage proposition as the retirement sector is a growing need area of the market.

The Society's lending is all secured with a first charge registered against the collateral property. Residential loans are shown at indexed loan to value using the quarterly regional Nationwide House Price Indices, all other loans are shown without indexing.

Further information on security loan to value is provided in note 31 on page 54.

Mortgage Credit Quality

Arrears

The Society has KPI measures for mortgage arrears of 2.5% or more (excluding possessions) for both number and value of loans. Although primarily a measure of the quality of the existing mortgage books, the Society also uses its arrears management functions to influence future lending with "lessons learned" fed back into lending policy.

ARREARS	By number		By balance £k	
PERFORMANCE	2017	2016	2017	2016
2.5% - 5%	3	9	296	587
5% - 7.5%	2	2	191	103
7.5% - 10%	2	4	77	1,679
>10%	8	8	428	611
Total	**15**	**23**	**992**	**2,980**
% of loan book	**0.60%**	**0.87%**	**0.44%**	**1.28%**

The overall level of mortgage arrears experienced has fallen once again in 2017, and the total arrears by number of loans, continues well below Council of Mortgage Lenders reported averages. Overall by number of loans arrears are down by 27bp to 0.60%, by balance down by 84bp to 0.44%. The loan book has reduced arrears compared to the previous year across both measures reflecting the excellent credit quality of the book and the resolution of one large arrears case with no loss to the Society.

Forbearance

The Society will work closely with any homeowner experiencing difficulties, offering help and advice on all aspects of the situation. Forbearance cases and options granted are monitored by the Society's Credit Committee with the levels of concessions granted not considered to be material for the size of the overall book.

Law of Property Act Receiverships and Possessions

The Society continued to experience a low level of possessions on residential loans and Law of Property Act receiver appointments. At the end of 2017 the Society had one property in possession which was sold subsequent to the year end with no loss. There were no exposures being managed by a Law of Property Act receiver.

Funding

The Society manages its funding levels, mix and duration carefully to ensure it has the required resources in place to meet its liquidity and lending targets. The Society is predominantly funded through retail savings with wholesale funding used to diversify funding sources. Retail savings balances increased by £0.7m during 2017 to £267.8m. Wholesale exposures decreased during the year by £4.5m as the strong retailing funding position meant that wholesale funding was not required.

Capital

The table below shows the composition of the Society's capital and the capital ratios at the end of the year. The capital metrics shown below are unaudited. The Society complied with Individual Capital Guidance (ICG) plus planning buffers, as notified by the Prudential Regulation Authority, throughout 2017. The ICG is set at 10.64% for the Society. The Common Equity Tier 1 ratio, which offers the greatest protection to Member's funds in the unlikely event of unforeseen financial stress, has increased to 19.8% in 2017 from 18.7% in 2016 reflecting the Society's increase in capital reserves.

CAPITAL	2017	2016
	£m	£m
Common Equity Tier 1 Capital	21.8	21.3
Collective Impairment Allowance	0.2	0.2
Total Capital	**22.0**	**21.5**
Credit Risk	101.0	105.3
Operational Risk	9.2	8.3
Total Risk Weighted Assets	**110.2**	**113.6**
CAPITAL RATIOS	**%**	**%**
Common Equity Tier 1	19.8	18.7
Tier 1 Ratio	19.8	18.7
Total Capital Ratio	19.9	19.0
Leverage Ratio	7.2	7.0

The leverage ratio is a simplified capital strength ratio measuring qualifying tier 1 capital against on and off balance sheet assets. The Board monitors the leverage ratio on a monthly basis and as at 31 December 2017 the figure was 7.2% (2016: 7.0%). This is, and has remained throughout 2017, well in excess of the regulatory minimum of 3.25%. Further details on the Society's capital position is given in the Pillar 3 disclosures to be published on the Society's website at the same time as these accounts.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Society are set out in the Risk Management Report on pages 23 to 26.

Outlook

The programme of investment as detailed in the Corporate Plan will continue with improvements to our processes, IT infrastructure and most importantly further investment in our people.

Global macroeconomic and political factors may continue to impact on the UK economy but the UK is proving to be remarkably resilient following the Brexit vote. This reliance, together with the current level of inflation, may result in some rate rises during 2018, possibly as early as Q2.

While there remains significant uncertainty on the horizon, the Society will focus on what it does best; providing great products and services to our customers and Members.

On behalf of the Board
Judith Aspin
Finance Director
7 March 2018

Community Support Round-up

Grants make our communities even better. Supporting our communities is core to what we do.

The Jubilee Fund has been running since 2012 and has donated over £60,000 to local charity and community groups enabling them to continue their work in the local area.

Members can now nominate local community groups, causes, and charities for awards and a short list is produced which is then voted on by Members and the local community. For the first time in 2017 people were able to vote on line.

The Society awards over £10,000 each year and here are some of the recipients;

The Stockport County Community Foundation received the top amount - £1,862 – at the November 2nd presentation evening after picking up the most votes online and from Stockport Express readers.

The Wellspring homeless charity in Stockport town centre was next with £1,716, followed by **AuKids magazine**, which received £968.63. Each vote was worth £1.92 to the chosen group.

There was also a special Vernon staff award of £500 on the night to **The Weekend Day Care Centre.**

Mike Hanson, Chief Executive of the Vernon, said:

"It was very humbling to meet the finalists and listen to how passionate they are about improving the community in which many of us live and work. We look forward to visiting them over the coming year and seeing first-hand the progress that they are making."

The Stockport County Community Foundation will use the money to support their coaching sessions and buy equipment for the 120 children and adults with physical and learning disabilities that take part in their football and multi-sport project.

Adrian Rigby-Bates, Disability Football Development Officer, said: "Everyone at Stockport County Community Foundation is absolutely delighted to have been chosen as one of the 16 charities that took part in this year's Vernon Building Society Jubilee Fund and to receive such a fabulous donation.

"It has given us the opportunity to talk to thousands of people in our local community to raise awareness about the good work that we do in providing football and multi-sport opportunities to children, young people and adults with a range of physical and learning disabilities.

"It really shows how the local community can make such a positive difference with their support."

Community Support Round-up

The Vernon Building Society handed out over £10,000 to 16 community groups and charities in Stockport from its Jubilee Fund in 2017.

Which Charities received what from the 2017 Vernon Jubilee Fund:

Stockport County Community Foundation	£1,862.25
The Wellspring	£1,716.20
AuKids magazine	£968.63
Bosden Farm Community Group	£693.82
The Weekend Day Centre for Dementia Care	£624.64
Stockport Foodbank	£611.19
Stroke Information	£538.16
Friends of St Joseph's	£530.47
1st Hazel Grove Scout Group	£482.43
Independent Options	£409.40
MedEquip4Kids	£388.26
Family Art Attack	£326.77
Beechwood Cancer Care	£247.98
Stockport Building Preservation Trust	£247.98
Love Reddish	£224.91
Avro Heritage Museum	£126.90

Other highlights from 2017

SOCIETY'S CHRISTMAS JUMPER DAY raises £40 for Save the Children

CHRISTMAS CONCERT RAISES OVER £680 FOR MACMILLAN
Vernon Building Society (Poynton) Brass Band under the leadership of Vernon Bear performed Christmas Carols outside the Sainsbury's in Cheadle, raising over £682 for Macmillan Cancer Support.

CHARITY 3 PEAK CHALLENGE RAISES OVER £2,000 FOR THE CHRISTIE
A group of 14 from the Vernon completed the 22km Cheshire Three Peaks in eight hours to raise funds following the fire at the Withington cancer hospital.

Our Directors

JOHN HUGHES
CHAIR

Joined the Board in April 2014, previously holding the position as Vice Chair, and Chair of the Risk & Compliance Committee. John moved into the position as Chair of the Board and Chair of the Nominations Committee 1st June 2017. John brings significant experience of strategic planning and risk management to the Board having held a wide range of senior roles within a major building society and a high street bank, most recently as the latter's Managing Director of Retail Banking.

SUSAN JEE
VICE CHAIR

Joined the Board in December 2014. Susan moved into the role as Vice Chair of the Board and Chair of the Risk & Compliance Committee 1st June 2017. Susan is a chartered accountant and has extensive experience of managing financial and strategic issues as Group Finance Director of British Nuclear Fuels plc. Susan has also had extensive experience of pension fund management and is currently a non-executive director and Treasurer of the Riverside Group Limited a substantial housing association which manages a portfolio of properties across the United Kingdom.

DONALD BAILEY
CHAIR OF REMUNERATION COMMITTEE

A chartered accountant, insolvency practioner and has considerable experience in business finance and the lending industry. He was appointed to the Board in 2006 and became Chair in May 2013. Donald stepped down as Chair of the Board and Chair of the Nominations Committee 1st June 2017.

ALAN MURDOCH
CHAIR OF THE AUDIT COMMITTEE

A chartered surveyor and a consultant with Scanlans Consultant Surveyors LLP based in Manchester. He has expertise in both commercial and residential property matters. Alan joined the Board in November 2007 and is Chair of the Audit Committee.

JUDITH ASPIN
FINANCE DIRECTOR

Joined the Society in September 2016 and became Finance Director. Judith is a Chartered Accountant and an Associate Member of the Association of Corporate Treasurers. She has extensive knowledge of managing financial risk having held senior positions in Treasury and Finance in a high street bank.

JOHN LONGWORTH
SENIOR INDEPENDENT DIRECTOR

Appointed to the Board in 2004 and served as Chair between 2008 and 2013. He is a solicitor who brings a broad range of legal experience and insight to the Board and has previously been a senior partner of Bromleys, Ashton-under- Lyne, where he continues to practise. John has been nominated as the Society's Senior Independent Director.

STEVEN FLETCHER
CHIEF EXECUTIVE & DIRECTOR

Joined the Society in January 2018 to become it's 5th CEO. Steve has a broad experience of leadership in financial services having worked for Eagle Star, Birmingham Midshires, Woolwich and Barclays Bank. Since 2005 Steve held senior leadership roles at Clydesdale and Yorkshire Bank including Retail Director and Head of Customer Banking Networks.

The Directors have pleasure in presenting their 94th Annual Report & Accounts Review for the year ended 31st December 2017, which they consider to be fair, balanced and understandable, providing Members with the information necessary to assess the Society's position and performance, business model and strategy.

Objectives and Activities

It is the intention of the Directors that the Society will continue to remain an independent local building society. The Society's purpose and strategy are set out on page 6 of the Strategic Review.

Business Review and Future Developments

The Chief Executive's Review and Strategic Report on page 5 set out the business activities and business performance in the year against our strategic objectives, as well as likely future developments. The Strategic Report also outlines the Society's key metrics, which include Member, people, process and financial/risk metrics, details of the Society's Member focus and people agenda, financial analysis, mortgage credit quality and capital position.

The Annual Business Statement on page 61 and the Credit Risk section of Note 31 on pages 53 to 54 contain the ratios and arrears disclosures required by the Building Societies Act 1986.

The Board has assessed the going concern of the Society by reviewing medium and long term plans over a detailed 5 year horizon with particular emphasis on examining forecast liquidity, capital and profitability of the Society and the risks to those forecasts through a variety of stress testing scenarios. This horizon is considered appropriate through alignment to the Society's usual forecasting and management reporting allowing robust and continuous assessment of the Society's expected position and principal risks over the time-frame. Active risk management is undertaken to mitigate the Society's principal risks as detailed on pages 23 to 26.

The outcome of this review is that the Directors are satisfied that the Society has adequate resources to continue in business and meet their liabilities as they fall due throughout the period of assessment. Accordingly the financial statements of the Society have been prepared on a going concern basis with no material uncertainties that the going concern basis of accounting is appropriate.

Risk Management, Principal Risks and Uncertainties

The Risk Management Report on pages 23 to 26 sets out the principal risks and uncertainties faced by the Society together with the Risk Management Framework and risk governance structure. The Risk Management Report also details how the Society mitigates the specific key risks to which it is exposed, which are credit, conduct, liquidity, interest rate, operational, and capital risks. In addition, Note 31 to the accounts on pages 49 to 58 to sets out the metrics associated with the key risks including sensitivity analysis and exposure levels.

Mortgage arrears

As at 31 December 2017 there were 15 cases (2016: 23) where payments were 2.5% or more in arrears. The capital balances of these loans were £1.0m (2016: £2.9m). The total amount of arrears on these loans was £0.1m (2016: £0.3m).

Charitable gifts

The charitable activities of our Jubilee fund are now a well renowned feature of the Society's activities. In 2017 we awarded over £10,000 to sixteen local charity and community groups to enable them to continue their work in the local area. Since its inception in 2012, the Jubilee Fund has donated over £60,000 in funding to 50 local charity and community groups. In addition, a further £2,000 was raised for local charity Christies and £1,040 for MacMillan Cancer Support during the year.

Further details on the Society's charitable giving during 2017 can be found in the Community Support Round-up on page 10.

Supplier Payment Policy

For all trade creditors it is the Society's policy to agree the terms of payment at the start of trading with that supplier and to pay in accordance with its contractual and other legal obligations. Creditors are paid on average within 24 days of receipt of invoice.

Directors

The Members of the Board, who have served at any time during the year are as follows:

Donald Bailey
John Hughes
John M Longworth,
Alan S Murdoch
Susan Jee
Michael J Hanson,*
Andrew Entwisle* (until 1st June 2017)
Judith Aspin.*
*Executive Directors

At the Annual General Meeting (AGM), to be held on 25th April 2018, John Hughes, Susan Jee, John Longworth and Alan Murdoch offer themselves up for re-election, the first two by rotation and the latter two as having served more than three terms.

Following the year end Mr Hanson stepped down from his role as Chief Executive and Director of the Society, and was replaced by Steve Fletcher effective 5th February 2018. Former Chair Donald Bailey has also announced that he will be standing down from his position as Non-Executive Director at the conclusion of the Annual General Meeting. In advance of Mr Bailey leaving Jenny Quirke was appointed to the Board in January 2018.

Directors and Officers insurance has been put in place by the Society.

All Directors are Members of the Society. Please see the Remuneration Committee Report on page 20 for further information.

Independent Auditors

PwC have been appointed external auditors during the year following a rigorous tender process. A resolution to re-appoint PriceWaterhouseCoopers LLP will be proposed at the Annual General Meeting.

Statement of Disclosure to Auditors

So far as each Director is aware, there is no relevant audit information of which the Society's auditors are unaware. Each of the Directors, whose names and functions are listed in the Our Directors section on pages 12 and 13 has taken all steps that he or she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

Corporate Governance

The Society's statement on corporate governance can be found in the Report of the Directors on Corporate Governance on pages 15 to 17.

The following statement, which should be read in conjunction with the statement of auditors' responsibilities on page 30, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts, Annual Business Statement and Directors' Report.

The Directors are responsible for preparing the Annual Report and Accounts, Annual Business Statement and Directors' Report in accordance with the appropriate law and regulations. The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society Annual Accounts for each financial year. Under the Act they are required to prepare the Group and Society Annual Accounts in accordance with Financial Reporting Standard 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102"), and applicable law.

The Group and Society Annual Accounts are required by law to give a true and fair view of the state of affairs of the Group and Society as at the end of the financial year and of the income and expenditure of the Group and Society for the financial year, and which provide details of Directors' emoluments in accordance with part VIII of the Act and the regulations made under it.

In preparing the Group and Society Annual Accounts, the Directors are required to:

- Select appropriate accounting policies and apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the Annual Accounts; and
- Prepare the Annual Accounts on the Going Concern basis unless it is inappropriate to presume the Society will continue in business.

In addition to the 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.

The Directors are responsible for ensuring that the Society:

- Keeps adequate accounting records that are sufficient to show and explain the Society's transactions and disclose with reasonable accuracy at any time the financial position of the Group and 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 businesses in accordance with the rules made by the Financial Services Authority and Markets Act 2000.

They are also responsible for safeguarding the assets of the Society and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the 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.

On behalf of the Board
John Hughes
Chair
7 March 2018

Introduction

In discharging its responsibilities to be accountable to the Society's Members for the operation of the Society, the Board regards good corporate governance as extremely important. The UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (FRC) in September 2014 is addressed to publicly quoted companies, however, the Society has been mindful of the code to the extent deemed reasonable and appropriate by the board when establishing and reviewing corporate governance arrangements.

This report outlines the approach taken by the Society and how the Board considers it has demonstrated application of the principles of the Code.

The Board

The Society recognises that it must be headed by an effective Board which is responsible for the long-term success of the Society. The composition of the Board is detailed on pages 12 and 13. In carrying out its role, the Board aims to ensure that excellent service is delivered to its Members and customers. The Board has responsibilities for contributing to and supporting the Values of the Society set by management, and believes that the interests of all stakeholders can be best served by remaining a strong and forward looking mutual building society.

There is a clear division of responsibilities between the running of the Board and the Executive responsibility for the running of the Society's business. No one individual has unfettered powers of decision and the roles of Chairman and Chief Executive are exercised by different people within the Society. The Nominations Committee (NomCo) carries out a review of the independence of Non-Executive Directors as set out on page 16.

An effective Board should not necessarily be a comfortable place, with challenge, as well as teamwork, being an essential feature. Challenge by Non-Executive Directors is something which is encouraged by the Chairman and, where appropriate, training is provided to support the challenge process. A culture of openness exists within the Society and Non-Executive Directors are encouraged to meet with Members of the Executive team.

John Hughes was appointed Chair of the Society and Susan Jee appointed Vice Chair on 1st June 2017. John Longworth has filled the role of Senior Independent Director since 2015. The Vice Chair and Senior Independent Director provide a sounding board for the Chair and where necessary serve as an intermediary for the other Directors. Following the year end Michael J Hanson stepped down from his role as Chief Executive and Director of the Society, and was replaced by Steve Fletcher effective 5th February 2018. In anticipation of Don Bailey stepping down after the AGM, Jenny Quirke was appointed in January 2018.

Board balance and independence is important and the Board should include an appropriate combination of Executive and Non-Executive Directors such that no individual or small group of individuals can dominate the Board's decision making. The composition of the Board, through NomCo, reflects an appropriate balance of skills and at the end of 2017 the Board comprised of 5 Non-Executive Directors and 2 Executive Directors.

Details of the various Board Committees in existence are set out later in this report.

Matters Reserved to the Board

The Board's Terms of Reference are reviewed on a regular basis. A schedule is maintained of matters reserved to the Board which includes the following:-

- **Strategy and Management** – determining the overall strategy of the Society including approval of the Corporate Plan, with the responsibility for its implementation delegated to the Executive team; monitoring operational and financial performance in pursuit of the strategy; overseeing and approving the Society's recovery options and resolution pack; monitoring any recovery plan and approving appropriate management actions; and approving budgets, forecasts and major capital expenditure.

- **Culture** – overseeing the culture and Values of the Society.

- **Structure, Capital and Liquidity** – approval of the Society's Internal Liquidity Adequacy Assessment Process (ILAAP); and approval of the Society's Internal Capital Adequacy Assessment Process (ICAAP).

- **Financial Reporting and Internal Controls** – approval of annual results; approval of the Annual Report and Accounts including the Strategic Report, Risk Management Report, Report of the Directors on Corporate Governance, and the Remuneration Committee Report; approval of the Pillar 3 disclosures; ratification of the Going Concern statement following review and approval by the Audit Committee; approval of any significant changes in accounting policies or practice, based on the recommendations of the Audit Committee; and ensuring an adequate internal control environment is in existence. The Board delegates oversight of internal controls to the Audit Committee.

- **Risk Management and Regulatory** – ensuring an adequate Risk Management Framework is in place. This includes approval of risk appetite, oversight of risk governance, reviewing the top risks, ensuring the strategy and risk appetite are consistent, and approving the ICAAP. The Board delegates oversight of risk management to the Risk & Compliance Committee, as well as oversight of compliance with regulations (including by the Prudential Regulation Authority and the Financial Conduct Authority).

- **Strengthening Accountability in Banking** – ensuring that the Society meets its obligations under the Senior Managers & Certification Regime (SMRC), including: reviewing at least annually the SMR Policy; maintaining a Management Responsibilities Map for all PRA Prescribed Responsibilities and FCA Business Activities and ensuring all prescribed responsibilities and business activities have been allocated; and leading the development of the Society's culture.

- **Board Membership and Senior Management Issues** – approval of changes to the structure, size and composition of the Board, following recommendations from NomCo; and ensuring that adequate succession planning for the Board and senior management is in place following recommendations from NomCo.

- **Appointment and/or re-appointment or removal of the external auditor** to be put to Members for approval, following a recommendation from the Audit Committee.

- **Remuneration** – agreeing the remuneration policy for the Directors and other Material Risk Takers (MRTs) following recommendations from the Remuneration Committee.

- **Delegation of Authority** – ratifying the terms of reference for Board Committees; and receiving minutes and/or reports from the chair of the Board Committees.

- **Corporate Governance Matters** – ensuring that a formal evaluation of the effectiveness of the Board is undertaken on an annual basis and considering whether an external assessment using outside consultants as a facilitator is undertaken every three years; determining the independence of Directors; reviewing the Society's overall corporate governance arrangements; and agreeing the policies that manage Director conflicts of interest and other relevant policies.

Board Changes and Elections/Re-elections

It is recognised that changes need to be made to the Board from time to time and in 2017 Don Bailey retired as Chair of the Board and was replaced by John Hughes, Mr Bailey is to retire as a Director at the 2018 Annual General Meeting. Directors are elected at the Annual General Meeting for a period of three years normally up to a maximum of three cycles. If NomCo deems it in the interests of the Society for a Director to serve for more than 9 years they will stand for re-election on an annual basis. The biographies of all of the Directors are detailed on page 12.

Management Information

The Chair is responsible for ensuring that the Directors receive accurate, timely and clear information. Board Members receive meeting packs in advance of each Board meeting. A rolling Board agenda is tabled at each meeting to ensure that all key areas are covered appropriately during the year. Sufficient time is set aside to ensure that constructive discussion and challenge can take place. All Directors have access to independent professional advice, if required, and also access to the services of the Society Secretary.

Board Committees

The Board has a number of Committees, all of which have their own Terms of Reference, which are reviewed on an annual basis, with further details provided below. The Chair of each Committee reports to the Board at its subsequent meeting on the matters discussed at each Committee meeting.
Similar to the Board, each Committee has carried out a review of its own effectiveness, and where improvement opportunities have been identified, the individual Committees are responsible for tracking action points. These reviews are carried out on an annual basis and the effectiveness review for each Committee is summarised and presented to the Board for review.
Information concerning attendances at the meetings is detailed on page 17. Terms of Reference for the Audit Committee, Risk & Compliance Committee, Remuneration Committee and NomCo are available upon request.

Audit Committee

Details of the Audit Committee are contained in the Audit Committee Report on pages 18 and 19. Through the work of the Audit Committee and Internal Audit during 2017, the Directors have carried out a review of the Society's risk management and internal control systems, covering all material controls, including financial, operational and compliance controls.

Remuneration Committee

Details of the Remuneration Committee are contained in the Remuneration Committee Report on pages 20 to 22.

Risk & Compliance Committee

Details of the Risk & Compliance Committee are contained in the Risk Management Report on pages 23 to 26.

Nominations Committee (NomCo)

The Society has a separate NomCo comprising a minimum of the Chair, Vice-Chair and Chief Executive, and which operates within the Terms of Reference agreed by the Board. The Terms of Reference and the effectiveness of NomCo are reviewed on an annual basis.

The main objectives of NomCo are summarised as follows:-

- To oversee the structure of the Board and Board Committees;
- To identify suitable candidates to fill Board vacancies;
- To ensure that the Board has the appropriate balance of skills, diversity and experience; and
- To oversee the Board's succession plan.

All key decisions of NomCo, for example, Board appointments, must also be ratified by the full Board.

Members of NomCo are John Hughes (Committee Chair), Susan Jee and Steve Fletcher.

NomCo operates to a rolling agenda to ensure it discharges its full responsibilities. It normally meets a minimum of three times a year and in 2017 it met on eight occasions.

Appointments to the Board

NomCo follows a stringent recruitment process when making appointments to the Board. This process is tailored to meet the requirements of each particular vacancy and the method of attracting candidates is adapted depending on the nature of the skills required for the vacancy. External consultants and advisers are normally utilised to ensure there is a robust list of suitable candidates with which to fill a vacancy. During the year the Society utilised the services of independent recruitment specialists Fletcher Jones and Warren Partners in the appointment of the new Chief Executive, a Chief Risk Officer and two Non-Executive Directors.

Whenever a new Director is appointed, the Financial Conduct Authority and Prudential Regulation Authority have the right, for certain key roles, to carry out formal Significant Influence Function (SIF) interviews in order that the Director becomes an Approved Person.

Directors have been issued with Role Descriptions, and Terms of Engagement for Non-Executive Directors, to ensure that all Directors fully understand and comply with their role and the responsibilities of being a Director of the Society.

Diversity of the Board

The Board recognises and embraces the benefits of having a diverse Board which utilises a range of factors including skills, industry experience, background, race, gender and the other qualities of its Directors. Giving specific regard to gender ratios, there were two female Directors on the Board throughout 2017. It is important to note that all Board appointments are made on the basis of individual competence, skills and expertise measured against identified objective criteria. Appointment is therefore based on merit and the Board has not set any measurable objectives for diversity although the position will be kept under review.

Re-election to the Board

As per the Society's rules all Directors, as appropriate, should be required to seek election or re-election at the AGM on a three year cycle, the forthcoming one to be held on 25 April 2018. Non-Executive Directors are usually expected to serve more than one three year term, subject to satisfactory performance evaluations and re-election by Members. If a Director serves more than three three year terms they are re-elected on an annual basis.

Independence of Directors

The Terms of Engagement for Non-Executive Directors require that they declare to the Society any other external interests.

NomCo carries out an annual review of the independence of Non-Executive Directors, against the criteria set out in the Code. The last review was carried out by NomCo in date where it was confirmed that the independence requirements in terms of character and judgement were met.

The Society recognises that it is good corporate governance to have a Senior Independent Director. John Longworth was re-appointed to this role in April 2017 and it is intended that he continues in this role.

Assessment of Directors

All Directors are subject to a formal appraisal of their performance on an annual basis. The Chair conducted the appraisals of the Chief Executive and Non-Executive Directors, the Chief Executive conducted the appraisals of the Executive Directors, whilst the Senior Independent Director led the appraisal of the Chair.

Skills and Continuous Development

All Directors are required, as part of their terms of engagement, to follow a process of continuous development to ensure that their skills and experience meet the needs of the Society and the regulatory environment in which it operates. The training and development plans of Non-Executive Directors are reviewed at least annually during their performance appraisal. NomCo oversees the on-going training and development of Non-Executive Directors including a formal induction programme for newly appointed Directors.

Relations with Members

Member engagement is at the heart of our strategy and the Society develops relationships with Members on a number of different levels. The first and most obvious is through the AGM voting process where Members are encouraged, as owners of the business, to use their vote and we try to make this process as easy as possible, including the ability to vote online and by post. For each Member who votes the Society donates £1 into the Jubilee Fund.

Understanding what Members think about our products and service is also extremely important. We use customer satisfaction surveys and obtain feedback from different types of product holders.

The Jubilee Fund provides a range of financial grants to local community groups nominated by our local community. We have also helped to raise money for local, worthy causes. Further details of Member and Community Engagement are given in the Community Support Round-up on page 10.

Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2017 with the number in brackets representing the maximum number of meetings the Director was eligible to attend.

	Board	Audit	Remuneration	Nominations	Compliance and Risk
D Bailey	10(12)	1(2)	5(5)	1(1)	4(4)
J Hughes	11(12)	-	5(5)	8(8)	7(7)
JM Longworth	12(12)	5(5)	5(5)	-	-
AS Murdoch	11(12)	5(5)	-	-	-
S Jee	12(12)	3(3)	4(4)	7(7)	3(3)
MJ Hanson	12(12)	-	-	2(2)	-
A Entwisle	5(5)	-	-	-	-
J Aspin	12(12)	-	-	-	-

Annual General Meeting (AGM)

The AGM provides an opportunity for Members to question the Chair, Chief Executive, Committee Chairs and fellow Directors on the resolutions to be proposed at the meeting, the Annual Report and Accounts, and on any other aspect of the Society's business. All Members who are eligible to vote at the Annual General Meeting are encouraged to participate, either in person or by using their proxy voting form. The use of the online voting system is encouraged and for each vote placed online, the Society will be donating £1 to the Vernon Building Society Jubilee Fund.

All votes are counted by independent scrutineers. As soon as practicable after the AGM, full details of the results of the voting are placed on the Society's website.

On behalf of the Board
John Hughes
Chair
7 March 2018

The main function of the Audit Committee is to review and provide assurance to the Board on the integrity of the annual accounts and the effectiveness of the internal control systems including internal financial control.

Members of Audit Committee

Alan Murdoch (Committee Chair), John Longworth and Don Bailey.

The Audit Committee's extensive experience and qualifications are detailed on page 62 of the Annual Report and Accounts. The Committee Members were selected for appointment by recommendation of the Nomination Committee in consultation with the Audit Committee Chairman.

Directors' remuneration, including the Members of the Audit Committee, is detailed within the Remuneration Committee Report on page 21 of the Annual Report and Accounts. The Report on Corporate Governance on pages 15 to 17 also sets out the process for review of effectiveness of Board sub-committees including the Audit Committee.

Committee meetings

The Committee meets at least four times each year coinciding with key dates in the Society's financial reporting calendar following a rolling schedule of items for discussion, agreed and reviewed on an ongoing basis. Meetings are attended by Audit Committee Members with other regular attendees at meetings including the Chief Executive, Finance Director, Chief Risk Officer, Director of Operations, representative of Internal Audit (RSM) and a representative of the External Auditors, PricewaterhouseCoopers LLP (PwC), as well as other management, as the Committee feels is appropriate and necessary.

For details of Committee meeting attendance see page 17 of the Annual Report and Accounts. As well as a formal annual meeting, the Audit Committee has an opportunity to meet with the External Auditors at each Audit Committee meeting, without senior management present. These meetings cover matters relating to its remit and any issues arising from audits, including matters required to be discussed by relevant law or regulations.

Key roles and responsibilities as delegated by the Board

The main function of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

Financial reporting

The Audit Committee's primary role regarding financial reporting is to monitor the integrity of the Annual Report and Accounts of the Society. This responsibility is discharged through:

- review of the Annual Report and Accounts, for completeness and compliance with relevant accounting standards and other regulatory and legal requirements;
- reporting to the board on the consistency and appropriateness of critical accounting policies and any changes thereto, taking into account the views of the external auditor;
- review and challenge of significant financial reporting judgements, estimates and the actions and judgements of management;
- review of any correspondence from regulators in relation to financial reporting;
- review of the going concern statement and business viability assessment produced by the Finance Director on an annual basis;

The main areas of financial reporting significance considered by the Audit Committee in 2017 were as follows:

- **Commercial and residential loan impairment provisions**: This is inherently an area of accounting estimate and judgement. The Society's loan impairment provisions are agreed by the Society's Credit Committee and then reported to the Audit Committee. The Audit Committee reviews the level of provisioning through detailed discussion with management on the key judgements and methodology behind impairment calculations. The impact of forbearance in the mortgage portfolios has been considered and appropriate disclosures made in the Annual Report and Accounts. The Committee is satisfied with the assumptions adopted and models used to calculate provisions over the residential and commercial mortgage books.

- **Going Concern**: Preparing the Annual Report and Accounts under the Going Concern assumption requires the Board and Audit Committee to be satisfied about the long term viability of the Society's business operations, business planning, business management and risk management. Long term liquidity, capital and funding forecasts alongside business viability considerations are assessed formally at the year-end to coincide with the approval of the Annual Report and Accounts. The Audit Committee concluded that the adoption of the Going Concern basis to prepare the accounts is appropriate.

- **Provisions for other liabilities and charges**: The Audit Committee reviews and challenges the estimates and assumptions made by management when calculating these and in particular provisions at the end of the reporting year. The Committee was satisfied with provisions in relation to the Financial Services Compensation Scheme Levy and pension provision.

- **Hedge accounting**: The Audit Committee is appraised of the Society's derivative and hedge accounting position and strategy and also agrees the accounting policy for hedging, including disclosures in the Annual Report and Accounts. The Committee has concluded satisfactorily in this area.

The Committee considers matters raised by the External Auditors and the Committee concluded there were no adjustments proposed that were material to the Annual Report and Accounts.

Having undertaken the above responsibilities and considerations throughout the Society's 2017 financial year the Audit Committee recommended to the Board that approval be given to the audited Annual Report and Accounts and Summary Financial Statements as at 31 December 2017. The Summary Financial Statements make up part of the Annual Review which can be downloaded from the Society's website.

Following an audit tender process in 2017, PwC have been appointed external auditors. Please see External Audit section on the following page for more details.

Internal control

The Audit Committee works closely with the Risk & Compliance Committee to ensure that management and staff take appropriate responsibility for departmental internal control. The Audit Committee agrees the audit plan detailing the work to be undertaken by internal audit during the forthcoming year as part of a three year cycle of work.

The Audit Committee is responsible for:

- review of the scope and effectiveness of the Society's internal control systems including Information Technology security and control.

- establishing the scope and frequency of Internal Audit and External Audit reviews relating to the internal control environment, particularly in relation to financial reporting.

Internal Audit

The Audit Committee is responsible for the appointment and removal of the Internal Auditors, agreeing the internal audit plan and monitoring activity relative to the plan. The Committee reviews the effectiveness of the Internal Audit function including conformance with required Standards. RSM have been the Society's Internal Auditors during the current and comparative financial periods.

The Committee approves and reviews the Internal Audit work programme and results and ensures that Internal Audit maintains sufficient access to the Board, management and the financial records of the Society. The Committee also reviews the responsiveness of management to findings and recommendations made by internal audit.

External audit

The Audit Committee is responsible for overseeing the Society's relationship with the External Auditors. As the previous auditors had been in office for 10 years, the Audit Committee undertook a rigorous audit tender process which included the submission of detailed proposals and a series of presentations. Following the conclusion of this process the Committee made the recommendation to appoint PricewaterhouseCoopers LLP (PwC) as external auditors for the Society. A resolution to this effect was approved by the Members at the Annual General meeting.

The audit committee's responsibilities with regards to external audit extends to:

- appointment, reappointment, removal and assessment of independence, objectivity and effectiveness of the External Auditors;

- approval of terms and remuneration in respect of audit services provided;

- annual approval of the Society policy on the use of the External Auditors for non-audit work; and

- consideration of audit quality including reports by the Audit Quality Review Team.

The Audit Committee assesses annually the qualification, expertise and resources of the External Auditors seeking reassurance on their independence. The External Auditors communicate their formal independence annually and appraise the Audit Committee of policies, processes and monitoring in place for maintaining their independence.

The Audit Committee ensures that non-audit services provided by the External Auditors will not adversely impact the independence and objectivity of the audit firm in performing their duties. A formal Society policy on use of the External Auditors for non-audit work is reviewed annually.

On behalf of the Board
Alan Murdoch
Chair of Audit Committee
7 March 2018

Introduction

This report details the Society's approach to pay for the period 1 January to 31 December 2017. It sets out the remuneration policy and remuneration details for the Executive, Non-Executive Directors and Material Risk Takers (MRTs) of the Society and how it applies the principles of the UK Corporate Governance Code relating to remuneration, the Regulators' Remuneration Code and the disclosure requirements arising under the EU Capital Requirements Directive IV (CRD IV). The report is split into three main areas; the Statement by the Chairman of the Remuneration Committee, the Report on Remuneration and the Directors' Remuneration Policy.

i) Statement by the Chairman of the Remuneration Committee

The Remuneration Committee operates within the Terms of Reference ToR agreed by the Board. The ToR are reviewed annually and were last reviewed in August 2017.

The main objectives of the committee are summarised as follows:

- To ensure a formal and transparent procedure is in place for developing policy on Executive and MRTs remuneration and for fixing the remuneration packages of individual Directors;
  - To design an Executive Remuneration Policy that promotes the long term success of the Society;
  - To ensure compliance with the Regulators' Remuneration Rules through at least annual review;
  - To determine and agree with the Board the framework for Executive and MRTs remuneration and conditions of employment;
  - Approval of the Society's Remuneration Policy, Remuneration Committee Reports in the Society's Annual Report and Accounts and Summary Financial Statements, and the remuneration sections of the Society's Pillar 3 disclosure;
  - To consider and make recommendations to the Board on the general framework of employee bonus schemes; and
  - To consider and make recommendations on the proposals made by the Chief Executive to the Board on fees paid to Non-Executive Directors.

The Board believes remuneration should be sufficient to attract, retain and motivate senior managers to continue to run the Society successfully, whilst avoiding paying more than is necessary for this purpose. The Remuneration Policy, therefore, focuses on rewarding our Executives and MRT in line with the achievement of our goals set out in the annual corporate plan whilst continuing to provide value for money for our Members.

Composition of the Committee

The Committee comprises solely of Non-Executive Directors who have no personal financial interest in the recommendations. The Chair of the Committee is Don Bailey, the other Members are John Hughes and Susan Jee appointed 1st June 2017. The Chief Executive (except for items relating to his own remuneration) also attends meetings but is not a Member of the Committee.

During the year the Committee met five times and activities included:

- Overseeing compliance of the Society's approach to remuneration against the requirements of the Regulators' Remuneration Rules;
- Considering and agreeing pay and benefits for Executive Directors and senior managers, MRTs, as well as overseeing remuneration matters across the Society;
- Reviewing the performance for the financial year and approving the resulting level of Corporate Bonus to be paid based on achievement of the Corporate Metrics; and
- Consideration of the disclosure requirements for the Remuneration Report including Pillar 3 disclosures.

There were no substantial changes relating to Directors' remuneration made during the year and the Society's Remuneration Policy does not include significant performance related variable remuneration. The Society has adopted a simple remuneration structure which is appropriate to its business and is efficient and cost effective in promoting its long term strategy. Transparent salary, other benefits and pension contributions are supplemented by a modest and straightforward Corporate Bonus Scheme that promotes continued involvement in the Society's ongoing success through cumulative performance targets without over-emphasising reward based on short term results.

ii) Report on Remuneration

The total remuneration received by Executive Directors is shown in the tables below. The Report on Remuneration is not audited. Total Directors emoluments are disclosed within note 9 of the audited financial statements. The information provided and disclosed is as required under the Building Society (Accounts and Related Provisions) Regulations 1998.
There is a requirement under Para 14 of the Society's Rules to have deposits to the value of not less than £1,000 in a Society share account in order to qualify as a Director. This means all Directors are Members of the Society.

The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director. For details of other non-Society Board positions held by the Society's Executive Director team see the Annual Business Statement on page 62 of the Annual Report and Accounts. None of the Executive Directors retained any remuneration as a result of their non-Society positions.

Executive Directors

£000		Basic Salary	Annual Bonus	Benefits	Pension Contribution	Total
MJ Hanson	**2017**	**135**	**6**	**8**	**17**	**166**
	2016	129	-	10	23	162
A Entwisle**	**2017**	**33**	**1**	**3**	**4**	**41**
	2016	88	-	8	11	107
J Aspin*	**2017**	**126**	**5**	**7**	**-**	**138**
	2016	13	-	1	-	14
Total	**2017**	**294**	**12**	**18**	**21**	**345**
	2016	230	-	19	34	283

* Appointed as a Director on 24 November 2016 **Resigned as a Director on 1 June 2017.

Compensation for Loss of Office

In April 2017 MJ Hanson advised the Board of his intention to step down from his role as CEO. He will receive compensation for loss of office of £130,000, due to be paid in 2018.

Non-Executive Directors

£000		Salary	Annual Bonus	Benefits	Pension Contribution	Total
J Hughes	**2017**	**31**	**-**	**-**	**-**	**31**
	2016	27	-	-	-	27
S Jee	**2017**	**26**	**-**	**-**	**-**	**26**
	2016	25	-	-	-	25
D Bailey	**2017**	**29**	**-**	**-**	**-**	**29**
	2016	34	-	-	-	34
JM Longworth	**2017**	**25**	**-**	**-**	**-**	**25**
	2016	25	-	-	-	25
A Murdoch	**2017**	**25**	**-**	**-**	**-**	**25**
	2016	25	-	-	-	25
Total NED	**2017**	**136**	**-**	**-**	**-**	**136**
	2016	136	-	-	-	136
Total	**2017**	**430**	**12**	**18**	**21**	**481**
All Directors	2016	366	-	19	34	419

The Society operates a Corporate Bonus scheme that is simple, modest and fair and applies to everyone across the Society. Basic remuneration potential (salary, other benefits and pensions) is not pre-determined against targeted Society performance, and is periodically reassessed by the Remuneration Committee with regard to actual Society performance. In implementing the Policy, the following key principles are observed:

- The Policy is clearly linked to the Society's business strategy, objectives and Values;
- Policy, process and practice are consistent with and promote effective risk management, whilst creating an acceptable relationship between risk and reward;
- Basic pay and total remuneration is set at a competitive level to attract and retain the appropriate calibre of people;
- The approach to pay satisfies regulatory requirements and good Corporate Governance practice;
- Remuneration arrangements are transparent, consistent and fair, reflecting individual responsibilities and performance; and
- Remuneration arrangements are straightforward to understand, communicate and administer.

The Committee is responsible for setting the remuneration of the Executive Directors and approves the policy for senior managers and MRTs. When setting salary increases for Executive Directors, the Committee considers the level of salary increases across the Society and Group. All employees of the Society receive a basic salary and benefits consistent with market practice, and are eligible to participate in the Society's Corporate Bonus Scheme and pension arrangements.

Remuneration for Executive Directors

The table below set outs the elements of remuneration for MRTs and how each element operates.

How elements support strategy	Operation	Maximum potential value	Performance conditions and assessment
Basic Salary Supports the recruitment and retention of Executive Directors, reflecting their individual role, skills and contribution.	**Basic Salary** Basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. In setting appropriate salary levels, the Committee takes into account data for similar roles in comparable organisations. The Society aims to position Executive Directors competitively within the reference group.	**Basic Salary** Increases in base salary are determined annually by the Committee taking into account: • Individual performance; • The scope of the role; and • Pay levels of comparable organisations.	**Basic Salary** None applicable however individual performance is taken into account when considering base increases.
Pension Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	**Pension** Generally the Society contributes to a defined contribution pension scheme for the Executive Directors. The contribution can instead be paid in cash (which is excluded from bonus calculations) if the Executive Director is likely to be affected by the limits for tax approved pension saving.	**Pension** 12.5% of basic salary.	**Pension** None applicable
Benefits To attract and retain Executive Directors; and • Provides a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	**Benefits** A number of benefits are provided to Executive Directors, including car allowance, private medical insurance, and life insurance. The Committee reviews benefits and from time to time may make changes, for example to reflect market practice or the needs of the business.	**Benefits** The Society bears the cost of providing benefits which may vary from year to year.	**Benefits** None applicable
Short Term Incentive Scheme Supports attraction and retention of Executive Directors; • Supports the development of a high performance culture; and • Rewards performance within the context of achieving Society goals and objectives as set out in the society plan.	**Short Term Incentive Scheme** Performance measures and targets are set on an annual basis and are measured over the financial year. Payment is made in cash, after performance has been assessed. Payment is made at the discretion of the Committee.	**Short Term Incentive Scheme** The Committee determines the maximum incentive. A Society bonus payment has been awarded of 4.15% of base salary in relation to 2017 performance.	**Short Term Incentive Scheme** The performance measures considered by the Committee in respect of the Society Scheme are delivery of the Society metrics which include: • Profit capital and liquidity targets; • Quality measures around service, complaints and customer satisfaction; • Targets for savings and mortgage business; and • Other metrics covering people engagement, process and delivery of major projects. The measures are assessed by the Committee.

Further information on metric performance can be found on page 8 and 9 of the Strategic Report.

Remuneration of Non-Executive Directors

The table set outs the elements of Non-Executive Directors' remuneration and the policy on how each element is determined.

Element	Approach
Basic Fees	Reviewed annually based on time commitment and responsibility required by Board and Board Committee meetings. Review takes into account fees paid by comparable financial services organisations. Fees set by the Remuneration Committee.
Additional Fees	Additional fees are payable for additional responsibilities such as Committee chair.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay and do not receive pensions or other benefits in kind.

A summary of the remuneration of Material risk Takers during 2017 and the business areas in which they operate is shown below.

The amount of time commitment required of the Chair and Vice Chair roles has increased which will result in higher fee levels in the next year.

Directors' service agreements and notice periods

Executive Directors are employed on service agreements which can be terminated by either the Society or the Director giving 6 months' notice.

Non-Executive Directors do not have service agreements. Non-Executive Directors are appointed for an initial three year term. They will generally be expected to serve more than one three year term.

Consideration of Member views

The Committee does not consult with the Society's Members on its Remuneration Policy but takes into account feedback given by Members. The Committee has for a number of years, invited Members to vote on the receipt of annual remuneration report, and Members have always voted in favour.

Deferred Remuneration

There was no deferred remuneration during 2017. As the Society's Remuneration Policy does not include significant performance related variable remuneration, no formal ratio between fixed and variable remuneration is relevant.

Summary of Material Risk Takers

Category	Year	Number in category during year	Fixed Remuneration [1]	Variable Remuneration [2]	Total Remuneration
Executive Directors	2017	2	283	10	293
	2016	3	283	-	283
Material Risk Takers	2017	9	553	19	572
	2016	7	417	-	417
Total	2017	11	836	29	865
	2016	10	700	-	700

1. Includes payment for loss of office of £30k in MRTs.
2. Variable remuneration reflects participation in the Society's annual Society Bonus Scheme.

On behalf of the Board
Don Bailey
Chair of Remuneration Committee
7 March 2018

The Society's Risk Management Framework is designed to enable the Society to proactively identify and manage risks to support the achievement of the Society's objectives.

It includes monitoring and controlling the significant risks to which the Society is exposed to ensure the security and resilience of the Society. The Society's ability to identify, measure, monitor, report and control risks is key to delivering sustainable and resilient business performance, including fair outcomes for Members and customers.

Risk Governance

The Board is ultimately responsible for ensuring that adequate systems of risk management are in place, and that the Society's strategy, risk appetite, and risk management are consistent. To assist the Board a Risk & Compliance Committee (RCC) oversees the management of risk across the Society (see below).

The RCC is supported by an independent Risk & Compliance department that is responsible for ensuring that appropriate risk management is used. This includes the provision of reports on risks, and risk management for the RCC. The Chief Risk Officer provides formal updates on risk management to the Board at each meeting.

Risk Framework

The Society's Risk Management Framework operates under the "Three Lines of Defence" principle. The First Line of Defence is within departments where everyone has responsibility for risk management and ensuring adequate controls are in place to mitigate risk. The Second Line of defence is provided by oversight of the first line by the Second Line Risk department, supported by the Executive Committee (Exco) and RCC. The Third Line of defence is provided by Internal Audit and the Audit Committee, which are responsible for reviewing the effectiveness of the First and Second Lines of Defence.

The Risk Management Framework includes the use of Board approved risk appetite statements covering capital, liquidity, operational risk, credit risk, interest rate risk, and conduct risk. They set out key limits and escalation triggers. The risk position is reported to the Board monthly and risk appetites are formally approved annually.

The Risk Management Framework makes use of stress testing and scenario testing. Stress tests consider the potential outcomes for portfolios and for the Society in the event of stressed scenarios incorporating, for example, falling house prices and rising unemployment. Scenario tests consider the outcome in the event of a particular risk or event occurring, and are used to help evaluate the controls, and assess the adequacy of the Society's incident management and business continuity plans.

Risk & Compliance Committee

The RCC oversees the Society's risk management and governance framework and the Society's overall risk profile. The Committee meets every two months.

Members of the RCC throughout the year were: Non-Executive Directors – Susan Jee (Committee Chair), John Hughes, and Adam Evetts (Chief Risk Officer).

The duties of RCC include:

- Oversight of overall risk appetite, risk management strategy and framework, including oversight of both prudential and conduct risk appetites;
- Oversight of compliance with risk policies;
- Review and assessment of the adequacy of risk management information to monitor and control risks;
- Approval of risk management of new initiatives and projects, and in particular the risks those initiatives and projects expose the Society to;
- Consideration and approval of the top risks for the Society including low likelihood, high impact risks; and
- Approval of stress testing and scenario testing.

During 2017 the Committee met six times and in particular considered the following matters:

- Review of the risk appetites for prudential and conduct risk;
- Review of the Society's Risk Management Framework;
- Oversight of the Risk Control Self-Assessment report including low likelihood high impact risks;
- Review and ratification of key risk policies covering lending, treasury, and operational risk;
- Review and approval of the Society's Risk & Compliance plan; and
- Review of compliance with the PRA guidance limits for building societies.

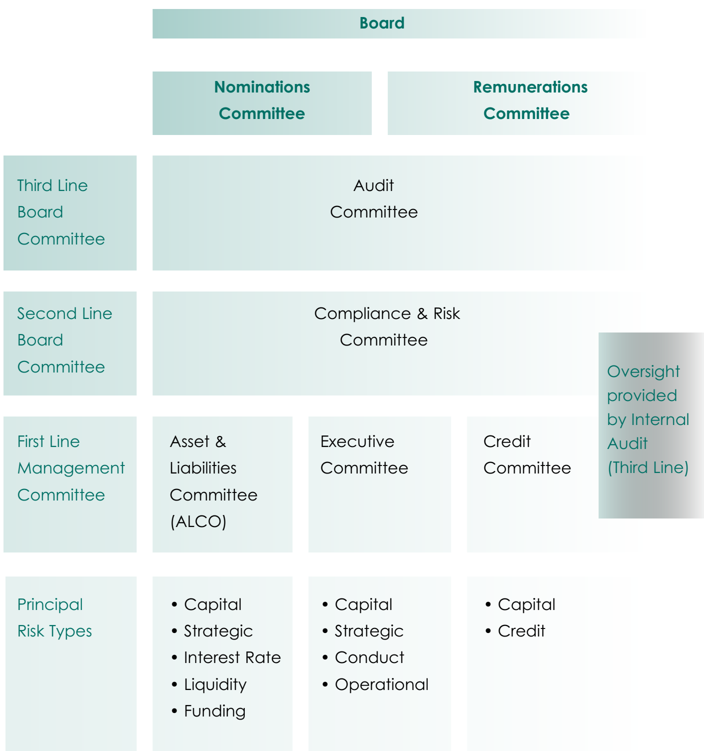
The RCC is supported by the Society's Executive committees, as follows:

The Executive Committee ExCo is responsible for "overlap" risks, i.e. risks that go across business areas, and in particular for conduct risks, and overall stress testing. It is responsible for approving compliance policy, monitoring compliance with policies, conduct risk indicators, business continuity policy, and overall stress testing. During 2017 ExCo met monthly.

The Credit Committee (CredCo) is responsible for credit risk across the Society's retail and non-retail mortgage portfolios; including loan strategy, limit monitoring, risk indicators and stress factors, annual reviews and breach reports, monitoring risk trends on the portfolio and stress testing. During 2017, CredCo met monthly.

The Asset and Liabilities Committee (ALCO) is responsible for all aspects of treasury risk management including liquidity risk, interest rate risk, counterparty credit risk, and balance sheet management. During 2017 ALCO met monthly.

Risk Governance Structure



The primary risks that the Society are exposed to are summarised below:

Risk & Impact	Mitigation	Commentary
The primary Credit Risks relate to commercial, residential, and investment (see below).		
Residential Credit Risk Retail borrowers do not repay the Society and the Society's collateral is insufficient to meet the debt obligations. The risk is sensitive to unemployment rates, house prices, and interest rates. For example, if a borrowing customer loses their job they may be unable to meet their repayments. If the Society takes possession of the property it may not realise enough on subsequent sale to repay the loan balance. In a recession when unemployment rises and house prices can fall the risk is greater.	Residential Loans are underwritten individually based on affordability, credit search and history, acceptable collateral (including loan to value), and the Society's lending criteria. The Society does not undertake sub-prime or self-certification lending. The Society's Lending Policy is subject to review at least annually. The residential book is subject to monthly reporting in relation to its credit risk characteristics (including loan to value, loan to income, arrears, early delinquencies, and arrears arising from cohorts of lending). The Society's risk appetite is expressed in terms of capital at risk in a stressed scenario, and stress testing is used to ensure that the portfolio is within the Society's risk appetite.	Residential The Society's net lending has decreased in 2017, but has seen increases in net BTL lending. The Society has a strategy to increase net lending during 2018. Indexed LTV has reduced due to house price rises and capital repayments. Loans 2.5% or more in arrears are at historically very low levels. The retail book remains within the Society's risk appetite. Actual losses on the residential book remain very low, £13,000 during 2017.
Commercial Credit Risk Commercial borrowers do not repay the Society and the Society's collateral is insufficient to meet the debt obligations. The risk is sensitive to economic conditions that can impact the viability of tenants and commercial real estate values. For example, if a commercial borrower has a property where the tenant is lost they may be unable to meet repayments. If the Society takes possession of the property it may not realise enough on subsequent sale to repay the loan balance. In a recession when more tenants may fail and commercial property values can fall the risk is greater.	Commercial The commercial loan book is being actively managed down. Concentration risk to single names and to sectors is monitored. In the event of a breach a report is provided to the RCC. Borrower watchlists are maintained and are reviewed monthly. Watchlists for borrowers are updated on a real time basis. Stress testing is used to determine the risk associated with the portfolio and with individual loans within it.	Commercial The Society withdrew from new commercial lending in 2016. Lending balances on commercial property have fallen by £1.3m 10.9% in 2017, and now represent 4.6% of the mortgage book. The Society's exposure to single name risk has also materially reduced. The assessment of risks has fallen significantly based on stress test losses and number of cases on watchlists. As a result, provisions have been reduced to £72k (2016: £160k)
Investment/Liquidity Credit Risk Wholesale counterparties the Society lends to default, or the value of the investment falls and the Society is obliged to crystallise that fall in value. This risk arises in relation to the treasury investments made by the Society in order to meet liquidity requirements. The risk is sensitive to market volatility and credit spreads (both general credit spreads and name specific credit spreads). For example, if the Society invests in Certificates of Deposits (CDs), and subsequently the market value of that falls, the Society may have to sell the assets at a loss. The risk is higher when there is greater market volatility.	Investment/Liquidity Credit Investments are subject to a RCC approved policy, which sets out what instruments, countries, and counterparties investments can be made in, and sets limits on exposures to instruments, countries, and counterparties. Investments are monitored monthly and reported to the Assets and Liabilities Committee (ALCO). including compliance with the policy. The mark to market value of the Society's investments in gilts, CDs, and term deposits are monitored monthly and reported to ALCO.	Investment/Liquidity Credit The Society's overall risk exposure has reduced as some liquid assets are now held in a Bank of England Account. Overall liquidity is at similar levels and the proportion of liquid assets held with highly rated counterparties has been maintained The Society has a simple product range covering mortgages, savings, and insurance.

Risk & Impact	Mitigation	Commentary
Conduct Risk Conduct risk is the risk of customer detriment arising from the Society's activities. Examples include products that do not perform as customers expected them to, or products being sold to customers for whom they are not suitable. Conduct risk and operational risk (see below) are closely aligned where the operational risk results in customer detriment (e.g. a failure to protect customer data is an operational risk which may result in customer detriment). For example, if the Society provides a mortgage product to a customer where the information the customer needed to make an informed decision was absent, and the product does not meet the customer's needs.	Conduct Risk Conduct risk is wide-ranging, and the key mitigants are:- The Society maintains a risk appetite statement relating to customer outcomes and measures performance relative to that statement monthly, reporting to the Executive Committee (Exco) with oversight from the RCC. All new products are developed using the Product Development Framework, which includes consideration of an assessment of risks to customer outcomes. The Society maintains an annual Compliance Plan, which is risk based, reporting to Exco with oversight from the RCC. (See also Operational Risk).	Conduct Risk The Society has a simple product range covering mortgages, savings, and insurance.
Liquidity Risk Liquidity risk is the risk of loss or failure caused by the Society being unable to meet its liabilities or commitments as they fall due, or to be able to do so only at excessive cost. For example, if there are exceptionally high withdrawals at a time when there is illiquidity in financial markets preventing the Society from selling its liquid assets, then it may have to sell assets at a discount to obtain liquid assets.	Liquidity Risk Liquidity is subject to a Board approved Policy, which sets out limits in relation to liquidity. Liquidity is monitored and reported to management weekly, and reported to the Asset and Liability Committee (ALCO) on a monthly basis, including compliance with the policy. Cash flow forecasts are used to forecast liquidity, and ensure compliance with the limits in the future. Stress tests are used to ensure that liquidity risk is within the risk appetite. Interest rate risk is subject to a Board approved policy.	Liquidity Risk Overall liquidity remains strong. The Society's LCR ratio improved during the year following the opening of the Bank of England deposit account. At the year end the LCR was 648%, comfortably above the industry requirements of 100%.
Interest Rate Risk Interest rate risk is the risk that the value of the Society's net assets or net interest income falls as a result of a change in interest rates. Basis risk is the risk that net interest income falls because of a change in the relationship between two market rates. For example, the Society has assets which earn interest based on the LIBOR rate, and liabilities where the rate is set by the Society. For example, if LIBOR falls at a time when base rate and savings rate do not, then the Society's assets realise lower income, but the costs remain unchanged.	Interest Rate Risk Interest rate risk is subject to a Board approved policy. Interest rate risk and basis risk are subject to policy limits. They are monitored and reported to ALCO monthly, including compliance with policy. The Society uses interest rate swaps to manage interest rate risk. Derivatives are only used, in accordance with the Building Societies Act 1986, to mitigate risks arising from interest rates or indices. Stress tests are used to assess the Society's exposure to interest rate and basis risk.	Interest Rate Risk The Society's policy in relation to interest rate risk has not changed in the year nor has the overall interest rate risk to which the Society is exposed. Note 31, page 58, provides details of the derivative financial instruments held at 31 December 2017, together with the impact of a rate change of 1% and 2%.

Risk & Impact	Mitigation	Commentary
Operational Risk Operational risk is the risk or loss, resulting from inadequate or failed internal processes, people and systems or from external events. For the Society this definition includes legal risk, strategic risk and reputational risk. Operational risk covers examples such as a fire or accident, fraud or theft, or, for example, a failure of IT systems resulting in customers being unable to log in.	Operational Risk Operational risk is subject to a suite of RCC approved policies which covers the framework for operational risk, including the measurement and management of risk, operational risk appetite, use of scenario testing for operational risk, tracking of risk events and operational losses, timescales for implementation of action plans and escalation procedures for more serious risk events that require immediate action to mitigate loss. Key risks and controls are identified for all areas of the business. Risk assessments remain the responsibility of the relevant departmental managers and Executives, and are updated regularly for new risks, the results of risk events and following internal audit reviews. Society Insurance policies are negotiated with regard to the key risks within the Society requiring greater mitigation.	Operational Risk The Society implemented several projects and recruited additional specialist risk staff in 2017 to further enhance its resilience. The Society also invested in capabilities to combat risks presented from cybercrime.
Capital Risk Capital risk is the risk that the Society is or becomes inadequately capitalised to address the risks to which it is exposed.	Capital Risk The Society updates its ICAAP on an annual basis. Capital adequacy is monitored on a monthly basis by the Board and the 5 year capital plan has been updated on a regular basis between ICAAP reviews against the background of changing economic circumstances and updated budgets and forecasts. The Society has set a target CET1 ratio which balances the requirement for capital to manage risk and investment in the Society. The Society maintains its capital at a level in excess of its Individual Capital Guidance. The Society publishes further information about risk exposures in its Pillar 3 disclosures, available on the Society's website.	Capital Risk The Society's ICG is set at 10.64%. The Society's Common Equity Tier 1 ratio has improved to 19.8% from 18.7%

On behalf of the Board
Susan Jee
Chair of Risk & Compliance Committee
7 March 2018

Report on the audit of the annual accounts

Opinion

In our opinion Vernon Building Society's Group annual accounts and Society annual accounts (the "annual accounts"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2017 and of the Group's and the Society's income and expenditure and the Group's and the Society's cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and as regards the Group annual accounts, Article 4 of the IAS Regulation.

We have audited the annual accounts, included within the Annual Report & Accounts (the "Annual Report"), which comprise: the Group and society statements of financial position as at 31 December 2017; the Group and society statements of comprehensive income, the Group cash flow statement, and the Group and society statements of changes in members' interests for the year then ended; and the notes to the accounts, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditor's responsibilities for the audit of the annual accounts section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Change of auditors

Before commencing audit work in July 2017, PricewaterhouseCoopers LLP ('PwC') confirmed its independence of the Group and Society. During this time, we met with the management of the Group and Society to understand the issues faced by the business and to gather information which we needed to plan our first audit effectively. We worked alongside the former auditors and attended the Audit Committee meetings. We also reviewed the audit working papers of the former auditors to familiarise ourselves with the controls on which they relied for the purposes of their opinion and to understand how they had responded to the key judgements used in preparing the financial statements.

Independence

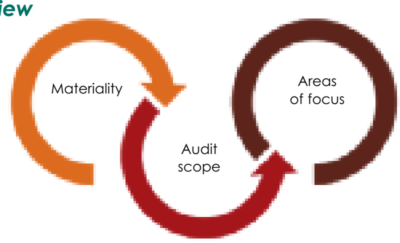
We remained independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the annual accounts in the UK, which includes the FRC's Ethical Standard applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group and the Society.

We have provided no non-audit services to the Group and the Society in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



- **Overall Group materiality: £217,000**
- This represents 1% of group net assets.
- **Overall Society materiality: £206,000**
- This represents a 5% haircut to overall group materiality.

- We conducted all of our audit work from the Society's head office in Stockport using one audit team.
- Audit procedures were performed over all material account balances and financial information in the Society due to its significance to the Group's financial performance and position.
- No audit procedures were performed over specific account balances and financial information in Group undertakings as they did not materially contribute to the Group or Society's financial performance and/or position.

The areas of focus for our audit which involved the greatest allocation of resources and effort were:

- The valuation of allowances for losses on loans and advances to customers (Group and Society).
- Risk of material misstatement in hedge accounting adjustments (Group and Society).
- Revenue recognition under the effective interest rate method (Group and Society).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We gained an understanding of the legal and regulatory framework applicable to the Group and Society and the industry in which they operate, and considered the risk of acts by the Group and Society which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and Society level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Society financial statements, including but not limited to, the Building Societies Act 1986, the Financial Conduct Authority's Client Asset Sourcebook, the Prudential Regulation Authority's regulations and the UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with the regulators, enquiries of management and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the annual accounts of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in our audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter

Valuation of allowances for losses on loans and advances to customers

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and note 17 for detailed disclosures.

The Group and Society have recognised an impairment release on loans and advances to customers of £76k (2016: £87k) in the year. A specific provision of £107k (2016: £191k) and a collective provision of £199k (2016: £204k) is held.

These loans and advances represent mortgages secured on residential and commercial property in the UK.

Significant judgement needs to be applied by the directors to estimate the potential loss on loans where an impairment event has occurred. Judgement is required in respect of identifying an impairment trigger event on loans and, once impaired, the estimate of loss on a loan is calculated by use of models to discount the future cash flows expected to be received on the loan. The calculation is impacted by a number of key judgements which we focussed on:

- Estimating cash flows for loans identified as specifically impaired;
- Incorporating the time value of cash flows when considering the recoverability of loans; and
- Accurately capturing impairment that is deemed to have already occurred, but has not emerged in the Group's and Society's data through a collective model.

The above are subject to estimation uncertainty and as a result there is an increased risk that impairment allowances may be materially under or over stated.

How our audit addressed the key audit matter

We evaluated and challenged the directors' future cash flow forecasts including key assumptions. This involved assessing the reasonableness of the assumptions used to derive the expected future cash flows and the probabilities of default used to quantify impairment triggers in collectively assessed portfolios. We undertook sensitivity analyses to assess the changes that would be required in those assumptions to result in material misstatement of the allowances, and the likelihood of such changes arising individually and in aggregate. The results of our work led us to conclude that the assumptions used by the directors were reasonable.

We performed an independent review of the Group's and Society's mortgage book, which assessed provisioning adequacy of various subsets of the book with different risk criteria, and consideration of industry-wide areas of focus to identify any areas of latent risk not appropriately provided for.

In testing the key data inputs to the model we agreed the accuracy and completeness of customer data and loan book metrics extracted from the Group's and Society's lending platform and tested a sample of controls relied upon by the directors to ensure accuracy of data held within the lending platform.

Data provided by third parties, such as property valuation, was agreed to external reports and the independence and objectivity of the third parties assessed. We did not identify any issues with the internally or externally sourced data utilised within the directors' provisioning models.

Based on the evidence obtained, we determined that the assumptions used within the loan loss provision calculation and the data underpinning them were reasonable.

Key audit matter

Risk of material misstatement in hedge accounting adjustments

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and notes 6 and 15 for the detailed disclosures.

The Society's operations expose the Group and Society to significant interest rate risk as a result of a mismatch between fixed and floating interest cash inflows and outflows.

The directors have sought to mitigate the risk of future movements in market interest rates affecting the Group's and Society's profitability through the use of derivative financial instruments, in the form of interest rate swap contracts. The Group and Society have designated these under hedge accounting arrangements, to reduce the effect of future movements in interest rates on the amounts recorded in the financial statements.

We focussed on this area as the hedge accounting rules are onerous and complex. Combined with the number of fixed interest mortgages and savings products, and interest rate swaps held on balance sheet, this gives rise to an increase in the risk of error in monitoring, maintaining correct documentation and journal postings.

The Group and Society use valuation systems to determine the fair value of interest rate swaps, and fixed interest rate mortgages and savings products that they are hedged against at the balance sheet date. The Group and Society also use systems to assess hedge effectiveness for the accounting hedges as required by accounting standards. The directors manually track hedge ineffectiveness that arises as a result of known limitations in the systems used.

In particular, we focussed on:

- Results of system driven hedge effectiveness tests performed throughout the year; and
- The Society's hedge documentation and calculation spreadsheets used to calculate ineffectiveness in hedge relationships; and
- System driven fair value calculations performed over interest rate swaps, and fixed rate mortgage and savings contracts.

How our audit addressed the key audit matter

We obtained and read the Group's and Society's hedge accounting documentation to evaluate whether this documentation was compliant with accounting requirements for applying hedge accounting and found no issues.

We also obtained and re-performed the hedge effectiveness calculations undertaken by management in assessing the effectiveness of the Group's and Society's hedge relationships. In performing this work we recalculated the ineffectiveness recorded in the income statement. This work involved testing the completeness and accuracy of management's manual tracking of hedge ineffectiveness and recalculating the element that arises as a result of known limitations in the systems used by management. In performance of these procedures we noted no differences to the effectiveness as calculated by the directors and recorded in the accounts.

We agreed fair values for each derivative financial instrument and fixed rate product from management's systems to the values recorded in the financial statements, as well as the adjustments required to record hedge ineffectiveness, from management's manual tracking.

We obtained a sample of derivative contracts and undertook independent valuations for these instruments at the balance sheet date using our own models. Within our models we used externally available sources for interest rate yield curves, in arriving at our independent estimates of fair value.

We compared our independently determined fair values to those calculated by management's systems to evaluate any differences arising. In performing this comparison, we calculated tolerable thresholds for valuation differences which took into account the complexity of the instrument being valued. We noted no significant differences outside of those tolerable thresholds.

Key audit matter

Revenue recognition under the effective interest rate method

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and note 3 for detailed disclosures.

The Group's and Society's loans and advances to customers are held at amortised cost with interest income recognised in accordance with the effective interest rate method. The recognition of revenue on loans and advances to customers using an effective interest rate method requires significant judgement by management to determine key assumptions related to the expected life of each loan. These assumptions are sensitive to the economic environment which may determine the rate at which customers prepay. The director's assumptions are based on observed historical data.

Fee income and expenses directly attributable to establishing mortgages are held on the balance sheet and amortised over the expected life of the associated mortgage portfolios.

We focussed on this area as director's assumptions involve a degree of management judgement which determines the level of income recognition.

In particular, we assessed:

- the completeness and accuracy of the data set of historic redemptions to articulate the rate of prepayment of customer loans; and
- the logic and accuracy of the effective interest rate calculation in accordance with the requirements of accounting standards; and
- the sensitivity of interest income recognition in light of management's key assumptions.

How our audit addressed the key audit matter

We agreed management's effective interest rate adjustment and spreading of mortgage origination costs from underlying calculation spreadsheets to the annual accounts.

We independently verified the completeness and accuracy of customer data used by management to determine their assumptions back to source system data.

We sample tested the accuracy of the fees charged to customers within their effective interest rate model back to source documentation of customer charges, and the associated customer origination costs. The completeness of fees was agreed to customer documentation and the appropriateness of inclusion for amortisation tested. We noted no exceptions as a result of this testing.

We recalculated the effective interest rate adjustment and amortisation of mortgage origination costs on a sample basis.

The data supporting the behavioural life of mortgages lifetime was sampled back to source data. We also performed sensitivity to understand the impact of estimation uncertainty on income recognition.

The results of our testing identified no exceptions and the underlying methodology used for the calculation of the effective interest rate adjustment is materially accurate in the context of the requirements of the relevant accounting standards.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the annual accounts as a whole, taking into account the structure of the Group and Society, the accounting processes and controls, and the industry in which the Group and Society operate.

All of the Group's activities are in the United Kingdom and it reports its operating results along a single business line, being the provision of mortgage finance for the purchase and improvement of residential property, savings products for private individuals and local businesses, related services and other financial services. The Group is formed of the Society and four dormant subsidiaries, none of which are material to the Group.

The accounting records and functions for all entities within the Group are located at the Society's principal office in Stockport, with consolidation of the Group annual accounts being performed from this location.

Our audit procedures on the Society and its subsidiary undertakings provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the annual accounts as a whole.

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

	Group annual accounts	Society annual accounts
Overall materiality	£217,000	£206,000
How we determined it	1% of net assets	

Rationale for benchmark applied

We consider that net assets is the most appropriate benchmark to use for the Group, whose strategy is not one of profit maximisation, but to provide a secure home for member investments and continued provision of mortgage lending. Regulatory capital is a key benchmark for management and regulators. Hence we base our materiality calculation on net assets, which is approximate to regulatory capital resources given the simple funding structure of the Group.

To determine the Society materiality we applied a 95% cap on Group materiality to ensure it is lower than the Group materiality, as required by ISA (UK) 600. Group components other than the Society did not materially contribute to the Group's financial performance and/or position.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £11,000 for the Group and £10,000 for the Society, as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the annual accounts is not appropriate; or

- the directors have not disclosed in the annual accounts any identified material uncertainties that may cast significant doubt about the Group's and Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the annual accounts are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern.

Reporting on other information

The other information comprises all the information in the Annual Report other than the annual accounts and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the annual accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the annual accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Annual Business Statement and Directors' Report we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Opinions on other matters prescribed by the Building Societies Act 1986

In our opinion, based on our work undertaken in the course of the audit:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the annual accounts are prepared 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.

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Statement of Directors' Responsibilities set out on page 14, the directors are responsible for the preparation of the annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for 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.

In preparing the annual accounts, the directors are responsible for assessing the Group's and 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 the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the annual accounts

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

A further description of our responsibilities for the audit of the annual accounts is located on the Financial Reporting Council's website at: *www.frc.org.uk/auditorsresponsibilities*. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

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; or
- the Society annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 27 April 2017 and formally engaged from 7 September 2017 to audit the annual accounts for the year ended 31 December 2017 and subsequent financial periods. This is therefore our first year of uninterrupted engagement.

Heather Varley (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
7 March 2018

Group and society statements of comprehensive income for the year ended 31 December 2017

	Notes	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Interest receivable and similar income	3	7,115	8,065
Interest payable and similar charge	4	(1,913)	(2,832)
Net interest receivable		**5,202**	**5,233**
Fees and commissions receivable	5	55	84
Fees and commissions payable		(31)	(21)
Net gains/(losses) from other financial instruments at fair value through profit or loss	6	76	(76)
Total income		**5,302**	**5,220**
Administration expenses	7	(4,428)	(3,753)
Depreciation and amortisation	19, 20	(180)	(170)
Other operating charges		(24)	(30)
Operating profit before impairment losses and provisions		**670**	**1,267**
Impairment losses on loans and advances to customers	17	76	87
Provisions for contingent liabilities and commitments	28	23	(51)
Gain / recovery on disposal of fixed assets		-	1
Profit on ordinary activities before tax		**769**	**1,304**
Tax on profit on ordinary activities	10	(151)	(251)
Profit for the financial year		**618**	**1,053**
Other Comprehensive Income			
Unrealised (losses) / gains on available for sale financial instruments		(33)	174
Realised gains recycled through comprehensive income		(83)	(67)
Movements in available for sale		**(116)**	**107**
Tax on other comprehensive income		19	(17)
Total comprehensive income for the year		**521**	**1,143**

Profit for the financial year arises from continuing operations. Both the profit for the financial year and total comprehensive income for the period are attributable to the Members of the Society.

The accounting policies and notes on pages 35 to 59 form part of these accounts.

Group and society statements of financial position at 31 December 2017

	Notes	GROUP 2017 £'000	SOCIETY 2017 £'000	GROUP 2016 £'000	SOCIETY 2016 £'000
ASSETS					
Cash in hand and balances with the Bank of England	11	18,325	18,325	264	264
Loans and advances to credit institutions	12	26,493	26,493	29,408	29,408
Debt securities	14	24,388	24,388	34,995	34,995
		69,206	**69,206**	**64,667**	**64,667**
Derivative financial instruments	15	44	44	22	22
		44	**44**	**22**	**22**
Loans and advances to customers					
Loans fully secured on residential property	16	215,060	215,060	222,037	222,037
Other loans fully secured on land	16	10,394	10,394	11,665	11,665
		225,454	**225,454**	**233,702**	**233,702**
Fixed asset investments	18	-	-	-	-
Tangible fixed assets	19	1,322	1,322	1,417	1,417
Intangible fixed assets	20	42	42	16	16
Deferred tax asset	22	46	46	17	17
Other assets	21	19	28	38	47
Prepayments and accrued income	23	442	442	353	353
TOTAL ASSETS		**296,575**	**296,584**	**300,232**	**300,241**
LIABILITIES					
Shares	24	257,878	257,878	260,482	260,482
Amounts owed to credit institutions	25	5,508	5,508	6,515	6,515
Amounts owed to other customers	26	10,239	10,239	10,429	10,429
Derivative financial instruments	15	243	243	573	573
Deferred tax liability	22	35	35	30	30
Other liabilities	27	340	402	497	559
Accruals and deferred income		356	356	183	183
Provisions for liabilities	28	143	143	211	211
		274,742	**274,804**	**278,920**	**278,982**
RESERVES					
General reserves		21,818	21,765	21,200	21,147
Available for sale reserves		15	15	112	112
TOTAL EQUITY AND LIABILITIES		**296,575**	**296,584**	**300,232**	**300,241**

The accounting policies and notes on pages 35 to 59 form part of these accounts.
The accounts were approved by the Board of Directors on 7 March 2018 and were signed on its behalf by:

J Hughes Chair

S Jee Vice-Chair

S Fletcher Director & Chief Executive

Group and society statements of changes in Members' interests at 31 December 2017

GROUP

	GENERAL RESERVE £'000	AVAILABLE-FOR-SALE RESERVE £'000	TOTAL EQUITY ATTRIBUTABLE TO MEMBERS £'000
At 1 January 2016	**20,147**	**22**	**20,169**
Profit for the financial year	1,053	-	1,053
Other comprehensive income for the year	-	90	90
Total comprehensive income for the year	1,053	90	1,143
At 31 December 2016	**21,200**	**112**	**21,312**
Profit for the financial year	618	-	618
Other comprehensive income/(expense) for the year	-	(97)	(97)
Total comprehensive income for the year	618	(97)	521
At 31 December 2017	**21,818**	**15**	**21,833**

SOCIETY

	GENERAL RESERVE £'000	AVAILABLE-FOR-SALE RESERVE £'000	TOTAL EQUITY ATTRIBUTABLE TO MEMBERS £'000
At 1 January 2016	**20,094**	**22**	**20,116**
Profit for the financial year	1,053	-	1,053
Other comprehensive income for the year	-	90	90
Total comprehensive income for the year	1,053	90	1,143
At 31 December 2016	**21,147**	**112**	**21,259**
Profit for the financial year	618	-	618
Other comprehensive income/(expense) for the year	-	(97)	(97)
Total comprehensive income for the year	618	(97)	521
At 31 December 2017	**21,765**	**15**	**21,780**

Group cash flow statement for the year ended 31 December 2017

	GROUP 2017 £'000	GROUP 2016 £'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating profit	769	1,304
Adjustments for:		
Depreciation and amortisation of fixed assets	180	170
Amortisation of loans and advances to customers	-	70
Amortisation of debt securities	118	128
Profit on disposal of debt securities	(83)	(67)
Impairment of tangible fixed assets	-	(1)
Impairment losses on loans and advances to customers	(76)	(87)
	908	**1,517**
Changes in operating assets and liabilities		
Changes in fair values	(88)	79
Increase in prepayments and accrued income	(89)	(9)
Increase / (decrease) in accruals and deferred income	173	(105)
Decrease / (increase) in other assets	19	(18)
Decrease in other liabilities	(46)	(227)
Decrease in provisions for liabilities	(68)	(24)
Decrease / (increase) in loans and advances to customers	8,067	(771)
(Decrease) / increase in shares	(2,611)	12,627
Taxation paid	(267)	(272)
Net cash inflow from operating activities	**5,998**	**12,797**
Cash flow from financing activities		
Movement in:		
Amounts owed to credit institutions and other customers	(1,197)	(13,057)
Net cash outflow from financing activities	**(1,197)**	**(13,057)**
Cash flow from investing activities		
Proceeds on sale/maturity of debt securities	46,449	34,885
Purchase of debt securities	(35,993)	(33,712)
Proceeds on disposal of fixed assets	-	8
Purchase of fixed assets	(111)	(117)
Loans and advances to credit institutions	(3,004)	(496)
Net cash inflow from investing activities	**7,341**	**568**
Net increase in cash and cash equivalents	**12,142**	**308**
Cash and cash equivalents at beginning of year	20,657	20,349
Cash and cash equivalents at end of year (note 11)	**32,799**	**20,657**

1 PRINCIPAL ACCOUNTING POLICIES

The accounts have been prepared in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and *Financial Reporting Standard 102 ("FRS 102"), The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The Group 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 accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these annual accounts.

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 and financial instruments classified at fair value through the income statement or available-for-sale reserve.

1.2 Basis of consolidation

The consolidated annual accounts include the annual accounts of the Society and its subsidiary undertakings made up to 31 December 2017. The Society has 4 dormant subsidiaries none of which have traded in the year.

1.3 Interest

Interest income and expense are recognised in the income statement using the effective interest method. The 'effective interest rate' 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 Group 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 or issue of a financial asset or financial liability.

Interest income and expense presented in the income statement and other comprehensive income (OCI) 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 other derivatives held for risk management purposes, and other financial assets and financial liabilities carried at fair value through the income statement, are presented in net income from other financial instruments at fair value through the income statement and OCI.

1.4 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 1.3).

Other fees and commission income – including account servicing fees and sales commission are recognised as the related services are performed.

Other fees and commission expense relates mainly to commission earned on the sale of general insurance and is recognised over the life of the policy.

1.5 Expenses

Operating lease

Payments made under operating leases are recognised in the income statement account on a straight-line basis over the term of the lease unless the payments to the lessor are structured to increase in line with expected general inflation; in which case the payments related to the structured increases are recognised as incurred.

1.6 Taxation

Tax on the profit or loss 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 equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet 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.

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 balance sheet date. Deferred tax balances are not discounted. Unrelieved tax losses and other deferred tax assets are recognised only to the extent that is it probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

1.7 Financial instruments

Recognition

The Group initially recognises loans and advances and deposits on the date on which they are originated. All other financial instruments are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

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

Classification

Financial assets

The Group 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 Group 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 1.3).

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 and are measured at fair value after initial recognition.

Interest income is recognised in the income statement using the effective interest method (see 1.3). Impairment losses are recognised in the income statement.

Other fair value changes, other than impairment losses, are recognised in OCI and presented in the fair value reserve within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to the income statement.

At fair value through profit and loss

The Group designates some investment securities as at fair value, with fair value changes recognised immediately in the income statement.

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged. On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedged items, 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. The Group makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and assesses actual results periodically to confirm that the each hedge is highly effective.

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 the income statement. 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 the income statement using the effective interest method over the remaining life of the hedged item.

Financial liabilities

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or fair value through the income statement.

Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset 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 the income statement. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

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 Group measures the fair value of an instrument 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 ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique in corporates 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 the Group determines 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 the income statement 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 Group assesses whether there is objective evidence that financial assets not carried at fair value through the income statement 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 Group on terms that the Group 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.

The Group considers evidence of impairment for loans and advances 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 and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment, the Group uses historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated based on the weighted average interest rate of the relevant section of the mortgage book.

If the terms of a financial asset are renegotiated or modified due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised.

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.

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, payslips etc. in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with our 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 the income statement 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 the income statement. Impairment losses on available-for-sale investment securities are recognised by reclassifying the losses accumulated in the fair value reserve in equity to the income statement. The cumulative loss that is reclassified from equity to the income statement 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 the income statement. 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 the income statement; otherwise, any increase in fair value is recognised through OCI. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognised in OCI.

The Society has a closed portfolio of equity release mortgage loans, representing 3.6% of total Loans and advances to customers (2016: 3.6%). A particular clause of the mortgage contract meets the definition of an insurance contract, which is accounted for under FRS103, where a borrower dies or goes into long term care and a redemption receipt is less than the contractual sum owed the Society does not have any further ability to recover amounts from the borrower or the estate.

Under FRS102 the Society has continued to account for these mortgage contracts using its existing accounting policies. The mortgage contract has been classified as being not unbundled. The impact of assessing the contracts as being "not unbundled" is that the income earned on the mortgage contracts is not split between interest and insurance premium and that the mortgage asset is included within loans and advances at the present value of future cash flows.

Measurement and recognition of the income earned on the mortgage contract has been undertaken in line with the Society's other mortgage contracts; the income earned has been included in the Consolidated statement of comprehensive income within the 'Interest receivable and similar income' category. Within the Consolidated statement of financial position the mortgage asset (page 32), along with any impairment if there were any, is disclosed in line with IAS 39.

The insurance risk liability associated with the no-negative equity guarantee is calculated by estimating potential shortfalls arising at redemption, discounted at the effective interest rate, and is represented by the impairment provision. The assessment in corporates assumptions relating to future house price values at the time of account redemption. Its assessment is also based on expected future outcomes relating to the date on which an account redeems which, given the nature of the product is expected to be on death of the borrower, but can be affected by health issues that would see borrowers move into care; it can also be affected by non-health related voluntary pre-payment. No resulting insurance liability arises.

1.8 Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises Cash in hand, balances with the Bank of England 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.

The Statements of Cash Flows have been prepared using the indirect method.

1.9 Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation. 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.

The Group assesses at each reporting date whether any tangible fixed assets are impaired.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are as follows:

- Freehold buildings 50 years
- Fixtures, fittings, plant, equipment and vehicles 4 to 10 years

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 Group expects to consume an asset's future economic benefits.

1.10 Intangible assets

Computer software

The costs of computer software acquired where the group will derive future economic benefit are capitalised at the acquisition date.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives. Computer software is amortised from the date it is available for use. The estimated useful lives have been adjusted during the year to four years (previously five) based on historical experience.

The Group reviews the amortisation period and method when events and circumstances indicate that the useful life may have changed since the last reporting date.

1.11 Impairment excluding financial assets and deferred tax assets

The carrying amounts of the entity'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 the income statement. An impairment loss is reversed if and only if the reasons for the impairment have ceased to apply.

1.12 Employee benefits

The Group operates a group personal pension plan, the Society is the entity legally responsible for the plan. This is a defined contributions scheme. The Group recognises a cost equal to its contribution payable for the period.

2. Accounting estimates and judgements

As part of the preparation the Annual report and Accounts the Group makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on many factors including historical experience and expectations of future events that are believed to be reasonable under the circumstances.

These estimates and judgements are described below:

a) Impairment losses on loans and advances to customers

The Group reviews its loans and advances to customers on a regular basis to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and information from external data agencies.

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 methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any difference between loss estimates and actual loss experience. The impact of a 5% increase in the forced sale discount would impact provisions in 2017 by circa £0.2m.

b) Effective Interest Rate (EIR)

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement. Throughout the year, the expected life of mortgage assets is reassessed for reasonableness. A variation in the expected life of mortgage assets may result in an adjustment to the carrying value in the statement of financial position and to the timing of the recognition of interest income. A change in the life of the loan by an additional month would change the net carrying value of mortgage assets by circa £0.1m.

c) Financial Services Compensation Scheme (FSCS)

The Society has provision for a levy of £22,000 covering the period April 2017 to March 2018. The amount has been determined by reference to the expected path of future interest rates applicable at the balance sheet date. Changes in interest rates over the period of the levy will impact the final amount of the payment.

d) Fair value of derivatives and financial assets

The Group employs the following techniques in determining the fair value of its derivatives and financial assets: Available-for-sale – these are measured at fair value using market prices. The Group holds a portfolio of high quality liquid assets and certificates of deposits in its management of liquidity risk.

Derivative financial instruments – calculated by discounted cash flow models using yield curves that are based on observable market data. These assets are held by the Group in its management of interest rate risk. A change in the yield curve of 0.5% would change the net fair value of derivative financial instruments by circa £0.3m.

e) Pension rights equalisation

The Society holds a provision of £121k for part time pension equalisation rights relating to a small number of past and current staff Members. This amount has been adjusted to account for changes in expectations of eligibility and interest rates.

		GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
3.	**INTEREST RECEIVABLE AND SIMILAR INCOME**		
	On loans fully secured on residential property	6,625	7,356
	On other loans fully secured on land	474	560
	On debt securities:		
	Interest and amortisation of premiums	166	296
	Profit on disposal	83	67
	On other liquid assets		
	Interest	104	138
	Net interest expense on derivatives	(337)	(352)
	Total interest receivable and similar income	**7,115**	**8,065**
4.	**INTEREST PAYABLE AND SIMILAR CHARGES**		
	On shares held by individuals	1,834	2,643
	On other shares	39	55
	On deposits and other borrowings	53	150
	Net interest income on derivatives	(13)	(16)
	Total interest payable and similar income	**1,913**	**2,832**
5.	**FEES AND COMMISSION RECEIVABLE**		
	Loans and advances related	8	11
	Insurance commissions	38	44
	Other	9	29
	Total fees and commission receivable	**55**	**84**
6.	**NET GAINS/(LOSSES) FROM OTHER FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS**		
	Derivatives in designated fair value hedge relationships	369	(178)
	Adjustments to hedged items in fair value hedge accounting relationships	(264)	129
	Derivatives not in designated fair value hedge accounting relationships	(29)	(27)
	Total net gains/(losses) from other financial instruments at fair value through profit or loss	**76**	**(76)**
7.	**ADMINISTRATIVE EXPENSES**		
	Staff costs (note 8)	2,797	2,214
	Other administrative expenses	1,631	1,539
	Total administrative expenses	**4,428**	**3,753**
	Other administrative expenses include:		
	Remuneration of auditors (excluding VAT)		
	Statutory audit fees	68	85
	Other audit fees	4	5
	Operating lease costs in respect of land and buildings (note 29)	40	38

8. STAFF NUMBERS AND COSTS

The average number of persons employed (including executive Directors) during the year was as follows:

	GROUP & SOCIETY 2017		GROUP & SOCIETY 2016	
	Full time No.	Part time No.	Full time No.	Part time No.
Head office	31	10	31	7
Branch offices	18	18	16	19
	49	**28**	**47**	**26**

The aggregate costs of these persons were as follows:	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Wages and salaries	2,400	1,878
Social security costs	231	177
Other pension costs	166	159
	2,797	**2,214**

9. DIRECTORS' EMOLUMENTS FOR 2017

(a) Directors' Emoluments total £481,000 (2016: £419,000) with a further accrual for compensation for loss of office of £130,000 (2016: £nil). Full details of all Directors' remuneration are contained in the Directors' Remuneration Report on page 20.

(b) There are no Directors (2016: one) who have loans described in section 65 of the Building Societies Act. (2016: £162,527). In accordance with section 68 of the Building Societies Act 1986, the Society maintains a register which shows details of all loans, transactions and arrangements with Directors. A statement of the appropriate details contained in the register for the current financial year will be available for inspection at the Head Office for a period of 15 days up to and including the Society's Annual General Meeting.

10. TAX ON PROFIT ON ORDINARY ACTIVITIES

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Current tax:		
Current tax on income for the period	152	264
Adjustments in respect of prior periods	-	-
Total current tax	152	264
Deferred tax (see note 22):		
Origination and reversal of timing differences	5	4
Change in tax rate	(6)	(17)
Total deferred tax	**(1)**	**(13)**
Total tax	**151**	**251**

	GROUP & SOCIETY 2017			GROUP & SOCIETY 2016		
	Current tax £'000	Deferred tax £'000	Total tax £'000	Current tax £'000	Deferred tax £'000	Total tax £'000
Recognised in profit and loss account	152	(1)	151	264	(13)	251
Recognised in other comprehensive income	4	(23)	(19)	5	12	17
Total tax	**156**	**(24)**	**132**	**269**	**(1)**	**268**

10. TAX ON PROFIT ON ORDINARY ACTIVITIES continued

Reconciliation of effective tax rate:	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Profit for the year	618	1,053
Total tax expense	151	251
Profit excluding taxation	**769**	**1,304**
Tax using the UK corporation tax rate of 19.25% (2016: 20%)	148	261
Non-deductable expenses	9	7
Adjustments in respect of prior periods	(6)	(17)
Total tax expense included in profit and loss	**151**	**251**

The effective rate of tax applied to operating profit on ordinary activities is 19.64% (2016 - 19.25%). HMRC have announced corporation tax rate reductions commencing in 2020 and these have been used for calculating deferred taxation.

11. CASH AND CASH EQUIVALENTS

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Cash in hand and balances with the Bank of England	18,325	264
Loans and advances to credit institutions (see note 12)	14,474	20,393
Cash and cash equivalants per cash flow statement	**32,799**	**20,657**

12. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Loans and advances to credit institutions are repayable from the balance sheet date as follows:

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
On demand	14,474	20,393
In not more than three months	6,014	5,006
In more than three months but less than one year	6,005	4,009
In more than one year but less than five years	11	11
	26,504	**29,419**
Less provisions (see note 13)	(11)	(11)
Total loans and advances to credit institutions	**26,493**	**29,408**

13. PROVISIONS FOR LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Provision at 1 January	11	11
Released to the income and expenditure account	-	-
Provision at 31 December	**11**	**11**

Included within loans and advances to Credit Institutions, is a deposit to Heritable Bank plc with a carrying value at 31 December 2017 of £11,000 (2016: £11,000). Heritable Bank plc was placed into administration by UK authorities on 7 October 2009 at which time the Society had a deposit of £1m. As at 31 December 2017 the Society had received dividends totalling £989,000 (2016: £989,000). The Society has provided an amount of £11,000 on the basis of publicly available information and information contained within Administrators' Reports to the Creditors. At the date of signing the financial statements there remains uncertainty over any further amount of the recoverability and timing of these distributions. The Provision is sufficient to cover any potential losses.

14. DEBT SECURITIES

		GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
a)	Gilts	6,439	4,254
	Treasury bills	999	8,997
	Certificates of deposit	11,031	12,103
	Fixed rate notes	-	3,722
	Floating rate notes	5,919	5,919
		24,388	**34,995**
	Debt securities have the following maturities:		
	In not more than one year	14,048	24,126
	In more than one year but less than five years	10,340	10,869
		24,388	**34,995**
	Transferable debt securities comprise:		
	Listed on a recognised exchange	13,357	22,891
	Unlisted	11,031	12,104
		24,388	**34,995**

b) Movements in debt securities:

The Directors consider the securities held as liquid assets are held with the intention of use on a continuing basis in the Group's activities and are therefore classified as 'financial fixed assets' rather than current assets. Movements during the year of transferable securities held as 'financial fixed assets' (debt securities) are analysed as follows:

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
At 1 January	34,995	36,121
Additions	35,992	33,711
Disposals and maturities	(46,441)	(35,006)
Amortisation	126	143
Accrued interest	(168)	(82)
Net gains/(losses) from changes in fair value recognised in other comprehensive income	(116)	108
At 31 December 2017	**24,388**	**34,995**

15. DERIVATIVE FINANCIAL INSTRUMENTS

	GROUP & SOCIETY POSITIVE MARKET VALUE 2017 £'000	GROUP & SOCIETY NEGATIVE MARKET VALUE 2017 £'000
Derivatives designated as fair value hedges:		
Interest rate swaps	42	(196)
Derivatives not in hedge relationships:		
Interest rate swaps	2	(47)
	44	**(243)**

	GROUP & SOCIETY POSITIVE MARKET VALUE 2016 £'000	GROUP & SOCIETY NEGATIVE MARKET VALUE 2016 £'000
Derivatives designated as fair value hedges:		
Interest rate swaps	22	(546)
Derivatives not in hedge relationships:		
Interest rate swaps	-	(27)
	22	**(573)**

16. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers comprise;	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Loans fully secured on residential property	214,899	221,618
Fair value adjustment for hedge risk	161	419
Fair value adjusted loans fully secured on residential property	**215,060**	**222,037**
Loans fully secured on land	10,393	11,665
Fair value adjustment for hedge risk	1	-
Fair value adjusted loans fully secured on land	**10,394**	**11,665**
	225,454	**233,702**

The remaining maturity of loans and advances to customers from the reporting date is a follows:

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
On call or short notice	851	806
In not more than three months	1,406	1,629
In more than three months but not more than one year	7,800	6,658
In more than one year but not more than five years	42,688	43,336
In more than five years	172,853	181,249
Fair value adjustment for hedge risk	162	419
	225,760	**234,097**
Less: Impairment of Loans and advances to customers (Note 17)	(306)	(395)
	225,454	**233,702**

Note: the maturity analysis is based upon contractual maturity not expected redemption levels.

17. IMPAIRMENT LOSSES ON LOANS AND ADVANCE TO CUSTOMERS

	GROUP & SOCIETY 2017		
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	TOTAL £'000
At 1 January 2017			
Collective impairment	112	92	204
Individual impairment	123	68	191
	235	**160**	**395**
Income and expenditure account			
Collective impairment	42	(47)	(5)
Individual impairment	(31)	(40)	(71)
	11	**(87)**	**(76)**
Amount written off during the year			
Collective impairment	-	-	-
Individual impairment	(13)	-	(13)
	(13)	**-**	**(13)**
At 31st December 2017			
Collective impairment	154	45	199
Individual impairment	79	28	107
	233	**73**	**306**

There we no loans written off during the year or net credits in respect of additional costs and recoveries against loans which had been written off in prior years.

17. IMPAIRMENT LOSSES ON LOANS AND ADVANCE TO CUSTOMERS continued

	GROUP & SOCIETY 2016		
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	TOTAL £'000
At 1 January 2016			
Collective impairment	113	121	234
Individual impairment	161	106	267
	274	**227**	**501**
Income and expenditure account			
Release for the year			
Collective impairment	(1)	(29)	(30)
Individual impairment	(19)	(38)	(57)
	(20)	**(67)**	**(87)**
Amount written off during the year			
Collective impairment	-	-	-
Individual impairment	(19)	-	(19)
	(19)	-	**(19)**
At 31st December 2016			
Collective impairment	112	92	204
Individual impairment	123	68	191
	235	**160**	**395**

Please refer to note 31 (pages 53-55) for more information on the credit risk associated with the Loans and advances to customers, the Group's approach to mitigating against this risk and analysis of the portfolio.

18. FIXED ASSET INVESTMENTS

	SHARES £
Subsidiary undertakings - Society	
Cost at 1 January 2017	8
Investments	-
Cost at 31 December 2017	**8**

Principal group investments

The Group have investments in the following subsidiary undertakings, associates and other significant investments.

Direct	Country of Registration*	Principal Activity	Class of Shares	Interest of Society
Vernon Financial Services Limited	England	Dormant	Ordinary	100%
Vernon Estates Limited	England	Dormant	Ordinary	100%
Vernon Property Services Limited	England	Dormant	Ordinary	100%
The Mortgage Gateway Limited	England	Dormant	Ordinary	100%

*All Group companies are registered at 19 St Petersgate, Stockport SK1 9HF.

19. TANGIBLE FIXED ASSETS

	GROUP & SOCIETY			
Cost	LAND & BUILDINGS FREEHOLD £'000	PLANT & MACHINERY £'000	EQUIPMENT FIXTURES FITTINGS & VEHICLES £'000	TOTAL £'000
At 1 January 2017	1,428	625	1,196	3,249
Additions	46	-	25	71
Disposals	-	-	(24)	(24)
At 31 December 2017	**1,474**	**625**	**1,197**	**3,296**
Accumulated depreciation				
At 1 January 2017	324	615	893	1,832
Charged in year	21	5	140	166
Disposals	-	-	(24)	(24)
At 31 December 2017	**345**	**620**	**1,009**	**1,974**
Net book value				
At 31 December 2017	**1,129**	**5**	**188**	**1,322**
At 31 December 2016	1,104	10	303	1,417

The net book value of land and buildings occupied by the Group and Society for its own activities as at 31 December 2017 was £1,129,000. (2016: £1,104,000).

20. INTANGIBLE FIXED ASSETS

	GROUP & SOCIETY
Cost	AQUIRED SOFTWARE £'000
At 1 January 2017	257
Additions	40
Disposals	-
At 31 December 2017	**297**
Accumulated amortisation	
At 1 January 2017	241
Charged in year	14
Disposals	-
At 31 December 2017	**255**
Net book value	
At 31 December 2017	**42**
At 31 December 2016	16

21. OTHER ASSETS

	GROUP 2017 £'000	SOCIETY 2017 £'000	GROUP 2016 £'000	SOCIETY 2016 £'000
Other assets due within one year comprise:				
Amounts due from subsidiary undertaking	-	9	-	9
Other assets	19	19	38	38
	19	**28**	**38**	**47**

Other assets include an amount of £nil not repayable for more than one year (2016:£nil).

22. DEFERRED TAX

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
At 1 January	(13)	(14)
Credit to profit and loss account	1	13
Charge / credit to other comprehensive income	23	(12)
At 31 December	**11**	**(13)**

Deferred tax assets and liabilities are attributable to the following items:

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Deferred tax assets		
Difference between accumulated depreciation and amortisation and capital allowances	-	(34)
Differences arising from transition to new GAAP	26	23
Other timing differences	20	28
	46	**17**
Deferred tax liabilities		
Other timing differences	(25)	-
Differences arising from transition to new GAAP	(10)	(30)
	(35)	**(30)**
At 31 December	**11**	**(13)**

Deferred tax assets and liabilities are offset only where the Group has a legally enforceable right to set off current tax assets against current tax liabilities and where the assets and liabilities relate to income taxes levied by the same taxation authority on the same taxable entity, or another entity within the group. During 2015 the Group transitioned to FRS 102 from former UK GAAP which crystalised timing differences relating to taxation in the form of deferred tax adjustments. These adjustments are amortised over 10 years.

23. PREPAYMENTS AND ACCRUED INCOME

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Prepayments	440	351
Accrued income	2	2
	442	**353**

24. SHARES

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Shares comprise:		
Held by individuals	251,646	249,949
Other shares	6,223	10,531
Fair value adjustments for hedged risk	9	2
	257,878	**260,482**

24. SHARES continued

Shares are repayable with the remaining maturities from the balance sheet date as follows:	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
On call or short notice	239,810	239,088
In not more than three months	4,926	6,120
In more than three months but not more than one year	13,133	13,835
In more than one year but not more than five years	-	1,437
Fair value adjustment for hedged risk	9	2
	257,878	**260,482**

25. AMOUNTS OWED TO CREDIT INSTITUTIONS

With agreed maturity dates or periods of notice:	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
In not more than three months	5,508	3,508
In more than three months but not more than one year	-	3,007
	5,508	**6,515**

26. AMOUNTS OWED TO OTHER CUSTOMERS

With agreed maturity dates or periods of notice:	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Repayable on demand	9,939	6,616
In not more than three months	300	3,813
In more than three months but not more than one year	-	-
	10,239	**10,429**

27. OTHER LIABILITIES

Other liabilities are all due within one year and comprise:	GROUP 2017 £'000	SOCIETY 2017 £'000	GROUP 2016 £'000	SOCIETY 2016 £'000
Amounts owed to subsidiary undertaking	-	62	-	62
Corporation tax	158	158	269	269
Other creditors	182	182	228	228
	340	**402**	**497**	**559**

From April 2017 income tax is no longer withheld on interest payable on shares and deposits.

28. PROVISIONS FOR LIABILITIES

	GROUP & SOCIETY		
	PENSION RIGHTS EQUALISATION £'000	FSCS LEVY £'000	TOTAL £'000
Balance at 1 January 2017	164	47	211
Provisions made during the year	(43)	20	(23)
Provisions utilised during the year	-	(45)	(45)
Balance at 31 December 2017	**121**	**22**	**143**

Pension Rights Equalisation

There is a historic position where some employees were not part of the pension scheme who may have been eligible retrospectively. The amount of the pension is subjective due to the complex interrelationship between personal and statutory pension provisions so management have made an assessment as to the potential quantity of the liability if it crystallised.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) makes annual levies on all regulated UK deposit-takers in relation to its running expenses (the management expenses levy) and any compensation claims makes against it (the compensation levy). The levies for each deposit-taker are based on its share of the total of protected deposits.

The management expenses levy includes the cost of interest on sums borrowed by the FSCS from the Bank of England, and eventually HM Treasury, in order to fund the exceptional compensation payments arising from deposit-taker failures during 2008 and 2009. Levies were made in relation to Bradford and Bingley plc, the U.K retail deposit taking arms of Icelandic banks (Heritable, Kaupthing Edge and Icesave) London Scottish Bank plc and Dunfermline Building Society.

Interest is charged on each outstanding loan at the higher of 12 months LIBOR plus 100 basis points and the relevant gilt rate published by the Debt Management Office, on which the management expenses levies for scheme years 2016 and 2017 have been based.

29. OPERATING LEASES

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Non-cancellable operating lease rentals are payable as follows:		
Less than one year	36	48
Between one and five years	43	79
	79	**127**

During the year £40,000 was recognised as an expense in the profit and loss account in respect of operating leases (2016: £38,000).

30. PENSIONS

The Group makes contributions to a defined contribution group personal pension plan for all qualifying staff.
The charge for the year was £166,000 (2016: £159,000)

A provision in respect of the equalisation rights under the former defined benefits scheme is shown in note 28.

31. FINANCIAL INSTRUMENTS

A financial instrument is a contract that gives rise to a financial asset or a financial liability. The Group is a retailer of financial instruments, mainly in the form of mortgage and savings products, however the Group also uses other financial instruments to invest liquid asset balances and raise wholesale funding. The Group also uses derivative financial instruments ('derivatives') to manage the risks arising from its operations.

The financial risks arising from the Group's activities include liquidity, interest rate and credit risk. The society also is exposed to capital risk, and the policies and processes for managing this is outlined in the strategic report on pages 6-9. The Board reviews and agrees policies for managing each of these risks, which include the establishment of the Group's risk appetite, risk limits, clear reporting lines and other controls. In addition, the Group's Asset and Liabilities Committee (ALCO) monitors the financial risks relating to the financial instruments held as well as funding and liquidity, in line with the Group's prudent policy statements. The ALCO also ensures that the management of retail credit risk is consistent with the credit risk appetite.

The Group does not hold derivatives for trading or speculative purposes but uses them for hedging purposes only in accordance with the Building Society Act 1986, specifically to limit the interest rate exposure that arises with the provision of fixed rate mortgage and savings products. The Group employs interest rate swap contracts to manage the interest rate risks as summarised below:

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

The fair value of these hedges are shown in note 15.

Categories of financial asset and liabilities

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1.7 'Financial instruments' 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 Group's assets and liabilities by financial classification:

CARRYING VALUES BY CATEGORY 31 DECEMBER 2017	HELD AT AMORTISED COST		HELD AT FAIR VALUE			
Group	LOANS AND RECEIVABLES £'000	FINANCIAL LIABILITIES AT AMORTISED COST £'000	AVAILABLE FOR SALE £'000	DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES £'000	UNMATCHED DERIVATIVES £'000	TOTAL £'000
Financial assets						
Cash in hand	295	-	-	-	-	295
Balances with the Bank of England	18,030	-	-	-	-	18,030
Loans and advances to credit institutions	26,493	-	-	-	-	26,493
Debt securities	-	-	24,388	-	-	24,388
Derivative financial instruments	-	-	-	32	12	44
Loan and advances to customers	225,454	-	-	-	-	225,454
Total financial assets	**270,272**	**-**	**24,388**	**32**	**12**	**294,704**
Non financial assets	1,871	-	-	-	-	1,871
Total assets	**272,143**	**-**	**24,388**	**32**	**12**	**296,575**
Financial liabilities						
Shares	-	257,878	-	-	-	257,878
Amounts owed to credit institutions	-	5,508	-	-	-	5,508
Amounts owed to other customers	-	10,239	-	-	-	10,239
Derivative financial instruments	-	-	-	196	47	243
Total financial liabilities	**-**	**273,625**	**-**	**196**	**47**	**273,868**
Non financial liabilities	-	874	-	-	-	874
Total liabilities	**-**	**274,499**	**-**	**196**	**47**	**274,742**

31. FINANCIAL INSTRUMENTS continued

Categories of financial asset and liabilities continued

CARRYING VALUES BY CATEGORY 31 DECEMBER 2016	HELD AT AMORTISED COST		HELD AT FAIR VALUE			
Group	LOANS AND RECEIVABLES £'000	FINANCIAL LIABILITIES AT AMORTISED COST £'000	AVAILABLE FOR SALE £'000	DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES £'000	UNMATCHED DERIVATIVES £'000	TOTAL £'000
Financial assets						
Cash in hand	264	-	-	-	-	264
Loans and advances to credit institutions	29,408	-	-	-	-	29,408
Debt securities	-	-	34,995	-	-	34,995
Derivative financial instruments	-	-	-	22	-	22
Loan and advances to customers	233,702	-	-	-	-	233,702
Total financial assets	**263,374**	**-**	**34,995**	**22**	-	**298,391**
Non financial assets	1,841	-	-	-	-	1,841
Total assets	**265,215**	**-**	**34,995**	**22**	-	**300,232**
Financial liabilities						
Shares	-	260,482	-	-	-	260,482
Amounts owed to credit institutions	-	6,515	-	-	-	6,515
Amounts owed to other customers	-	10,429	-	-	-	10,429
Derivative financial instruments	-	-	-	546	27	573
Total financial liabilities	**-**	**277,426**	**-**	**546**	**27**	**277,999**
Non financial liabilities	-	921	-	-	-	921
Total liabilities	**-**	**278,347**	**-**	**546**	**27**	**278,920**

At the year end the Group has loan commitments of £10.5m (2016: £6.7m) measured at cost less impairment.

31. FINANCIAL INSTRUMENTS continued

Valuation of financial Instruments continued

Financial instruments carried at fair value

The table below summarises the fair values of the Group's financial assets and liabilities that are accounted for at fair value and are grouped into levels (1 and 2) to reflect the significance of the inputs in measuring fair value:

Level 1

Observable market prices have been used to determine the fair value of the debt securities.

Level 2

The fair value for the interest rate swaps have been determined using generally observable LIBOR yield curves derived from quoted interest rates which match the timings of the cash flows and maturities of the instruments.

Group & Society

31 December 2017

	LEVEL 1 £'000	LEVEL 2 £'000	TOTAL £'000
Financial assets			
Available-for-sale			
Debt securities	24,388	-	24,388
Fair value through the comprehensive income			
Derivative financial assets	-	44	44
	24,388	**44**	**24,432**
Financial liabilities			
Fair value through the comprehensive income			
Derivative financial liabilities	-	243	243
	-	**243**	**243**

31 December 2016

	LEVEL 1 £'000	LEVEL 2 £'000	TOTAL £'000
Financial assets			
Available-for-sale			
Debt securities	34,995	-	34,995
Fair value through the comprehensive income			
Derivative financial assets	-	22	22
	34,995	**22**	**35,017**
Financial liabilities			
Fair value through the comprehensive income			
Derivative financial liabilities	-	573	573
	-	**573**	**573**

31. FINANCIAL INSTRUMENTS continued

Credit Risk

Credit risk is the risk that counterparties will not meet their obligations as they fall due. All loan applications are assessed with reference to the Society's lending policy.

Treasury counterparties are approved and monitored by the Board.

The Group operates an experienced credit risk function, driven by the need to manage the potential and actual risk both currently and in the future. Through this, any variations in risk resulting from market, economic or competitive changes are identified and appropriate controls and strategies are implemented.

The Group's maximum credit exposure is detailed below:

	GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Cash in hand	295	264
Balances with the Bank of England	18,030	-
Loans and advances to credit institutions	26,493	29,408
Debt securities	24,388	34,995
Derivative financial instruments	44	22
Loans and advances to customers	225,454	233,702
Total statement of financial position exposure (1)	**294,704**	**298,391**
Off balance sheet exposure: mortgage commitments (2)	10,461	6,712
Total	**305,165**	**305,103**

(1) All values are stated at balance sheet amounts. (2) This reflects business that has been formally offered but has not yet completed.

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

The Society holds various investments in order to meet current and future liquidity regulatory requirements, as well as to satisfy operational demand. Credit risk arises due to factors such as deterioration in the counterparty's financial health and wider uncertainty within the market. Credit risk relating to treasury investments and derivative hedges is managed through setting strict upper and lower limits to each type of investment that are dependant on criteria such as, time to maturity, credit rating and originating country. These limits are set by ALCO, approved by the Board and monitored by the treasury team on a continuous basis.

Comprehensive management information on movement and performance within the treasury asset portfolios ensures that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance.

There has been no change in the year to the manner in which the Group manages and measures treasury related credit risk.

An analysis of the Group's treasury concentration is shown in the tables below:

Group & Society **Industry sector**	2017 £'000	2017 %	2016 £'000	2016 %
Unrated Building Societies	12,019	33.19%	9,015	20.74%
Rated Banks & Building Societies	10,832	29.92%	11,552	26.58%
Multinational Development Banks	5,919	16.35%	9,641	22.18%
Central Government	7,438	20.54%	13,251	30.49%
Total	**36,208**		**43,459**	

31. FINANCIAL INSTRUMENTS continued

Credit Risk continued

Treasury exposures broken down by Fitch ratings:

		GROUP & SOCIETY 2017 £'000	GROUP & SOCIETY 2016 £'000
Credit Grades	AAA - AA	13,347	22,846
	A+ - A	6,829	10,627
	BBB+	4,013	972
	Unrated	12,019	9,014
	Total	**36,208**	**43,459**

'Unrated' relates to investments in unrated Building Societies.

At 31 December 2017 none of the Group's treasury portfolio exposure was either past due or impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The largest exposure to a single institution other than the UK Government is £5.9m (2016 - £9.6m).

The Majority of treasury assets held by the Group are with counterparties based within the United Kingdom such a the UK Government and UK Banks and Building Societies. The Group also holds assets issued by a Multinational Development Bank located in Luxembourg.
The Group does not have exposure to foreign exchange risk as all treasury assets are denominated in Sterling.

All derivative assets are issued by UK based credit institutions. The Group prefers to document its derivative activity via the International Swaps and Derivatives Association ('ISDA') Master Agreement.

Loans and advances to customers

The Group is committed to mitigating risk through all stages of the lending cycle. The Group monitors customer affordability and the LTV percentages of all loans at the application stage. Additionally the group employs underwriting and fraud detection policies to minimise losses once loans have been approved as well as taking a proactive approach to the monitoring and treatment of impaired loans through the collections and recovery functions.

The Group maintains comprehensive management information on the performance and movements within the various loans portfolios to ensure that credit risk is adequately controlled, and any adverse trends are identified before they impact on performance. Group performance is benchmarked against the industry when appropriate to identify any outlying trends. This management information is distributed throughout the Group and monitored at a Board committee level.

The table below provides further information on the Group's loans and advances to customers by payment due status as at 31 December 2017, and the allowance for impairment held by the Group against those assets. The balances exclude the fair value adjustment for hedge risk and impairment losses. Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely (for example when loans are past due) or the property is in possession, or where fraud or negligence has been identified. Further consideration is given in accounting policy 1.7 to the accounts.

Group & Society - Arrears analysis	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	LOANS FULLY SECURED ON LAND 2017 £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2016 £'000	LOANS LLY SECURED ON LAND 2016 £'000
Collectively assessed for impairment				
Not past due	210,027	9,607	215,471	10,560
Past due up to one month	2,165	153	845	515
Total collectively assessed for impairment	**212,192**	**9,760**	**216,316**	**11,075**
Individually assessed for impairment				
Not past due	957	398	901	437
Past due between 1 to 3 months	828	76	1,805	-
Past due between 3 to 6 months	131	-	335	-
Past due between 6 to 9 months	158	-	107	-
Past due between 9 to 12 months	278	-	400	-
Past due over 12 months	319	160	2,053	153
Possession	197	-	120	-
Total individually assessed for impairment	**2,868**	**634**	**5,721**	**590**
Loans and advances to customers	**215,060**	**10,394**	**222,037**	**11,665**
Allowance for impairment				
Collective	154	45	112	92
Individual	79	28	123	68
Total allowance for impairment	**233**	**73**	**235**	**160**

31. FINANCIAL INSTRUMENTS continued

Credit Risk continued

Fair value of collateral held

The Group holds collateral against each loan and advance in the form of property. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

The tables below stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in the Nationwide house price indices.

The indexed loan-to-value analysis on the Group's loan portfolio is as follows:

Group & Society	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	LOANS FULLY SECURED ON LAND 2017 £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2016 £'000	LOANS FULLY SECURED ON LAND 2016 £'000
LTV ratio				
Less than 50%	107,186	5,313	104,776	5,218
51 - 80%	94,637	5,082	100,199	6,447
81 - 90%	10,296	-	14,947	-
91 - 95%	2,020	-	1,387	-
95 - 100%	707	-	121	-
Over 100%	48	-	188	-
Total loans	**214,894**	**10,395**	**221,618**	**11,665**

Group & Society	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND 2017 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2016 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND 2016 £'000
Collectively assessed for impairment	657,364	28,436	654,200	32,491
Individually assessed for impairment:				
Not passed due	2,016	670	1,505	670
Passed due up to 6 months	2,600	163	6,216	-
Past due over 6 months	1,636	530	5,491	540
Total collateral value	**663,616**	**29,799**	**667,412**	**33,701**

The overall indexed loan-to-value of the residential portfolio is 32.38% (2016: 33.21%).
At the year end there was one case of possession of assets held as collateral against loans and advances (2016: One).

Forbearance strategies

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that customers are treated fairly. Such forbearance strategies include the use of arrangements or renegotiation of covenants to assist borrowers in arrears who are not able to meet agreed repayment strategies, including or excluding arrears balances. Forbearance strategies aim to avoid repossession.

The tables below provides further information on loans existing at the 2017 and 2016 reporting periods by types of account renegotiations applied to our customers over the past 12 months. This includes renegotiations where there is an instance for forbearance in repaying their loan with the Group.

Group & Society 31 December 2017	PARTIAL PAYMENTS £'000	INTEREST ONLY £'000	TOTAL FORBEARANCE £'000
Past due up to 3 months	95	-	95
Past due more than 3 months	58	138	196
Possessions	-	-	-
	153	**138**	**291**

31. FINANCIAL INSTRUMENTS continued

Credit Risk continued

Forbearance strategies continued

Group & Society 31 December 2016	PARTIAL PAYMENTS £'000	INTEREST ONLY £'000	TOTAL FORBEARANCE £'000
Past due up to 3 months	148	136	284
Past due more than 3 months	33	191	224
Possessions	-	-	-
	181	**327**	**508**

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

LIQUIDITY RISK

'Liquidity risk' is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's liquidity policy is to maintain sufficient funds in a liquid form at all times to ensure that it can meet its liabilities as they fall due. The objective of liquidity is to help smooth mismatches between maturing assets and liabilities and to provide protection against any unexpected events that may occur.

Liquidity is monitored daily and reported to the ALCO on a weekly basis. The Group's liquidity policy is designed to provide the Group with the resources to withstand a range of stressed scenarios. A number of appropriate stressed scenarios have been identified as part of the Group's liquidity risk management. The scenarios developed include idiosyncratic, market-wide and combination stress tests, fulfilling the specific requirements of the Prudential Regulatory Authority ('PRA').

The Group's liquid resources comprise high quality liquid assets such as Treasury Bills, Gilts and investment grade fixed and floating notes issued by highly rated Multinational Development Banks. At the year end the percentage of total shares and deposits held in these high quality liquid assets was 4.88% (2016: 8.25%). In addition the Group also held deposits with UK banks and portfolio's of certificates of deposits ('CDs') and time deposits ('TDs') with other financial institutions. When taking the bank deposits, CDs and TDs into account the percentage of total shares and deposits held in liquidity resources was 25.22% (2016: 23.31%).

Maturity analysis for financial assets and financial liabilities

The tables below set out the remaining contractual maturities of the Group's financial liabilities and financial assets. In practice, contractual maturities are not a reflection of actual experience and therefore is not representative of the Group's management of liquidity. For example the contractual term for the majority of the loans and advances to customers range from 10-30 years, however these tend to repay ahead of contractual maturity, with the average life of a loan under 4 years. Conversley customer deposits (for example shares) repayable on demand are likely to remain on balance sheet much longer.

Group & Society Residual maturity as at 31 December 2017	ON DEMAND £'000	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	MORE THAN FIVE YEARS £'000	TOTAL £'000
Financial assets						
Cash in hand	295	-	-	-	-	295
Balances with the Bank of England	18,030	-	-	-	-	18,030
Loans and advances to credit institutions	14,474	6,014	6,005	-	-	26,493
Debt securities	-	4,015	10,033	10,340	-	24,388
Total liquid assets	**32,799**	**10,029**	**16,038**	**10,340**	**-**	**69,206**
Derivative financial instruments	-	-	3	41	-	44
Loans and advances to customers	851	1,406	7,836	42,814	172,547	225,454
Total financial assets	**33,650**	**11,435**	**23,877**	**53,195**	**172,547**	**294,704**
Financial liabilities						
Shares	239,810	4,926	13,142	-	-	257,878
Amounts owed to credit institutions	-	5,508	-	-	-	5,508
Amounts owed to other customers	9,939	300	-	-	-	10,239
Derivative financial instruments	-	8	52	183	-	243
Total financial liabilities	**249,749**	**10,742**	**13,194**	**183**	**-**	**273,868**
Net liquidity gap	**(216,099)**	**693**	**10,683**	**53,012**	**172,547**	**20,836**

31. FINANCIAL INSTRUMENTS continued

LIQUIDITY RISK continued

Maturity analysis for financial assets and financial liabilities continued

Group & Society
Residual maturity as at 31 December 2016

	ON DEMAND £'000	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	MORE THAN FIVE YEARS £'000	TOTAL £'000
Financial assets						
Cash in hand	264	-	-	-	-	264
Loans and advances to credit institutions	20,393	5,006	4,009	-	-	29,408
Debt securities	-	15,070	9,056	10,869	-	34,995
Total liquid assets	**20,657**	**20,076**	**13,065**	**10,869**	**-**	**64,667**
Derivative financial instruments	-	2	1	19	-	22
Loans and advances to customers	806	1,629	6,658	43,365	181,244	233,702
Total financial assets	**21,463**	**21,707**	**19,724**	**54,253**	**181,244**	**298,391**
Financial liabilities						
Shares	239,087	6,120	13,835	1,440	-	260,482
Amounts owed to credit institutions	-	3,508	3,007	-	-	6,515
Amounts owed to other customers	6,616	3,813	-	-	-	10,429
Derivative financial instruments	-	15	55	503	-	573
Total financial liabilities	**245,703**	**13,456**	**16,897**	**1,943**	**-**	**277,999**
Net liquidity gap	**(224,240)**	**8,251**	**2,827**	**52,310**	**181,244**	**20,392**

At the year end the Group has pledged £200,000 of loans and advances to credit institutions as collateral with respect to the interest rate hedges held (2016: £525,000). All remaining Group liquid assets are unencumbered as at the balance sheet date.

The tables below sets out maturity analysis for financial liabilities that shows the remaining contractual maturities at undiscounted amounts. 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.

Group & Society 31 December 2017

	ON DEMAND £'000	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	MORE THAN FIVE YEARS £'000	TOTAL £'000
Shares	239,810	4,932	13,225	-	-	257,967
Amounts owed to credit institutions	-	5,513	-	-	-	5,513
Amounts owed to other customers	9,939	300	-	-	-	10,239
Derivative financial instruments	-	7	42	323	-	372
Total financial liabilities	**249,749**	**10,752**	**13,267**	**323**	**-**	**274,091**

Group & Society 31 December 2016

	ON DEMAND £'000	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	MORE THAN FIVE YEARS £'000	TOTAL £'000
Shares	239,088	6,131	13,947	1,468	-	260,634
Amounts owed to credit institutions	-	3,510	3,019	-	-	6,529
Amounts owed to other customers	6,616	3,816	-	-	-	10,432
Derivative financial instruments	-	18	40	542	-	600
Total financial liabilities	**245,704**	**13,475**	**17,006**	**2,010**	**-**	**278,195**

31. FINANCIAL INSTRUMENTS continued

MARKET RISK

'Market risk' is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market prices comprise three types of risk; currency risk, interest rate risk and other price risk. As the Group is not exposed to foreign currencies the primary risk associated with market prices comes from interest rate risk.

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Society manages this exposure continually within approved limits by using financial instruments.

INTEREST RATE RISK

The Group has adopted the 'Matched' approach to interest rate risk, as defined by the PRA, operating within the exemptions permitted within section 9A of the 1986 Act. The 'Matched' approach aims to use 'standard' hedging instruments to manage the interest rate risks associated with offering fixed rate retail products, as detailed within the opening paragraph to this note. 'Standard' instruments include interest rate swaps and plain vanilla 'over the counter' ('OTC') derivatives.

The group's interest risk management includes a regular review of the product to hedge instrument matches by senior management supported by monthly review by the ALCO and the board. In addition interest rate gap analysis is performed on a monthly basis and presented to the ALCO.

The analysis below summaries the Group's exposure to interest rate risk. The tables present the Group's assets and liabilities by repricing date, along with the derivatives financial instruments that are used to reduce the exposure to interest rate risk.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and financial liabilities to various standard and non-standard interest rate scenarios. The analysis below therefore also an interest rate sensitivity assessment to represents market value movement, calculated using a discounted cash flow basis on all of the Society's financial assets and liabilities. The sensitivity analysis is based on immediate 100 and 200 basis point parallel shifts in interest rates. All exposures include investments of the Group's reserves. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics; say LIBOR and Bank of England Base Rate) and prepayment risk (the risk of loss arising from early repayments of fixed rate mortgages and loans) are also monitored closely and regularly reported to the ALCO.

Group interest rate risk at 31 December 2017	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	NON-INTEREST BEARING £'000	TOTAL £'000
Assets					
Financial assets					
Cash in hand	-	-	-	295	295
Balances with the Bank of England	18,030	-	-	-	18,030
Loans and advances to credit institutions	20,474	6,000	-	19	26,493
Debt securities	9,914	10,004	4,393	77	24,388
Derivative financial instruments	-	-	-	44	44
Loans and advances to customers	190,227	6,983	28,388	(144)	225,454
Other assets	-	-	-	1,871	1,871
Total assets	**238,645**	**22,987**	**32,781**	**2,162**	**296,575**
Liabilities and reserves					
Shares	243,623	13,094	-	1,161	257,878
Amounts owed to credit institutions	5,499	-	-	9	5,508
Amounts owed to other customers	10,227	-	-	12	10,239
Derivative financial instruments	-	-	-	243	243
Other liabilities	-	-	-	874	874
Reserves	-	-	-	21,833	21,833
Total liabilities and reserves	**259,349**	**13,094**	**-**	**24,132**	**296,575**
Impact of derivative instruments	22,955	4,310	(27,265)	-	-
Interest rate sensitivity gap	**2,251**	**14,203**	**5,516**	**(21,970)**	**-**
Sensitivity to profit and loss reserves					
Parallel shift of +1%	(3)	(87)	(157)	-	(247)
Parallel shift of +2%	(6)	(173)	(308)	-	(487)

31. FINANCIAL INSTRUMENTS continued

MARKET RISK continued

INTEREST RATE RISK continued

GROUP

Interest rate risk at 31 December 2016

	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	NON-INTEREST BEARING £'000	TOTAL £'000
Assets					
Cash in hand	-	-	-	264	264
Loans and advances to credit institutions	25,393	4,000	-	15	29,408
Debt securities	20,917	9,004	4,829	245	34,995
Derivative financial instruments -	-	-	-	22	22
Loans and advances to customers	198,432	5,392	29,854	24	233,702
Other assets	-	-	-	1,841	1,841
Total assets	**244,742**	**18,396**	**34,683**	**2,411**	**300,232**
Liabilities and reserves					
Shares	241,985	15,413	1,423	1,661	260,482
Amounts owed to credit institutions	3,500	3,000	-	15	6,515
Amounts owed to other customers	10,387	-	-	42	10,429
Derivative financial instruments	-	-	-	573	573
Other liabilities	-	-	-	921	921
Reserves	-	-	-	21,312	21,312
Total liabilities and reserves	**255,872**	**18,413**	**1,423**	**24,524**	**300,232**
Impact of derivative instruments	18,695	8,920	(27,615)	-	-
Interest rate sensitivity gap	**7,565**	**8,903**	**5,645**	**(22,113)**	**-**
Sensitivity to profit and loss reserves					
Parallel shift of +1%	(9)	(55)	(162)	-	(226)
Parallel shift of +2%	(19)	(109)	(318)	-	(446)

There is no material difference between the risk profile for the Group and that for the Society.

Derivatives held for risk management

The Group uses derivatives designated to manage certain risks it faces in accordance with section 9A of the Building Societies Act 1986. In particular the Group employs 'fair value hedges' in the form of interest rate swaps to manage the exposure to interest rate risk inherent when providing fixed rate retail products. The interest rate swaps essentially hedge the exposure to changes in the fair values of the fixed products supplied by the Group, driven by changes in market interest rates.

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

The fair values of derivatives designated as fair value hedges are as follows.

Group & Society	2017 ASSETS £'000	2017 LIABILITIES £'000	2016 ASSETS £'000	2016 LIABILITIES £'000
Interest rate swap	42	196	22	546

Interest rate swaps are matched to specific issuances of fixed rate retail shares or loans.
All hedges are supported by comprehensive hedging documentation as per the requirement in FRS 102.
The Group utilises the derivative instruments for hedging purposes only and no such instruments are used for trading activity or speculative purposes.
All fair value hedges are against 3 month LIBOR.

Other price risk

Other price risk is the risk resulting from the possibility that the price of a security may decline. The Group's policy is to have no material exposure to equity markets. Any exposures arising from the Group's products are eliminated as far as it is practicable by appropriate hedging contracts.

32. RELATED PARTY TRANSACTIONS

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity'). This note discloses any related parties to the Society and any transactions that may have taken place.

Transactions with Group entities

The Society is the parent entity to four dormant entities as disclosed within note 18. There have not been any transactions with these entities during the current or comparative periods.

Transactions with key personnel

The Group ensures that its business activities are carried out at arms length. Controls are in place to ensure that related parties are identified, such as the review of vendors at onboarding, and declarations made by Directors of the Group to prevent potential conflicts of interests.

The table below summarises the current related party transactions for the Group and Society:

	2017 Number of key personnel and their close family members	**2017** Amounts in respect of key personnel and their close family members £'000	2016 Number of key personnel and their close family members	2016 Amounts in respect of key personnel and their close family members £'000
Loans and advances to customers	3	544	3	511

Country by Country reporting for the year ended 31 December 2017

Article 89 of the Capital Requirements Directive IV (CRD IV) requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the information shown below on a consolidated basis by 31 December 2017. Vernon Building Society meets the definition of a 'credit institution' and is classified within the retail banking category. It is registered and trades solely in the United Kingdom.

	2017	**2016**
Number of employees (full time equivalent)	60	57
Turnover £m (1)	5.20	5.23
Pre-tax profit £m	0.77	1.30
Corporation tax paid £m (2)	0.27	0.27
Public subsidies received	Nil	Nil

1) Turnover is defined as total income (net interest receivable and net fee/commission income) in accordance with guidance from UK Treasury.
2) Corporation tax paid in 2017 is in respect of the results for the year ended 31 December 2016.

Independent auditor's report to the Directors of the Vernon Building Society.

We have audited the accompanying schedule of Vernon Building Society for the year ended 31 December 2017 ("the schedule"). The schedule has been prepared by the directors based on the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Directors' Responsibility for the schedule

The directors are responsible for the preparation of the schedule in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013, for the appropriateness of the basis of preparation and the interpretation of the Regulations as they affect the preparation of the schedule, and for such internal control as the directors determine is necessary to enable the preparation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

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

Opinion

In our opinion, the country-by-country information in the schedule as at 31 December 2017 is prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Basis of Preparation and Restriction on Distribution

Without modifying our opinion, we draw attention to the Basis of Preparation and Restriction on Distribution within the schedule, which describes the basis of preparation. The schedule is prepared to assist the directors to meet the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. As a result, the schedule may not be suitable for another purpose.

Our report is intended solely for the benefit of the directors of Vernon Building Society. We do not accept or assume any responsibility or liability to any other party save where terms are agreed between us in writing.

PricewaterhouseCoopers LLP
Chartered Accountants
7 March 2018
Manchester, UK

1. STATUTORY PERCENTAGES

	2017 %	STATUTORY LIMIT %
Proportion of business assets not fully secured on residential property (Lending Limit)	4.85	25
Proportion of shares and borrowings not held by individuals (Funding Limit)	7.90	50

The above percentages have been calculated in accordance with the provisions of Building Societies Act 1986.

The Lending Limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus provisions for bad and doubtful debts less liquid assets and tangible fixed assets as shown in the Group's Accounts.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property.

The Funding Limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = Shares and borrowings being the aggregate of
i) the principal value of, and interest accrued on, shares in the Group;
ii) the principal of, and interest accrued on, sums deposited with the Group.
Y = the principal value of, and interest accrued on, shares in the Group held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its Members.

2. OTHER PERCENTAGES

	GROUP 2017 %	GROUP 2016 %
Gross capital as a percentage of shares and borrowings	7.98	7.68
Free capital as a percentage of shares and borrowings	7.55	7.24
Liquid assets as a percentage of shares and borrowings	25.22	23.31
Profit after taxation as a percentage of mean total assets	0.21	0.31
Management expenses as a percentage of mean total assets	1.54	1.32

The above percentages have been prepared from the Group's annual accounts.

Gross capital represents the general reserve together with the available-for-sale reserve as shown within the Group Statement of Financial Position.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment and intangible assets as shown within the Group Statement of Financial Position.

Shares and borrowings represent the total of shares, amounts owed to credit institutions and amounts owed to other customers.

Mean reserves is the average of the 2017 and 2016 general reserves.

Mean total assets is the average of the 2017 and 2016 total assets.

Management expenses represent the aggregate of administrative expenses and depreciation.

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AS AT 31 DECEMBER 2017

DIRECTORS	DATE OF BIRTH	DATE OF APPOINTMENT	OCCUPATION	OTHER DIRECTORSHIPS
M.J. Hanson	30.06.56	29.09.94	Building Society Chief Executive.	Stockport District Citizens Advice Bureau Ltd Vernon Estates Ltd* Vernon Financial Services Ltd* Vernon Property Services Ltd* The Mortgage Gateway Ltd* Farthing & Co. Ltd† Pecunia Ltd† Trustee of the North West Young People's Development Fund
J. Aspin	13.05.70	24.11.16	Building Society Finance Director.	_
J.M. Longworth	23.12.47	30.11.04	Solicitor.	Ashburrow Ltd
D. Bailey	03.07.55	15.12.06	Chartered Accountant.	Vernon Estates Ltd* Vernon Financial Services Ltd* Vernon Property Services Ltd* The Mortgage Gateway Ltd*
A.S. Murdoch	27.03.49	29.11.07	Chartered Surveyor.	Hollymount (Rawtenstall) Management Company Ltd Berkeley Towers Residents Company Limited Brookhouse Properties Limited
J. Hughes	24.02.62	01.04.14	Company Director/Consultant.	_
S. Jee	29.05.55	01.12.14	Chartered Accountant.	Magnox Limited The Sutton Academy Magnox Electric Pension Trustee Co. Ltd. The Riverside Group Limited (IP30938R) Riverside Consultancy Services Limited Riverside Urban Services Limited Riverside Group Pension Trustees Ltd. Riverside Foundation Riverside Finance plc The St. Michael's Housing Trust Donald Bates Charity Eleanor Godfrey Crittal Charity Eventide Homes Trust Feelgood Theatre Productions Limited Hulme Hall Trust Foundation (Charity no. 526647)

The Executive Directors are employed on rolling contracts which were signed requiring six months notice by the Society and the individual.

EXECUTIVE DIRECTORS				
M.J. Hanson BA FCA ACIB			Director and Chief Executive.	-
J. Aspin MA FCA AMCT			Finance Director.	-
OFFICERS				
A. Evetts			Chief Risk Officer.	-
A. Entwisle BA FCCA			Director of Operations and Secretary.	-
I. Keeling			Director of Sales & Marketing.	-
M. Purewal			Director of I.T.	-

* Dormant subsidiary of Society † Dormant company

Correspondence to Directors should be addressed: 'Private and Confidential' C/o PricewaterhouseCoopers LLP 1 Hardman Square, Manchester M3 3EB.

VERNON
BUILDING SOCIETY

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0161 429 4312

HAZEL GROVE

190 London Road SK7 4DQ

0161 429 4313

MARPLE

1 The Ridgedale Centre

Hollins Lane SK6 6AW

0161 429 4316

POYNTON

87 Park Lane SK12 1RD

01625 855830

REDDISH

4 Gorton Road SK5 6AE

0161 429 4315

Vernon Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority (registration number 195475).

Telephone calls are recorded and may be monitored for regulatory and training purposes to help maintain service quality.

Your home may be repossessed if you do not keep up repayments on your mortgage.

e-mail: info@thevernon.co.uk

www.thevernon.co.uk

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BUILDING SOCIETY