VERNON
BUILDING SOCIETY

2018

Annual Report & Accounts

Contents

I am pleased with the progress we have made in the past twelve months. Steve and his team have continued with the improvements started by Mike and as a result the Society has delivered its targets for the year. Whilst there is further investment to come, not least in the IT arena, we are well positioned to continue to grow the business in line with our long term plans.

Our 2018 financial performance saw a small decrease in profit before tax to £755,000 as we continue to make significant investment in the business which will continue into 2019. During the year a greater proportion of our savings were lent as mortgages and therefore increased the net margin made from last year. Our overall Tier 1 capital has improved again and is at a very robust level of 21.0%, whilst the liquidity ratio remains strong, dropping slightly to 577%. Last year a sustainable growth plan was developed and the Society has continued its delivery of the five year plan which will ensure our financial position will remain strong for the years to come.

Economy

The uncertainties around the decision to exit the EU persisted throughout 2018, however, the UK economy proved relatively resilient. There is clearly a potential for more uncertainty as the EU exit plans are implemented. In August, the Bank of England increased the base rate from 0.5% to 0.75%. The Board felt able to pass the full increase on to the majority of savers on this occasion. Activity in the mortgage market has continued to be restrained, reflecting a number of factors including affordability pressures and house price stagnation in the South East. Government schemes such as Help-to-Buy have helped bolster first time buyer numbers

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.

The Society was pleased to be 'Commended' in the Best First-Time Buyer Mortgage Provider category at the 2018 Moneyfacts awards, and has plans to develop more options for this category of borrower in 2019. The range of mortgages designed to meet Members' needs remains comprehensive, including contractors, self-employed, self-build and buy to let landlords.

The Retirement Mortgage received national press recognition in the year; this product 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.

A partnership with Build Store has also resulted in additional Self Build mortgages, again utilising our individual underwriting expertise.

On the savings front, our savings products continued to pay a fair market rate and this was demonstrated through our response to the Bank of England Base Rate increase in September. Our Help to Buy: ISA interest rate is one of the best in the market and has additional benefits that have led to many potential new first time buyers being attracted to the Society during the year. We continue to provide a range of savings 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 and launch a 3 year fixed rate bond to allow Members an option of a longer term savings account with a fixed interest rate.

We revitalised the Jubilee Fund and renamed it the Vernon Community Awards; the fund was promoted and voted for on-line or in branch and distributes money to the local good causes with the highest votes. The scheme is now in its 7th year and has donated over £70,000 to the community since its launch. We also have 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. We continued to support Stockport County's schools presentations that deliver fun interactive assemblies to local primary schools promoting the benefits of making the right healthy choices.

2018 also saw the Society launch its Schools Financial Education programme. This has been very well received and so far over 180 children have benefited from this programme and we will continue to engage more schools in the coming year

Our People

The Society employs 85 people across its branches and support functions. Our customer surveys show what a great job they do and how well they continue to serve Members and I thank them for their continued hard work and commitment. Following on from the People Development and Performance Management Frameworks in 2017, we have been developing our People Managers with additional leadership skills to help deliver the Society's long term plans. In 2018 we have also reviewed our employee benefits package with the aim of being 'an employer of choice' and this will be rolled out in 2019.

Our Board

This year saw the retirement of two long serving directors, Donald Bailey and John Longworth, and on behalf of the Board I thank them both for their commitment and service to the Society. We have welcomed two new Board Members Jenny Quirke and William Gray who both have excellent skills and experience that they bring to the Board. 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.

Summary

The Society remains in a strong financial position which is demonstrated by its capital and liquidity. Significant investment across the Society will continue into 2019 as the Society seeks to consolidate its role as a key lender and employer - within and for the region. 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. 27 February 2019

I am delighted to report the Society has made good progress in 2018, meeting its financial targets whilst delivering on the ambitious change agenda set for the year including improving the mortgage products and underwriting process to reach a wider audience.

A few highlights from 2018 are our great Net Promoter Score (NPS) which is very high at 87.2% on a 12 month average in the Smart Money People surveys. NPS is an independent measure of those customers who would actively recommend the Society, against those who wouldn't. Customer recognition and feedback is really important, as we're always looking for ways to improve the service and products we offer and to find out what really matters to our Members. It was also great to be recognised within the industry 2018 Moneyfacts awards receiving a Commended in the Best First-Time Buyer Mortgage Provider category.

Of course financial performance is also important and across 2018 profit, capital and liquidity ratios remained strong and continuing low arrears figures were achieved.

Financial Performance

Profit before tax was £755,000 for the year ended 31 December 2018 compared to £769,000 for 2017, slightly lower due to reinvestment in the business offset by a higher proportion of our deposits being lent out as mortgages. This is very much down to our innovative product range which includes retirement mortgages, self-build and buy to let as well as our award winning first time buyer mortgages. This means net interest margin has increased to 1.77% from 1.74%, reflecting the stability of the Society's balance sheet.

In 2018 the Society invested in improving the mortgage processing and underwriting to make sure our Members receive not only a personal, friendly service, but an efficient one too. The branches now have wifi so Members can use the network and our people can share articles and highlight how to get the best from our website.

During the year there has been a small increase in loan impairment provisioning by £10,000 to £316,000 (2017: £76,000 release). The Society's capital ratios continue to improve with the Common Equity Tier 1 improving from 19.8% to 21.0%. The leverage ratio has decreased slightly from 7.2% to 7.1% as a result of the growth in the Society's balance sheet during the year.

2018 started with a healthy pipeline of mortgage business and this has been maintained for most of the year, meaning gross residential mortgage new lending increased 50.4% from £29.0m to £43.6m and net lending increased from £225.5m to £232.4m.

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, increased slightly from 0.44% to 0.47%; lower than the industry average of 0.86%.

The Society's liquidity decreased slightly over the year in line with our plan for a more efficient balance sheet, highlighted by key liquidity metrics. At the year-end our liquidity assets represented 24.4% of our total funding (2017: 25.2%). Our Liquidity Coverage Ratio ('LCR', the European measure) has also decreased to 577% (2017: 648%) as a higher proportion of deposits are funding mortgages. The liquidity position is still strong and in excess of industry requirements.

Supporting our Members

The Bank of England base rate increase in August meant that our variable rate mortgage borrowers saw an increase in their mortgage rate during the year. This rate increase was passed on in full to the majority of our savings Members. The main account type where the rate was not increased was the highly transactional Instant Access Account and we wrote to all Members who were using this as a savings account to ensure the account is still suitable for their needs and highlighting other accounts with higher rates. The fair treatment of savers has resulted in an increase in savings balances. As well as continuing to offer a great range of products for savings Members, the Society's approach to individually underwriting mortgages continues to attract positive recognition. During the year our 'later life' mortgages received publicity on how we are able to provide mortgage solutions for people in retirement including the ability to release equity without a build-up of further debt.

First time buyer lending was successful in 2018 with good value fixed rate products up to 95% Loan to Value (LTV) for those customers taking their first step onto the property ladder. This was recognised by the Moneyfacts Award and supported by our ability to provide face to face mortgage advice in all our branches.

Supporting our Community

The Society revitalised the Jubilee Fund and renamed it the Vernon Community Awards Fund to better reflect the support given to our local community. The engagement received from the communities in the new format was a great success and one that we will build on next year. We were delighted to once again donate £10,000 to local good causes.

The launch of our Schools Financial Education programme targets children to ensure they understand finance and the importance of saving. This has been very well received and is a highlight of the year for all involved. So far over 180 children have benefited from this programme and we will continue to engage more schools in the coming year.

Supporting our People

All our colleagues play a key part in providing a great customer experience for our Members. Our annual research with colleagues allows us to see where we're doing well and areas we can improve. I recognise that we're going through a considerable amount of change at the moment and have asked a lot from our colleagues. Despite this I'm pleased that 29 of the 31 employee measures on the employee opinion survey improved year on year and that 92% of our people stated they were "proud to be an employee of the Society".

We have also reviewed our employee benefits package with the aim of being 'an employer of choice' and this will be rolled out in 2019. The benefits include a health cash plan for all employees, flexible working opportunities, volunteering days and improved leave for when employees need extra support such as sickness, maternity and paternity.

The Society continued to invest in recruitment and development of people across the business, and this year we have demonstrated our ongoing commitment to create jobs in Stockport by recruiting 18 new people during 2018. All leaders have been trained in Leadership Development so they can encourage every member of their team to fulfil their true potential.

Summary

I would like to thank our people for their exceptional contribution in 2018. I look forward to further strengthening our relationships with the communities of Stockport and to stay true to our original purpose and values. We will continue to provide straight forward, good value mortgage and savings products with individual personal service to meet the needs of Members and customers.

Steve Fletcher, Chief Executive. 27 February 2019

The Directors present their Strategic Report on the Society for the year ended 31 December 2018

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

Our Annual Customer Satisfaction Survey where the Vernon asked over 20,000 customers what they think of our service, showed that the proportion of our customers who say that the Vernon treats them fairly is 93% with 92% trusting the Vernon as a provider of financial products. In 2017 we received the same response from the survey, indicating we have maintained our fair and trusted service.

We also use an independent web based feedback service called 'Smart Money people (SMP)' which provides a detailed analysis of what our customers think about our service and products. Customers can complete a survey in branch or online and the results are collated and published on the SMP website, ensuring transparency for potential customers of the Vernon and an insight into how our customers feel.

We use this data as an expression of how our customers rate the products and services that we provide, and more generally our overall performance. The feedback is valuable as it informs the Society what is going well, whilst also highlighting opportunities to further improve the way we serve our Members and customers.

Our overall customer service score is very high, with 98.2% of our customers feeling that we provide good customer service. Key highlights of their individual feedback include words such as 'efficient' 'friendly' and 'approachable', supporting one of our core Vernon values that "we care".

We are particularly pleased to be nominated for 'Best Savings Provider', 'Best Customer Service' AND 'Best Specialist Mortgage Provider' in this year's British Bank Awards, along with a nomination for the 2019 Moneyfacts Consumer Awards in the 'First-Time Mortgage Buyers' Choice' category.

Other customer metrics in 2018 include the growth in both deposit and mortgage balances for which the targets have been achieved.

2018 has seen investment in the processes around mortgage application and underwriting to improve on our customer experience still further. The Society has implemented wifi in the branches making it easier to find out about our products and services. Further details of what the Society has been doing for Members and customers are included in the Chief Executive's Review on page 5.

Leadership Team Balanced Scorecard Measures 2019

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
- Process & Performance

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.

- Customer satisfaction.
- Grow our customer base.
- Redevelop our brand.

Financial Stewardship & Risk Management (40%)

Achieve all essential financial objectives – 20%

Deliver key Risk Management objectives – 20%

- No major risk events as a result of internal controls failing.
- Implement a more robust RCSA process.

People (20%)

Valued and proud to be an effective team member admired by all those who deal with us.

- Improve employee satisfaction score in mid - 2019.
- Improve quality and management of individual objectives and PDPs.
- Deliver the People development plan.

Process & Performance (20%)

Known for our creativity in product design and the speed and efficiency of our personalised service.

- Fully refresh infrastructure moving to Windows 10 and Cloud.
- Further streamline the end to end mortgage process.
- Further develop back book mortgage processes.

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 2018 we continued the People Plan with the roll out of the Leadership Development Programme to equip all our people leaders with the necessary skills required. The appraisal system has now been operating for over a year and is becoming embedded. Our People Plan was informed by the annual staff survey from which the Society developed a 'You said, We did' list of items. This included an update to the current employee package to make the Society an 'employer of choice'. New aspects include benefits such as health cash plan for all employees, flexible working opportunities, volunteering days and improved leave for when employees need extra support such as sickness, maternity and paternity.

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 ongoing engagement in the People Plan through embedding the appraisal system, developing individuals and engagement through employee survey participation.

Many of our people volunteer to help local charities and groups through participating in a wide variety of activities and events. This is encouraged further by the implementation of volunteering days within the new Employee Benefits Package. Further details are given in the Community Support Awards 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 2018 Society Bonus Scheme will pay all eligible staff who have a satisfactory appraisal rating an amount equal to 5% of salary.

The Society operates an Equal Opportunities Policy. It is the commitment 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 gender diversity for the Society's staff at 31 December 2018 is as follows:

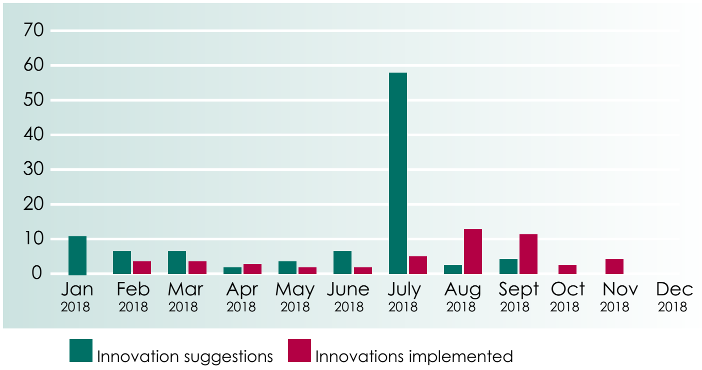
	2018		2017	
	Female	Male	Female	Male
Executives	17%	83%	17%	83%
Managers	56%	44%	53%	47%
Employees	86%	14%	89%	11%
Overall	**75%**	**25%**	**76%**	**24%**

The Society does not quote metrics for unplanned staff turnover as the levels are very low. 2018 saw a number of our long term employees retire, a result of having a long serving, loyal and dedicated team. The Society has a Health & Safety Policy and there were no health and safety incidents raised during the year.

Progress
The Society monitors a number of key metrics which 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' is used to enable people to put forward suggestion that they have to improve the way the Society and its people operate, such as improving efficiency or customer service.

Inspiring Innovation Submissions and number Implemented



Since its launch in October 2017 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 shows the number of initiatives that the Society has raised during the year to improve processes, with the Society implementing 43.8% of the submissions made. A large portion of the submissions and implementations made were the result of a comprehensive mortgage applications process review that took place in July, to help improve our customers' experience still further. Other innovation suggestions have contributed towards wider process improvements and have also helped the Society to better serve the communities in which it operates.

Financial Stewardship and Risk Management

Risk Management
Having invested significantly in risk management during 2017, the Society has continued to enhance and develop its approach in 2018, ensuring we have the right capabilities in place to support the Society's Corporate Plan, develop innovative products to meet our Members' and customers' needs.

The focus for 2018 was very much on embedding robust risk management practices across the Society, ensuring policies remain fit for purpose amidst the backdrop of ever increasing regulatory and risk management demands and developing relevant and timely management information to support decision making. For 2019 a number of initiatives have been identified that will again see the Society's risk management capabilities enhanced, as well as continuing to engage with all staff to ensure they understand their role in managing risk.

The Society also invested in a Governance Risk and Compliance (GRC) system in 2018 to support staff across Society in recording, managing and monitoring risks and controls. This will continue to be developed during 2019, including looking at other ways the system can be used to enhance the Society's approach to risk management. Risk management remains a key element of the Society's Balanced Scorecard, reflecting the ongoing need to ensure the Society maintains robust 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.

INCOME STATEMENT	2018	2017
	£m	£m
Net interest income	5.3	5.2
Other income and charges	-	0.1
Total Income	**5.3**	**5.3**
Administrative expenses	(4.5)	(4.6)
Loan impairment provision release	-	0.1
Other provision adjustments	-	-
Profit before tax	**0.8**	**0.8**

Profit before tax decreased by £14,000 to £755,000 in 2018 from £769,000 in 2017 due to a higher proportion of our savings being lent out as mortgages offset by a small bad debt charge.

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 increased by 0.03% in 2018. 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 £10,000 in 2018 (2017: £76,000). The movement 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') was similar to last year, reducing slightly to £4.5m for the year (2017: £4.6m), for 2018, reflecting the Society's ongoing strategy of investing in people and processes to support expected growth in the business. Staff costs increased by £92,000 in 2018 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 decreased by £137,000 in 2018 compared to the prior year. Although there has been a slight decrease in non-staff costs, investment in information technology has continued during the year, offset by reductions in other costs. 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 decreased slightly to 1.52% in 2018 compared to 1.54% in 2017.

Impairment charges

The impairment charge for the year was £10,000 (2017: credit of £76,000) resulting from the increase in the provision for loans and advances to customers from £306,000 to £316,000. 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 recognised in the Statement of comprehensive income of £57,000 relating to movements in the provisions for the Financial Services Compensation Scheme (FSCS) levy and the Pension Rights equalisation provision. During June 2018 the FSCS informed the industry that the final loan instalment relating to historic defaulted deposit takers had been repaid to HM Treasury, as a result there is no requirement to hold an FSCS provision for future periods. This news, together with a lower than forecast 2018 charge, crystallised a net £12,000 FSCS levy provision release. A partial release in the pension right equalisation of £45,000 was also made during the year.

Taxation

The Society shows an effective corporation tax rate of 20.53% in 2018, compared to 19.64% in 2017. Note 10 on pages 40-41.

Balance Sheet

Liquid assets

The Society has continued to maintain high quality liquid assets throughout 2018, strategically reallocating its holdings and electing to increase its deposit into the Society's Bank of England Account which further enhanced the Society's liquidity profile.

LIQUID RESOURCES YEAR ENDED:	2018	2017
Total liquid resources (£m)	68.4	69.2
BY ASSET CLASS	**%**	**%**
Cash in hand and balances with the Bank of England	50.2	26.5
Gilts	6.4	10.8
Other sovereign bonds	8.6	8.5
Loans & advances to credit institutions	34.8	54.2

The Society decreased liquid assets slightly during the year, improving margin. The statutory liquidity percentage reported at 31 December 2018 was 22.6% compared to 23.3% in 2017. 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 2018 was 577% (2017: 648%), comfortably in excess of the minimum regulatory limit set by the PRA of 100%.

Loans and advances to customers

Loans and advances to customers increased by £7.0m overall in 2018 as shown in the table below, which highlights the strong product range despite the competitive market place during the year.

LOAN PORTFOLIOS	2018		2017	
	£m	LTV %	£m	LTV %
Prime Residential	186.1	31.3	175.5	30.6
BTL	37.0	42.9	39.6	44.3
Commercial	9.5	33.1	10.5	35.1
Provisions	(0.3)		(0.3)	
	232.3		**225.3**	

The Society entered a relationship with BuildStore to promote its Self Build mortgages during the year. In addition the retirement mortgage received national press coverage; this mortgage proposition targets 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 PERFORMANCE	By number		By balance £k	
	2018	2017	**2018**	2017
2.5% - 5%	8	3	432	296
5% - 7.5%	1	2	42	191
7.5% - 10%	2	2	117	77
>10%	8	8	493	428
Total	**19**	**15**	**1,084**	**992**
% of loan book	**0.77%**	**0.60%**	**0.47%**	**0.44%**

The overall level of mortgage arrears of 2.5% or more experienced, along with the total arrears by number of loans, has risen slightly from last year, however the levels of arrears cases continue to be well below Council of Mortgage Lenders reported averages. Overall by number of loans arrears are up by 17bp to 0.77% and by balance up by 3bp to 0.47%. The loan book arrears has increased slightly compared to the previous year across both measures however arrears levels remain low reflecting the excellent credit quality of the book.

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 2018 the Society had no properties in possession (2017: one, which was sold during the year 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 £6.8m during 2018 to 274.7m. Wholesale exposures decreased during the year by £0.8m as the strong retail funding position meant that a lower amount of wholesale funding was 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 unless otherwise stated. The Society complied with Individual Capital Guidance (ICG) plus planning buffers, as notified by the Prudential Regulation Authority, throughout 2018. 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 21.0% in 2018 from 19.8% in 2017 reflecting the Society's increase in capital reserves.

CAPITAL	**2018**	2017
	£m	£m
Common Equity Tier 1 Capital	22.3	21.8
Collective Impairment Allowance	0.2	0.2
Total Capital (Audited)	**22.5**	**22.0**
Credit Risk	96.6	101.0
Operational Risk	9.8	9.2
Total Risk Weighted Assets	**106.4**	**110.2**
CAPITAL RATIOS	**%**	**%**
Common Equity Tier 1	21.0	19.8
Tier 1 Ratio	21.0	19.8
Total Capital Ratio	21.2	19.9
Leverage Ratio	7.1	7.2

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 2018 the figure was 7.1% (2017: 7.2%). This is, and has remained throughout 2018, 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 2019, 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
27 February 2019

Community Awards

The Community Awards initiative directly supports local groups that make our communities better. This is core to what we do and our mutual status.

The Community Awards have been running since 2012 and have donated over £70,000 to local charity and community groups giving them an opportunity to receive significant funding opportunities that are not readily available elsewhere.

This year saw record numbers of local people have a say in the allocation of funds with a total of 8,185 people registering their vote in support of the groups.

Millie's Trust, which provides paediatric first-aid courses to new parents, nurseries, schools and businesses, topped the public vote with 3,324 votes and received a total award of £1,500.
Their CEO Joanne Thompson said:
"Millie's Trust are very proud to have the support of so many local people and businesses, such as the Vernon Building Society, that allows us to gain funds to use in our own community. We are looking forward to working on our Stockport Schools Project in 2019 that will see over 1,000 local children trained in basic life-savings skills that they will carry with them for the rest of their lives."

The Community Awards presentation evening was a unique opportunity to bring the local groups together to discuss their ambitions for the future.

The Vernon staff choice award added £500 to the amount already given to **Beechwood Cancer Care Centre**. Linda Steggles, their Chief Executive, said:
"It was a pleasure to be at the presentation evening and to meet the other fantastic finalists. We are delighted to be one of Vernon's Community Awards beneficiaries and look forward to working more closely with them in the future."

OTHER HIGHLIGHTS FROM 2018

CALENDAR DONATIONS AWARDED TO SIGNPOST STOCKPORT FOR CARERS TOTAL £873.60

POYNTON BRASS BAND CONCERT IN SUPPORT OF STOCKPORT FOODBANK – RAISED £1,000

Community Awards

Community Awards final Score -
The society awarded £10,000 of funding to 14 finalists listed below;

CHARITY	Donation	% of vote	No. of votes
Millie's Trust	£1,500	40.61%	3,324
Adventure Mexico2020	£1,250	12.36%	1,012
Middlewood Riding for the Disabled Group	£1,100	10.46%	856
AuKids Magazine	£1,000	7.54%	617
Stockport County Community Foundation	£850	6.23%	510
Signpost Stockport for Carers	£750	3.97%	325
Jump Space	£750	3.19%	261
Pure Innovations	£600	2.97%	243
Friends of South Park	£450	2.58%	211
Beechwood Cancer Care	£450	2.47%	202
Action for Sick Children	£450	2.28%	187
Friends of Reddish South Station	£300	2.14%	175
Friends of Stockport Cemeteries	£300	1.65%	135
Bramhall Green Guide Hut	£250	1.55%	127

OTHER HIGHLIGHTS FROM 2018

Macmillan Coffee Morning – Raised £532.90

Delivering supplies to Chelwood Foodbank and Stockport Foodbank

Our Directors

JOHN HUGHES
CHAIR & CHAIR OF THE NOMINATIONS COMMITTEE

Joined the Board in April 2014 and is Chair of the Board and Chair of the Nominations Committee. 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 and is Vice Chair of the Board and Chair of the Risk & Compliance Committee. 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.

JENNY QUIRKE
CHAIR OF THE AUDIT COMMITTEE

Jenny is a Chartered Management Accountant with many years of Board level experience in the financial services sector. She brings experience of managing change in an organisation and financial risk management to the Board, having held senior level roles both with a major building society and a high street bank.

ALAN MURDOCH
CHAIR OF THE REMUNERATION COMMITTEE & SENIOR INDEPENDENT DIRECTOR

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

WILLIAM GRAY
NON-EXCECUTIVE DIRECTOR

Bill joins after spending 25 years in senior roles at Lloyds Bank, Experian and Santander. Bill brings with him a wealth of experience in managing retail risk and strategy, whilst in recent years he has been appointed Non-Executive Director and Chair of the Board Risk committee at Wesleyan Bank and is Chair of Market Mortgage Ltd.

STEVE FLETCHER
CHIEF EXECUTIVE & DIRECTOR

Joined the Society in January 2018 to become its 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 95th Annual Report & Accounts Review for the year ended 31st December 2018, 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 Report.

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 Report and Accounts 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 2018 there were 19 cases (2017: 15) where payments were 2.5% or more in arrears. The capital balances of these loans were £1.1m (2017: £1.0m). The total amount of arrears on these loans was £0.1m (2017: £0.1m).

Charitable gifts and activities

The charitable activities of our Community Awards (previously known as the Jubilee Fund) are now a well renowned feature of the Society's activities. In 2018 we awarded over £10,500 to fourteen local charity and community groups to enable them to continue their work in the local area. Since its inception in 2012, the Community Awards has donated over £70,000 in funding to a variety of local charity and community groups in Stockport. In addition, a further £159 was raised for Jeans for Genes Day and £533 for MacMillan Cancer Support during the year.

Further details on the Society's charitable giving during 2018 can be found in the Community Support Awards 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	(until 25th April 2018)
John Hughes	
John M Longworth	(until 1st August 2018)
Alan S Murdoch	
Susan Jee	
Jenny Quirke	(from 4th January 2018)
William Gray	(from 2nd April 2018)
Michael J Hanson*	(until 2nd February 2018)
Steve Fletcher*	(from 5th February 2018)
Judith Aspin*	

*Executive Directors

At the Annual General Meeting (AGM), to be held on 30th April 2019, Alan Murdoch offers himself up for re-election, having served more than three terms.

On 5th February 2018 Steve Fletcher was appointed as Chief Executive and Director of the Society. Jenny Quirke was appointed as a Non-Executive Director in January 2018, and appointed as Chair of the Audit Committee effective 2nd August 2018, replacing Alan Murdoch. Alan Murdoch was appointed as Chair of the Remunerations Committee in 2nd August 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

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 page 12 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.

Statement of Directors' Responsibilities in respect of the financial statements

for the year ended 31 December 2018

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements 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). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 102, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations

In the case of each director in office at the date the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

On behalf of the Board
John Hughes
Chair
27 February 2019

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 July 2018 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 to 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. Alan Murdoch was appointed to the role of Senior Independent Director 2nd August 2018. 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. On 5th February 2018 Steve Fletcher was appointed as Chief Executive and Director of the Society. Jenny Quirke was appointed as a Non-Executive Director in January 2018, and appointed as Chair of the Audit Committee effective 2nd August 2018, replacing Alan Murdoch. Alan Murdoch was appointed as Chair of the Remuneration Committee in 2nd August 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 2018 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 SMCR 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 2018 John Longworth retired as Senior Independent Director and was replaced by Alan Murdoch, Mr Longworth retired as a Director on 1st August 2018. 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 2018, 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 2018 it met on 4 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 2018, closing the year with three (representing 43% of board Members). 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 30 April 2019. 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 2018 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. Alan Murdoch was appointed to this role on 2nd August 2018.

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 Community Awards (previously known as 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 Community Awards 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 Awards on pages 10 to 11.

Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2018 with the number in brackets representing the maximum number of meetings the Director was eligible to attend.

	Board	Audit	Remuneration	Nominations	Risk and Compliance
D Bailey	3(4)	3(3)	0(1)	-	-
J Hughes	11(11)	2(2)	3(3)	3(3)	6(6)
JM Longworth	6(7)	4(4)	-	-	-
AS Murdoch	10(11)	6(6)	2(2)	-	-
S Jee	11(11)	-	3(3)	3(3)	6(7)
J Quirke	10(11)	3(3)	-	-	-
W Gray	8(8)	-	-	-	2(2)
MJ Hanson	1(1)	-	-	-	-
S Fletcher	10(10)	-	-	3(3)	-
J Aspin	10(11)	-	-	-	-

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 Community Awards.

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
27 February 2019

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

Jenny Quirke (Committee Chair) and Alan Murdoch.

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 page 15 to 17 also sets out the process for review of effectiveness of Board subcommittees 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 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 2018 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 2018 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 2018. The Summary Financial Statements make up part of the Annual Review which can be downloaded from the Society's website.

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 five year cycle of work following the appointment of Deloitte as internal auditors (see 'Internal Audit' section page 19).

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 years.

As RSM has 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 Deloitte LLP as the internal auditors for the Society, to succeed RSM effective 01/01/2019.

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, PwC, who were appointed 2017.

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
Jenny Quirke
Chair of Audit Committee
27 February 2019

Introduction

This report details the Society's approach to pay for the period 1 January to 31 December 2018. 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 December 2018.

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 Alan Murdoch, the other Members are John Hughes and Susan Jee appointed 1st June 2017. The Chief Executive and Finance Director (except for items relating to their own remuneration) also attend meetings but are not a Member of the Committee.

During the year the Committee met three 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 straight-forward Corporate Bonus Scheme that promotes continued involvement in the Society's ongoing success through cumulative performance targets without overemphasising 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 Report and Accounts. 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		Salary	Annual Bonus	Benefits	Pension	Other	Total
S Fletcher	**2018**	**158**	**13**	**-**	**-**	**-**	**171**
	2017	-	-	-	-	-	-
MJ Hanson*	**2018**	**12**	**-**	**2**	**1**	**-**	**15**
	2017	135	6	8	17	130	296
J Aspin	**2018**	**129**	**6**	**7**	**-**	**-**	**142**
	2017	126	5	7	-	-	138
A Entwisle **	**2018**	**-**	**-**	**-**	**-**	**-**	**-**
	2017	33	1	3	4	-	41
Total	**2018**	**299**	**19**	**9**	**1**	**-**	**328**
	2017	294	12	18	21	130	475

*Resigned as Director 2 February 2018 **Resigned as Director 1 June 2017

Compensation for Loss of Office

As stated in last year's accounts, in April 2017 MJ Hanson advised the Board of his intention to step down from his role as CEO. As a result he received compensation for loss of office of £130,000 following his resignation during 2018.

Non-Executive Directors

£000		Salary	Annual Bonus	Benefits	Pension	Other	Total
J Hughes	**2018**	**39**	**-**	**-**	**-**	**-**	**39**
	2017	31	-	-	-	-	31
S Jee	**2018**	**30**	**-**	**-**	**-**	**-**	**30**
	2017	26	-	-	-	-	26
D Bailey[1]	**2018**	**8**	**-**	**-**	**-**	**-**	**8**
	2017	29	-	-	-	-	29
JM Longworth[2]	**2018**	**17**	**-**	**-**	**-**	**-**	**17**
	2017	25	-	-	-	-	25
A Murdoch	**2018**	**26**	**-**	**-**	**-**	**-**	**26**
	2017	25	-	-	-	-	25
J Quirke[3]	**2018**	**26**	**-**	**-**	**-**	**-**	**26**
	2017	-	-	-	-	-	-
W Gray[4]	**2018**	**19**	**-**	**-**	**-**	**-**	**19**
	2017	-	-	-	-	-	-
Total NED	**2018**	**165**	**-**	**-**	**-**	**-**	**165**
	2017	136	-	-	-	-	136
Total all Directors	**2018**	**464**	**19**	**9**	**1**	**-**	**493**
	2017	430	12	18	21	130	611

1 Resigned as Director 25 April 2018
2 Resigned as Director 1 August 2018
3 Appointed as Director 4 January 2018
4 Appointed as Director 2 April 2018

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 5.0% of base salary in relation to 2018 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.

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.

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 six 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 2018. As the Society's Remuneration Policy does not include significant performance related variable remuneration, no formal ratio between fixed and variable remuneration is relevant.

A summary of the remuneration of Material risk Takers during 2018 is shown below.

Summary of Material Risk Takers

Category	Year	Number in category during year	Fixed Remuneration	Variable Remuneration [1]	Total Remuneration
Executive Directors	2018	2	309	19	328
	2017	2	283	10	293
Material Risk Takers [2]	2018	6	534	21	555
	2017	9	553	19	572
Total	2018	8	843	40	883
	2017	11	836	29	865

1. Variable remuneration reflects participation in the Society's annual Society Bonus Scheme.
2. During the year a reassessment of Material Risk Takers was completed by the Society, this resulted in the reclassification of three individuals from this designation.

On behalf of the Board
Alan Murdoch
Chair of Remuneration Committee
27 February 2019

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 its security and resilience and ongoing sustainability. 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 both 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).

RCC is supported by the Risk Department that is responsible for ensuring that the Society's risks are appropriately managed. This includes overseeing the approaches used to manage risk by business areas, and the provision of independent reports on risk management for the RCC. The Chief Risk Officer provides formal updates on risk management to both RCC and the Board at each meeting.

Risk Management Framework

The Society documents its approach to risk management within its Risk Management Framework (RMF). The RMF is reviewed and approved annually by RCC, and explains how a number of processes fit together to create a consistent and effective way of managing risk across the Society. It includes details relating to the Society's risk strategy, how a strong risk culture is fostered, setting risk appetites, the approach to risk assessment and control and how assurance of the RMF's effectiveness is achieved through monitoring and reporting.

The Society 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 Risk Department are the Second Line of Defence and provide oversight of the First Line, reporting their findings into RCC. The Third Line of Defence is provided by Internal Audit who are responsible for reviewing the effectiveness of the First and Second Lines of Defence and providing reports on their findings directly to the Audit Committee.

The RMF includes the use of Board approved risk appetite statements covering capital, liquidity, funding risk, 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 reviewed and approved annually.

The RMF makes use of stress and scenario testing to ensure the Society's approach to risk management will remain effective under a range of hypothetical economic and business conditions. For example, they may assess how the Society's mortgages will perform if house prices fall and unemployment rises, or evaluate the effectiveness of the controls in place Society's to management a specific indecent.

Risk & Compliance Committee

RCC oversees the Society's risk management and governance framework and monitors the Society's overall risk profile. The Committee meets at least 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;
- Review and recommendation to the Board of the key documents such as the Corporate Plan, ICAAP, ILAAP and Recovery Plan.
- 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 and scenario tests.

During 2018 the Committee met seven 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

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

The Executive Committee (ExCo) is responsible for "overlap" risks, i.e. risks that go across business areas such as strategic risk, conduct risk and operational risk. During 2018 ExCo met monthly.

The Credit Committee (CredCo) is responsible for monitoring credit risk across the Society's retail and non-retail mortgage portfolios. During 2018, 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 2018 ALCO met monthly.

All of the above committees monitor compliance with agreed policies and risk appetites and are responsible for ensuring any issues identified are appropriately and effectively managed.

Risk Governance Structure

	Board			
	Nominations Committee		Remunerations Committee	
Third Line Board Committee	Audit Committee			
Second Line Board Committee	Risk & Compliance Committee			Oversight provided by Internal Audit (Third Line)
First Line Management Committee	Asset & Liabilities Committee (ALCO)	Executive Committee	Credit Committee	
Principal Risk Types	• Capital • Interest Rate • Liquidity • Funding	• Capital • Strategic • Conduct • Operational	• Capital • Credit	

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 residential credit risk appetite is expressed in terms of a series of exposure limits in relation to the characteristics of new and existing business.	Residential The Society's net lending increased by £7.0m during 2018 and will grow further in 2019. While house price growth has been modest over the year, the overall indexed LTV of the book has increased marginally as a result of new lending in higher LTV segments. The percentage of loans 2.5% or more in arrears has risen 0.03% over the year to 0.47% but remains well below the industry average. The assessment of risks remains low based on stress test losses and number of cases on watchlists. During the year provision held against residential loans increased to £306k (2017: £233k).
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 and is managed on a case-by-case basis. Concentration risk to single names and to sectors is monitored. In the event of a breach a report is provided to the RCC. 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 2018. Lending balances on commercial property have fallen by £0.9m (8.8%) and now represents 4.1% of the mortgage book. The Society's exposure to single name risk continues to reduce. The assessment of risks remains low based on stress test losses and number of cases on watchlists. During the year provision held against commercial loans reduced to £10k (2017: £72k).
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 meeting a Board approved policy which sets criteria and limits around what instruments, countries, and counterparties can be used for investment purposes. Investments are monitored monthly and reported to the Assets and Liabilities Committee (ALCo). 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 business 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 as operational risk may result in customer detriment (for example a failure to protect customer data is an operational risk which may result in customer detriment).	Conduct Risk Conduct risk is managed by the Society in a number ways:- The Board have approved a Conduct Risk Policy that identifies where the Society is exposed to conduct risk and how it should be managed. The Policy includes a risk appetite statement that is supported by a range of key risk indictors that aim to provide early warning in relation to any of the Society's practices that may be causing conduct risk, Reporting is provided to ExCo on a monthly basis 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 Risk Department conducts regular monitoring reviews to ensure policies and procedures are being adhered to.	Conduct Risk The Society has a simple product range that aims to reduce potential exposure to conduct risk. All staff who engage with customers receive relevant training in accordance with the relevant Training and Competency Scheme to ensure customers are treated fairly.
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.	Liquidity Risk Overall liquidity remains strong. The Society's LCR ratio decreased slightly as more customer deposits were lent out as mortgages. At the year end the LCR was 577% 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 which includes a number of 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 2018, together with the impact of a rate change of 1% and 2%.

Risk & Impact	Mitigation	Commentary
Operational Risk Operational risk is the risk of 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 also includes the Society's operational resilience plans which set out how it would respond to events that disrupt it business activities, for example a fire or incident at the head office and a failure or attack on the Society's IT systems .	Operational Risk Operational risk is subject to a suite of RCC approved policies which cover a range of operational sub-risks identified within the RMF. The policies include detail relating to the measurement and management of operational risk, risk appetite and key risk indicators, monitoring and reporting. The Society also captures details relating to operational risk events losses and near misses. These are used alongside an ongoing programme of control testing that seeks to confirm that the controls put in place to manage risk are working effectively. The results of control testing is reported to ExCo on a monthly basis along with details of reported risk events.	Capital Risk The Society continues to enhance its approach to operational risk, particularly in relation to control testing. There were no material risk events during the 2018 while losses incurred as a result of risk events remain immaterial.
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 21.0% from 19.8%.

On behalf of the Board
Susan Jee
Chair of Risk & Compliance Committee
27 February 2019

Independent auditors' report to the members of Vernon Building Society
Report on the audit of the annual accounts

Opinion
In our opinion, Vernon Building Society's Group 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 2018 and of the Group's and the Society's income and expenditure and 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 and Accounts (the "Annual Report"), which comprise:

- the Group and Society Statements of Financial Position as at 31 December 2018;
- the Group and Society Statements of Comprehensive Income for the year then ended;
- the Group and Society Cash Flow Statement for the year then ended;
- 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.

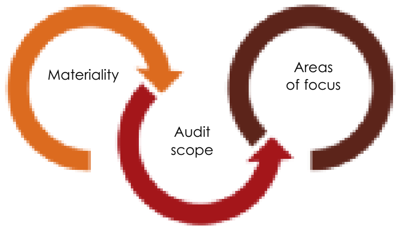
Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditor's responsibilities for the audit of the annual accounts section of our report. We believe that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

Independence
We remained independent of the Group 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 2018 to 31 December 2018.

Our audit approach.
Overview



Materiality
- Overall Group materiality of £224,000 based on 1% of net assets
- Overall Society materiality of £212,000 based on 1% of net assets (capped at 95% of Group materiality level)

Audit Scope
- Audit procedures were performed over all material account balances and financial information of the Society due to its significance to the Group's financial performance and position
- We did not perform audit procedures over other entities within the Group as they do not materially contribute to the Group's financial performance and/or position.
- All audit procedures were conducted from the Society's head office in Stockport, performed by a single audit team.

Key audit matters
- Impairment of loans and advances to customers (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 annual accounts. 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.

Capability of the audit in detecting irregularities, including fraud
Based on our understanding of the Group and Society, we identified that the principal risks of non-compliance with laws and regulations related to breaches of the Building Society Act 1986, regulations of the Prudential Regulatory Authority and the Financial Conduct Authority and UK tax legislation and we considered the extent to which non-compliance might have a material effect on the annual accounts. We evaluated management's incentives and opportunities for fraudulent manipulation of the annual accounts (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries and management bias in accounting estimates.

Our audit procedures included, but were not limited to: enquiring of management and those charged with governance including consideration of known or suspected non-compliance with laws and regulations and fraud; reviewing correspondence with the regulatory authorities; meeting and holding discussions with regulators; reviewing internal audit reports in so far as they related to the annual accounts challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to impairment of loans and advances to customers (see related key audit matter below); and identifying and testing journal entries meeting certain risk-based criteria, including unusual or unexpected account combinations.

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 annual accounts, the less likely we would become aware of it.

We did not identify any matters relating to irregularities, including non-compliance with laws and regulations and fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' 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) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, 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 matters

Impairment of loans and advances to customers. (Group and Society)

Refer to note 1 for accounting policies, note 2 for accounting estimates and judgements, and notes 17 and 31 for detailed disclosures around impairment provisions and credit risk.

An impairment provision of £316,000 (2017: £306,000) is recognised by the Group and Society against loans and advances to customers. The loans and advances represent mortgages secured against residential property, commercial property or land.

The total impairment provision comprises individual provisions of £115,000 (2017: £107,000) and collective provision of £201,000 (2017: £199,000). Individual provisions are determined based on loans which meet certain risk criteria (e.g. arrears, bankruptcy) with collective provisions capturing the risk across the remaining portfolio relating to impairment events which have been incurred but not yet identified at the balance sheet date.

The determination of impairment provisions requires the use of several assumptions incorporating a significant level of judgement, particularly given the low levels of losses experienced historically. Key assumptions relate to the probability of default and loss given default (including forced sales discount).

How our audit addressed the key audit matter

We understood, evaluated and challenged the appropriateness of the key assumptions used in determining impairment provisions, particularly probability of default of forced sale discount. This included assessing the assumptions adopted compared to historical experience.

We also performed sensitivity analysis to assess the impact of adopting different assumptions which could be considered reasonable based on our industry knowledge and experience.

We performed testing to ensure that loans meeting the defined risk criteria had been captured in the assessment of individual provisions.

We considered provision levels on sub-sets of the portfolio with different risk characteristics (e.g. forbearance, interest-only exposures etc) in order to identify and assess areas of latent risk which could be inappropriately provided for.

We consider that the impairment provisions are within an acceptable range.

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 the Society, the accounting processes and controls, and the industry in which they operate.

All of the Group's activities are undertaken in the United Kingdom, along a single line of business being the provision of mortgages, savings products and other financial services to members and other customers. The Group is formed of the Society and four dormant subsidiaries, none of which are material to the Group. The accounting records 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.

Audit procedures were performed over all material account balances and financial information of the Society due to its significance to the Group's financial performance and position. We did not perform audit procedures over the four subsidiaries as they are dormant and do not materially contribute to the Group's financial performance or position.

All audit procedures were conducted from the Society's head office in Stockport, performed by a single audit team. We did not require the involvement of any component auditors.

The audit procedures performed 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 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	Society
Overall materiality	£224,000 (2017: £217,000)	£212,000 (2017: £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 and Society, whose strategy is not one of profit maximisation, but to provide mortgages, savings products and other financial services for the mutual benefit of members and customers.

Regulatory capital is a key benchmark for management and regulators although it not a statutory measure in the annual accounts. Therefore, we base our materiality calculation on net assets, which is an approximation of regulatory capital resources.

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. We did not perform audit procedures over other entities within the Group as they do 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 (2017: £11,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- 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.

We have nothing to report in respect of the above matters.

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. For example, the terms on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear, and it is difficult to evaluate all of the potential implications on the Group's business, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of 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.

Building Society Act 1986 – Opinion on Annual Business Statement and Directors' Report

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 year ended 31 December 2018 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 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 and 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 to audit the annual accounts for the year ended 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement is two years.

Nick Dumper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester. 27 February 2019

Group and Society Statements of Comprehensive Income for the year ended 31 December 2018

	Notes	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Interest receivable and similar income	3	7,637	7,115
Interest payable and similar charge	4	(2,323)	(1,913)
Net interest receivable		**5,314**	**5,202**
Fees and commissions receivable	5	42	55
Fees payable		(36)	(31)
Net gains from other financial instruments at fair value through profit or loss	6	13	76
Total income		**5,333**	**5,302**
Administrative expenses	7	(4,415)	(4,428)
Depreciation and amortisation	19, 20	(148)	(180)
Other operating charges		(9)	(24)
Operating profit before impairment losses and provisions		**761**	**670**
Provisions for impairment on loans and advances to customers	17	(10)	76
Provisions for contingent liabilities and commitments	28	57	23
Loss on disposal of fixed assets	19	(53)	-
Profit on ordinary activities before tax		**755**	**769**
Tax on profit on ordinary activities	10	(155)	(151)
Profit for the financial year		**600**	**618**
Other Comprehensive Income			
Unrealised losses on available for sale financial instruments		(19)	(33)
Realised gains/(losses) recycled through comprehensive income		3	(83)
Movements in available for sale		**(16)**	**(116)**
Tax on other comprehensive income		3	19
Total comprehensive income for the year		**587**	**521**

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 2018

	Notes	GROUP 2018 £'000	SOCIETY 2018 £'000	GROUP 2017 £'000	SOCIETY 2017 £'000
ASSETS					
Cash in hand and balances with the Bank of England	11	34,378	34,378	18,325	18,325
Loans and advances to credit institutions	12	19,780	19,780	26,493	26,493
Debt securities	14	14,286	14,286	24,388	24,388
		68,444	**68,444**	**69,206**	**69,206**
Derivative financial instruments	15	76	76	44	44
		76	**76**	**44**	**44**
Loans and advances to customers					
Loans fully secured on residential property	16	222,878	222,878	215,060	215,060
Other loans fully secured on land	16	9,482	9,482	10,394	10,394
		232,360	**232,360**	**225,454**	**225,454**
Fixed asset investments	18	-	-	-	-
Tangible fixed assets	19	1,562	1,562	1,322	1,322
Intangible fixed assets	20	85	85	42	42
Deferred tax asset	22	35	35	46	46
Other assets	21	16	25	19	28
Prepayments and accrued income	23	518	518	442	442
TOTAL ASSETS		**303,096**	**303,105**	**296,575**	**296,584**
LIABILITIES					
Shares	24	266,891	266,891	257,878	257,878
Amounts owed to credit institutions	25	4,507	4,507	5,508	5,508
Amounts owed to other customers	26	8,268	8,268	10,239	10,239
Derivative financial instruments	15	184	184	243	243
Deferred tax liability	22	44	44	35	35
Other liabilities	27	444	506	340	402
Accruals and deferred income		262	262	356	356
Provisions for liabilities	28	76	76	143	143
		280,676	**280,738**	**274,742**	**274,804**
RESERVES					
General reserves		22,418	22,365	21,818	21,765
Available for sale reserves		2	2	15	15
TOTAL EQUITY AND LIABILITIES		**303,096**	**303,105**	**296,575**	**296,584**

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 27 February 2019 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 2018

GROUP	GENERAL RESERVE £'000	AVAILABLE-FOR-SALE RESERVE £'000	TOTAL EQUITY ATTRIBUTABLE TO MEMBERS £'000
At 1 January 2017	**21,200**	**112**	**21,312**
Profit for the financial year	618	-	618
Other comprehensive income for the year	-	(97)	(97)
Total comprehensive income for the year	618	(97)	521
At 31 December 2017	**21,818**	**15**	**21,833**
Profit for the financial year	600	-	600
Other comprehensive income/(expense) for the year	-	(13)	(13)
Total comprehensive income for the year	600	(13)	587
At 31 December 2018	**22,418**	**2**	**22,420**

SOCIETY	GENERAL RESERVE £'000	AVAILABLE-FOR-SALE RESERVE £'000	TOTAL EQUITY ATTRIBUTABLE TO MEMBERS £'000
At 1 January 2017	**21,147**	**112**	**21,259**
Profit for the financial year	618	-	618
Other comprehensive income for the year	-	(97)	(97)
Total comprehensive income for the year	618	(97)	521
At 31 December 2017	**21,765**	**15**	**21,780**
Profit for the financial year	600	-	600
Other comprehensive income/(expense) for the year	-	(13)	(13)
Total comprehensive income for the year	600	(13)	587
At 31 December 2018	**22,365**	**2**	**22,367**

Group and Society Cash Flow Statement for the year ended 31 December 2018

CASH FLOWS FROM OPERATING ACTIVITIES	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Operating profit	755	769
Adjustments for:		
Depreciation and amortisation of fixed assets	148	180
Amortisation of loans and advances to customers	(63)	-
Amortisation of debt securities	76	118
Loss/(gain) on disposal of debt securities	3	(83)
Loss on disposal of tangible fixed assets	53	-
Impairment on loans and advances to customers	10	(76)
	982	**908**
Changes in operating assets and liabilities		
Changes in fair values	(12)	(88)
Increase in prepayments and accrued income	(76)	(89)
(Decrease) / increase in accruals and deferred income	(94)	173
Decrease in other assets	3	19
Increase / (decrease) in other liabilities	133	(46)
Decrease in provisions for liabilities	(67)	(68)
(Increase) / decrease in loans and advances to customers	(6,941)	8,067
Increase / (decrease) in shares	9,022	(2,611)
Taxation paid	(160)	(267)
Net cash inflow from operating activities	**2,790**	**5,998**
Cash flow from financing activities		
Movement in:		
Amounts owed to credit institutions and other customers	(2,972)	(1,197)
Net cash outflow from financing activities	**(2,972)**	**(1,197)**
Cash flow from investing activities		
Proceeds on sale/maturity of debt securities	18,193	46,449
Purchase of debt securities	(8,187)	(35,993)
Purchase of fixed assets	(484)	(111)
Loans and advances to credit institutions	994	(3,004)
Net cash inflow from investing activities	**10,516**	**7,341**
Net increase in cash and cash equivalents	**10,334**	**12,142**
Cash and cash equivalents at beginning of year	32,799	20,657
Cash and cash equivalents at end of year (note 11)	**43,133**	**32,799**

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 2018. 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 relates mainly to finances charges incurred for Bank of England services and brokerage fees relating to investment transactions and safe custody of investment holdings. These fees are recognised as the related services are performed.

1.5 Expenses

Operating leases

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

Principal Accounting Policies continued

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.

Principal accounting policies continued

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 or into an individual voluntary arrangement;
- 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 3.3% of total Loans and advances to customers (2017: 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 incorporates 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 material 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

Principal Accounting Policies continued

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 10 to 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 is four years 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 2018 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 £0.2m (representing a 0.08% change in the carrying value of mortgage assets).

c) 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 £0.7m.

d) Pension rights equalisation

The Society holds a provision of £76k 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 2018 £'000	GROUP & SOCIETY 2017 £'000
3.	**INTEREST RECEIVABLE AND SIMILAR INCOME**		
	On loans fully secured on residential property	7,028	6,625
	On other loans fully secured on land	443	474
	On debt securities:		
	Interest and amortisation of premiums	139	166
	Profit on disposal	(3)	83
	On other liquid assets		
	Interest	250	104
	Net interest expense on derivatives	(220)	(337)
	Total interest receivable and similar income	**7,637**	**7,115**
4.	**INTEREST PAYABLE AND SIMILAR CHARGES**		
	On shares held by individuals	2,224	1,834
	On other shares	36	39
	On deposits and other borrowings	58	53
	Net interest expense/(income) on derivatives	5	(13)
	Total interest payable and similar income	**2,323**	**1,913**
5.	**FEES AND COMMISSION RECEIVABLE**		
	Loans and advances related	11	8
	Insurance commissions	38	38
	Other	(7)	9
	Total fees and commission receivable	**42**	**55**
6.	**NET GAINS FROM OTHER FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT AND LOSS**		
	Derivatives in designated fair value hedge relationships	61	369
	Adjustments to hedged items in fair value hedge accounting relationships	(80)	(264)
	Derivatives not in designated fair value hedge accounting relationships	32	(29)
	Total net gains from other financial instruments at fair value through profit and loss	**13**	**76**
7.	**ADMINISTRATIVE EXPENSES**		
	Staff costs (note 8)	2,889	2,797
	Other administrative expenses	1,526	1,631
	Total administrative expenses	**4,415**	**4,428**
	Other administrative expenses include:		
	Remuneration of auditors (excluding VAT)		
	Statutory audit fees	72	68
	Other audit fees	4	4
	Operating lease costs in respect of land and buildings (note 29)	40	40

8. STAFF NUMBERS AND COSTS

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

	GROUP & SOCIETY 2018		GROUP & SOCIETY 2017	
	Full time No.	Part time No.	Full time No.	Part time No.
Head office	34	13	31	10
Branch offices	19	17	18	18
	53	**30**	**49**	**28**

The aggregate costs of these persons were as follows:

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Wages and salaries	2,480	2,400
Social security costs	236	231
Other pension costs	173	166
	2,889	**2,797**

9. DIRECTORS' EMOLUMENTS FOR 2018

(a) Directors' Emoluments total £493,000 (2017: £481,000). A payment for compensation for loss of office of £130,000 was fully accrued during 2017 and was paid during the year. Full details of all Directors' remuneration are contained in the Directors' Remuneration Report on page 20.

(b) There are no Directors who have loans described in section 65 of the Building Societies Act. 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 2018 £'000	GROUP & SOCIETY 2017 £'000
Current tax:		
Current tax on income for the period	131	152
Total current tax	**131**	**152**
Deferred tax (see note 22):		
Origination and reversal of timing differences	26	5
Adjustments in respect of prior periods	(2)	(6)
Total deferred tax	**24**	**(1)**
Total tax	**155**	**151**

	GROUP & SOCIETY 2018			GROUP & SOCIETY 2017		
	Current tax £'000	Deferred tax £'000	Total tax £'000	Current tax £'000	Deferred tax £'000	Total tax £'000
Recognised in profit and loss account	131	24	155	152	(1)	151
Recognised in other comprehensive income	1	(4)	(3)	4	(23)	(19)
Total tax	**132**	**20**	**152**	**156**	**(24)**	**132**

10. TAX ON PROFIT ON ORDINARY ACTIVITIES continued

Reconciliation of effective tax rate:	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Profit for the year	600	618
Total tax expense	155	151
Profit excluding taxation	**755**	**769**
Tax using the UK corporation tax rate of 19% (2017: 19.25%)	144	148
Non-deductable expenses	13	9
Adjustments in respect of prior periods	(2)	(6)
Total tax expense included in profit and loss	**155**	**151**

The effective rate of tax applied to operating profit on ordinary activities is 20.53% (2017 - 19.64%). 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 2018 £'000	GROUP & SOCIETY 2017 £'000
Cash in hand and balances with the Bank of England	34,378	18,325
Loans and advances to credit institutions (see note 12)	8,755	14,474
Cash and cash equivalants per cash flow statement	**43,133**	**32,799**

12. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

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

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
On demand	8,755	14,474
In not more than three months	5,013	6,014
In more than three months but less than one year	6,012	6,005
In more than one year but less than five years	11	11
	19,791	**26,504**
Less provisions (see note 13)	(11)	(11)
Total loans and advances to credit institutions	**19,780**	**26,493**

13. PROVISIONS FOR LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'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 2018 of £11,000 (2017: £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 2018 the Society had received dividends totalling £989,000 (2017: £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

a)

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Gilts	4,355	6,439
Treasury bills	-	999
Certificates of deposit	4,011	11,031
Floating rate notes	5,920	5,919
	14,286	**24,388**
Debt securities have the following maturities:		
In not more than one year	4,615	14,048
In more than one year but less than five years	9,671	10,340
	14,286	**24,388**
Transferable debt securities comprise:		
Listed on a recognised exchange	10,275	13,357
Unlisted	4,011	11,031
	14,286	**24,388**

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 2018 £'000	GROUP & SOCIETY 2017 £'000
At 1 January	24,388	34,995
Additions	8,187	35,992
Disposals and maturities	(18,215)	(46,441)
Amortisation	(31)	126
Accrued interest	(27)	(168)
Net losses from changes in fair value recognised in other comprehensive income	(16)	(116)
At 31 December	**14,286**	**24,388**

15. DERIVATIVE FINANCIAL INSTRUMENTS

	GROUP & SOCIETY POSITIVE MARKET VALUE 2018 £'000	GROUP & SOCIETY NEGATIVE MARKET VALUE 2018 £'000
Derivatives designated as fair value hedges:		
Interest rate swaps	67	(158)
Derivatives not in hedge relationships:		
Interest rate swaps	9	(26)
	76	**(184)**

	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)**

16. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers comprise;	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Loans fully secured on residential property	222,805	214,899
Fair value adjustment for hedge risk	73	161
Fair value adjusted loans fully secured on residential property	**222,878**	**215,060**
Loans fully secured on land	9,481	10,393
Fair value adjustment for hedge risk	1	1
Fair value adjusted loans fully secured on land	**9,482**	**10,394**
	232,360	**225,454**

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

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
On call or short notice	661	851
In not more than three months	1,510	1,406
In more than three months but not more than one year	6,430	7,800
In more than one year but not more than five years	45,360	42,688
In more than five years	178,641	172,853
Fair value adjustment for hedge risk	74	162
	232,676	**225,760**
Less: Impairment of Loans and advances to customers (note 17)	(316)	(306)
	232,360	**225,454**

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

17. IMPAIRMENT LOSSES ON LOANS AND ADVANCE TO CUSTOMERS

	GROUP & SOCIETY 2018		
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	TOTAL £'000
At 1st January 2018			
Collective impairment	154	45	199
Individual impairment	79	28	107
	233	**73**	**306**
Income and expenditure account			
Charge/(Release) for the year			
Collective impairment	37	(35)	2
Individual impairment	36	(28)	8
	73	**(63)**	**10**
Amount written off during the year			
Collective impairment	-	-	-
Individual impairment	-	-	-
	-	**-**	**-**
At 31st December 2018			
Collective impairment	191	10	201
Individual impairment	115	-	115
	306	**10**	**316**

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 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			
Release for the year			
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**

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 2018	8
Investments	-
Cost at 31 December 2018	**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 2018	1,474	625	1,197	3,296
Additions	277	-	146	423
Disposals	(49)	(270)	(321)	(640)
At 31 December 2018	**1,702**	**355**	**1,022**	**3,079**
Accumulated depreciation				
At 1 January 2017	345	620	1,009	1,974
Charged in year	28	3	99	130
Disposals	(13)	(270)	(304)	(587)
At 31 December 2018	**360**	**353**	**804**	**1,517**
Net book value				
At 31 December 2018	**1,342**	**2**	**218**	**1,562**
At 31 December 2017	1,129	5	188	1,322

The net book value of land and buildings occupied by the Group and Society for its own activities as at 31 December 2018 was £1,342,000 (2017: £1,129,000).

20. INTANGIBLE FIXED ASSETS

	GROUP & SOCIETY
Cost	AQUIRED SOFTWARE £'000
At 1 January 2018	297
Additions	61
Disposals	-
At 31 December 2018	**358**
Accumulated amortisation	
At 1 January 2018	255
Charged in year	18
Disposals	-
At 31 December 2018	**273**
Net book value	
At 31 December 2018	**85**
At 31 December 2017	42

21. OTHER ASSETS

	GROUP 2018 £'000	SOCIETY 2018 £'000	GROUP 2017 £'000	SOCIETY 2017 £'000
Other assets due within one year comprise:				
Amounts due from subsidiary undertaking	-	9	-	9
Other assets	16	16	19	19
	16	**25**	**19**	**28**

Other assets include an amount of £nil not repayable for more than one year (2017:£nil).

22. DEFERRED TAX

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
At 1 January	11	(13)
Credit to profit and loss account	(24)	1
Credit to other comprehensive income	4	23
At 31 December	**(9)**	**11**

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Deferred tax assets and liabilities are attributable to the following items:		
Deferred tax assets		
Differences arising from transition to new GAAP	22	26
Other timing differences	13	20
	35	**46**
Deferred tax liabilities		
Other timing differences	(37)	(25)
Differences arising from transition to new GAAP	(7)	(10)
	(44)	**(35)**
At 31 December	**(9)**	**11**

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 2018 £'000	GROUP & SOCIETY 2017 £'000
Prepayments	516	440
Accrued income	2	2
	518	**442**

24. SHARES

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Shares comprise:		
Held by individuals	260,577	251,646
Other shares	6,314	6,223
Fair value adjustments for hedged risk	-	9
	266,891	**257,878**

24. SHARES continued

Shares are repayable with the remaining maturities from the balance sheet date as follows:

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
On call or short notice	246,389	239,810
In not more than three months	4,209	4,926
In more than three months but not more than one year	10,447	13,133
In more than one year but not more than five years	5,846	-
Fair value adjustment for hedged risk	-	9
	266,891	**257,878**

25. AMOUNTS OWED TO CREDIT INSTITUTIONS

With agreed maturity dates or periods of notice:

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
In not more than three months	2,505	5,508
In more than three months but not more than one year	2,002	-
	4,507	**5,508**

26. AMOUNTS OWED TO OTHER CUSTOMERS

With agreed maturity dates or periods of notice:

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Repayable on demand	7,768	9,939
In not more than three months	-	300
In more than three months but not more than one year	500	-
	8,268	**10,239**

27. OTHER LIABILITIES

Other liabilities are all due within one year and comprise:

	GROUP 2018 £'000	SOCIETY 2018 £'000	GROUP 2017 £'000	SOCIETY 2017 £'000
Amounts owed to subsidiary undertaking	-	62	-	62
Corporation tax	129	129	158	158
Other creditors	315	315	182	182
	444	**506**	**340**	**402**

28. PROVISIONS FOR LIABILITIES

	GROUP & SOCIETY		
	PENSION RIGHTS EQUALISATION £'000	FSCS LEVY £'000	TOTAL £'000
Balance at 1 January 2018	121	22	143
Provisions released during the year	(45)	(12)	(57)
Provisions utilised during the year	-	(10)	(10)
Balance at 31 December 2018	**76**	**-**	**76**

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 2017 and 2018 have been based.

During the year HM Treasury received the final loan installment from the FSCS. As a result no further interest payments will be collected from deposit takers in relation to these compensation payments and no provision has been recognised at the year end.

29. OPERATING LEASES

	GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Non-cancellable operating lease rentals are payable as follows:		
Less than one year	46	36
Between one and five years	99	43
	145	**79**

During the year £40,000 was recognised as an expense in the profit and loss account in respect of operating leases (2017: £40,000).

30. PENSIONS

The Group makes contributions to a defined contribution group personal pension plan for all qualifying staff.
The charge for the year was £173,000 (2017: £166,000)

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 2018	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	272	-	-	-	-	272
Balances with the Bank of England	34,106	-	-	-	-	34,106
Loans and advances to credit institutions	19,780	-	-	-	-	19,780
Debt securities	-	-	14,286	-	-	14,286
Derivative financial instruments	-	-	-	67	9	76
Loan and advances to customers	232,360	-	-	-	-	232,360
Total financial assets	**286,518**	**-**	**14,286**	**67**	**9**	**300,880**
Non financial assets	2,216	-	-	-	-	2,216
Total assets	**288,734**	**-**	**14,286**	**67**	**9**	**303,096**
Financial liabilities						
Shares	-	266,891	-	-	-	266,891
Amounts owed to credit institutions	-	4,507	-	-	-	4,507
Amounts owed to other customers	-	8,268	-	-	-	8,268
Derivative financial instruments	-	-	-	158	26	184
Total financial liabilities	**-**	**279,666**	**-**	**158**	**26**	**279,850**
Non financial liabilities	-	826	-	-	-	826
Total liabilities	**-**	**280,492**	**-**	**158**	**26**	**280,676**

31. FINANCIAL INSTRUMENTS continued

Categories of financial asset and liabilities continued

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	-	-	-	42	2	44
Loan and advances to customers	225,454	-	-	-	-	225,454
Total financial assets	**270,272**	**-**	**24,388**	**42**	**2**	**294,704**
Non financial assets	1,871	-	-	-	-	1,871
Total assets	**272,143**	**-**	**24,388**	**42**	**2**	**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**

At the year end the Group has loan commitments of £13.4m (2017: £10.5m) 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 2018

	LEVEL 1 £'000	LEVEL 2 £'000	TOTAL £'000
Financial assets			
Available for sale			
Debt securities	14,286	-	14,286
Fair value through the comprehensive income			
Interest rate swaps	-	76	76
	14,286	**76**	**14,362**
Financial liabilities			
Fair value through the comprehensive income			
Interest rate swaps	-	184	184
	-	**184**	**184**

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			
Interest rate swaps	-	44	44
	24,388	**44**	**24,432**
Financial liabilities			
Fair value through the comprehensive income			
Interest rate swaps	-	243	243
	-	**243**	**243**

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 2018 £'000	GROUP & SOCIETY 2017 £'000
Cash in hand	272	295
Balances with the Bank of England	34,106	18,030
Loans and advances to credit institutions	19,780	26,493
Debt securities	14,286	24,388
Derivative financial instruments	76	44
Loans and advances to customers	232,360	225,454
Total statement of financial position exposure (1)	**300,880**	**294,704**
Off balance sheet exposure: mortgage commitments (2)	13,429	10,461
Total	**314,309**	**305,165**

(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**	2018 £'000	2018 %	2017 £'000	2017 %
Unrated Building Societies	11,025	43.74%	12,019	33.19%
Rated Banks & Building Societies	3,903	15.49%	10,832	29.92%
Multinational Development Banks	5,920	23.49%	5,919	16.35%
Central Government	4,355	17.28%	7,438	20.54%
Total	**25,203**		**36,208**	

31. FINANCIAL INSTRUMENTS continued

Credit Risk continued

Treasury exposures broken down by Fitch ratings:

		GROUP & SOCIETY 2018 £'000	GROUP & SOCIETY 2017 £'000
Credit Grades	AAA - AA	10,275	13,347
	A+ - A	1,946	6,829
	BBB+	1,957	4,013
	Unrated	11,025	12,019
	Total	**25,203**	**36,208**

'Unrated' relates to investments in unrated Building Societies.

At 31 December 2018 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 (2017 - £5.9m).

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 2018, 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 2018 £'000	LOANS FULLY SECURED ON LAND 2018 £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	LOANS FULLY SECURED ON LAND 2017 £'000
Collectively assessed for impairment				
Not past due	210,973	7,477	210,027	9,607
Past due up to one month	1,215	1,485	2,165	153
Total collectively assessed for impairment	**212,188**	**8,962**	**212,192**	**9,760**
Individually assessed for impairment				
Not past due	9,191	-	957	398
Past due between 1 to 3 months	487	368	828	76
Past due between 3 to 6 months	343	-	131	-
Past due between 6 to 9 months	173	-	158	-
Past due between 9 to 12 months	91	152	278	-
Past due over 12 months	405	-	319	160
Possession	-	-	197	-
Total individually assessed for impairment	**10,690**	**520**	**2,868**	**634**
Loans and advances to customers	**222,878**	**9,482**	**215,060**	**10,394**
Allowance for impairment				
Collective	191	10	154	45
Individual	115	-	79	28
Total allowance for impairment	**306**	**10**	**233**	**73**

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 2018 £'000	LOANS FULLY SECURED ON LAND 2018 £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	LOANS FULLY SECURED ON LAND 2017 £'000
LTV ratio				
Less than 50%	110,564	4,277	107,186	5,313
51 - 80%	96,217	5,205	94,637	5,082
81 - 90%	9,189	-	10,296	-
91 - 95%	5,997	-	2,020	-
95 - 100%	802	-	707	-
Over 100%	36	-	48	-
Total loans	**222,805**	**9,482**	**214,894**	**10,395**

Group & Society	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2018 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND 2018 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY 2017 £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND 2017 £'000
Collectively assessed for impairment	636,022	27,514	657,364	28,436
Individually assessed for impairment:				
Not past due	35,210	-	2,016	670
Past due up to 6 months	2,327	670	2,600	163
Past due over 6 months	1,358	455	1,636	530
Total collateral value	**674,917**	**28,639**	**663,616**	**29,799**

The overall indexed loan-to-value of the residential portfolio is 34.68% (2017: 32.38%).
At the year end there were no cases of possession of assets held as collateral against loans and advances (2017: 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 2018 and 2017 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 2018	PARTIAL PAYMENTS £'000	INTEREST ONLY £'000	TOTAL FORBEARANCE £'000
Past due up to 3 months	133	-	133
Past due more than 3 months	403	123	526
	536	**123**	**659**

31. FINANCIAL INSTRUMENTS continued

Credit Risk continued

Forbearance strategies continued

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
	153	**138**	**291**

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 3.67% (2017: 4.88%). 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 24.40% (2017: 25.22%).

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 2018	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	272	-	-	-	-	272
Balances with the Bank of England	34,106	-	-	-	-	34,106
Loans and advances to credit institutions	8,755	5,013	6,012	-	-	19,780
Debt securities	-	1,007	3,608	9,671	-	14,286
Total liquid assets	**43,133**	**6,020**	**9,620**	**9,671**	**-**	**68,444**
Derivative financial instruments	-	-	14	62	-	76
Loans and advances to customers	661	1,510	6,430	45,434	178,325	232,360
Total financial assets	**43,794**	**7,530**	**16,064**	**55,167**	**178,325**	**300,880**
Financial liabilities						
Shares	246,389	4,209	10,447	5,846	-	266,891
Amounts owed to credit institutions	-	2,505	2,002	-	-	4,507
Amounts owed to other customers	7,768	-	500	-	-	8,268
Derivative financial instruments	-	10	14	160	-	184
Total financial liabilities	**254,157**	**6,724**	**12,963**	**6,006**	**-**	**279,850**
Net liquidity gap	**(210,363)**	**806**	**3,101**	**49,161**	**178,325**	**21,030**

31. FINANCIAL INSTRUMENTS continued

LIQUIDITY RISK continued

Maturity analysis for financial assets and financial liabilities continued

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**

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 (2017: £200,000). 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 2018	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	246,389	4,216	10,529	6,166	-	267,300
Amounts owed to credit institutions	-	2,508	2,014	-	-	4,522
Amounts owed to other customers	7,768	-	502	-	-	8,270
Derivative financial instruments	-	7	11	513	-	531
Total financial liabilities	**254,157**	**6,731**	**13,056**	**6,679**	**-**	**280,623**

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**

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 is also an interest rate sensitivity assessment to represent 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 2018	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	-	-	-	272	272
Balances with the Bank of England	34,106	-	-	-	34,106
Loans and advances to credit institutions	13,756	5,999	-	25	19,780
Debt securities	6,920	3,600	3,716	50	14,286
Derivative financial instruments	-	-	-	76	76
Loans and advances to customers	167,485	7,417	57,700	(242)	232,360
Other assets	-	-	-	2,216	2,216
Total assets	**222,267**	**17,016**	**61,416**	**2,397**	**303,096**
Liabilities and reserves					
Shares	249,101	10,413	5,826	1,551	266,891
Amounts owed to credit institutions	2,497	2,002	-	8	4,507
Amounts owed to other customers	7,756	500	-	12	8,268
Derivative financial instruments	-	-	-	184	184
Other liabilities	-	-	-	826	826
Reserves	-	-	-	22,420	22,420
Total liabilities and reserves	**259,354**	**12,915**	**5,826**	**25,001**	**303,096**
Impact of derivative instruments	52,475	565	(53,040)	-	-
Interest rate sensitivity gap	**15,388**	**4,666**	**2,550**	**(22,604)**	-
Sensitivity to profit and loss reserves					
Parallel shift of +1%	(19)	(28)	(72)	-	(119)
Parallel shift of +2%	(38)	(57)	(141)	-	(236)

31. FINANCIAL INSTRUMENTS continued

MARKET RISK continued

INTEREST RATE RISK continued

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					
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)

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	2018 ASSETS £'000	2018 LIABILITIES £'000	2017 ASSETS £'000	2017 LIABILITIES £'000
Interest rate swap	67	158	42	196

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:

	2018 Number of key personnel and their close family members	**2018** Amounts in respect of key personnel and their close family members £'000	2017 Number of key personnel and their close family members	2017 Amounts in respect of key personnel and their close family members £'000
Loans and advances to customers	**1**	**138**	3	544
Share and deposit accounts	**18**	**159**	18	139

Country by Country Reporting for the year ended 31 December 2018

Basis of preparation.

The Capital Requirements (Country-by-Country) Regulations 2013 ("the Regulations") implement Article 89 of the Capital Requirements Directive IV ("CRD IV"), which require credit institutions and investment firms in the EU to disclose annually, certain information on a consolidated basis. The disclosures below have been prepared to comply with the requirements of the Regulations for the year ended 31 December 2018.

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.

	2018	2017
Number of employees (average full time equivalent for the year)	**65**	60
Turnover £'000 (1)	**5,314**	5,202
Pre-tax profit £'000	**755**	769
Corporation tax paid £'000 (2)	**160**	269
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 2018 is in respect of the results for the year ended 31 December 2017.

Independent Auditor's Report to the Directors of the Vernon Building Society.

Report on the audit of the country-by-country information

Opinion
In our opinion, Vernon Building Society's country-by-country information for the year ended 31 December 2018 has been properly prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

We have audited the country-by-country information for the year ended 31 December 2018 in the Country by Country Reporting disclosures.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the country-by-country information section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Emphasis of matter - Basis of preparation
In forming our opinion on the country-by-country information, which is not modified, we draw attention to the basis of preparation and related notes. The country-by-country information is prepared for the directors for the purpose of complying with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. The country-by-country information has therefore been prepared in accordance with a special purpose framework and, as a result, the country-by-country information may not be suitable for another purpose.

Conclusions relating to going concern
ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the country-by-country information is not appropriate; or
- the directors have not disclosed in the country-by-country information any identified material uncertainties that may cast significant doubt about the 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 country-by-country information is authorised for issue.

We have nothing to report in respect of the above matters. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Society's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear, and it is difficult to evaluate all of the potential implications on the Society's trade, customers, suppliers and the wider economy.

Responsibilities for the country-by-country information and the audit

Responsibilities of the directors for the country-by-country information
The directors are responsible for the preparation of the country-by-country information in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013 as explained in the basis of preparation in the country-by-country information, and for determining that the basis of preparation and accounting policies are acceptable in the circumstances. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of country-by-country information that is free from material misstatement, whether due to fraud or error.

In preparing the country-by-country information, the directors are responsible for assessing the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the country-by-country information
It is our responsibility to report on whether the country-by-country information has been properly prepared in accordance with the relevant requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Our objectives are to obtain reasonable assurance about whether the country-by-country information as a whole is 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 this country-by-country information.

A further description of our responsibilities for the audit of the country-by-country information is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
This report, including the opinion, has been prepared for and only for the Society's directors in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013 and for no other purpose. We do not, in giving this opinion, 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.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
27 February 2019

1. STATUTORY PERCENTAGES

	2018 %	STATUTORY LIMIT %
Proportion of business assets not fully secured on residential property (Lending Limit)	4.34	25
Proportion of shares and borrowings not held by individuals (Funding Limit)	6.69	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 2018 %	GROUP 2017 %
Gross capital as a percentage of shares and borrowings	8.02	7.98
Free capital as a percentage of shares and borrowings	7.50	7.55
Liquid assets as a percentage of shares and borrowings	24.40	25.22
Profit after taxation as a percentage of mean total assets	0.20	0.21
Management expenses as a percentage of mean total assets	1.52	1.54

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 2018 and 2017 general reserves.

Mean total assets is the average of the 2018 and 2017 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 2018

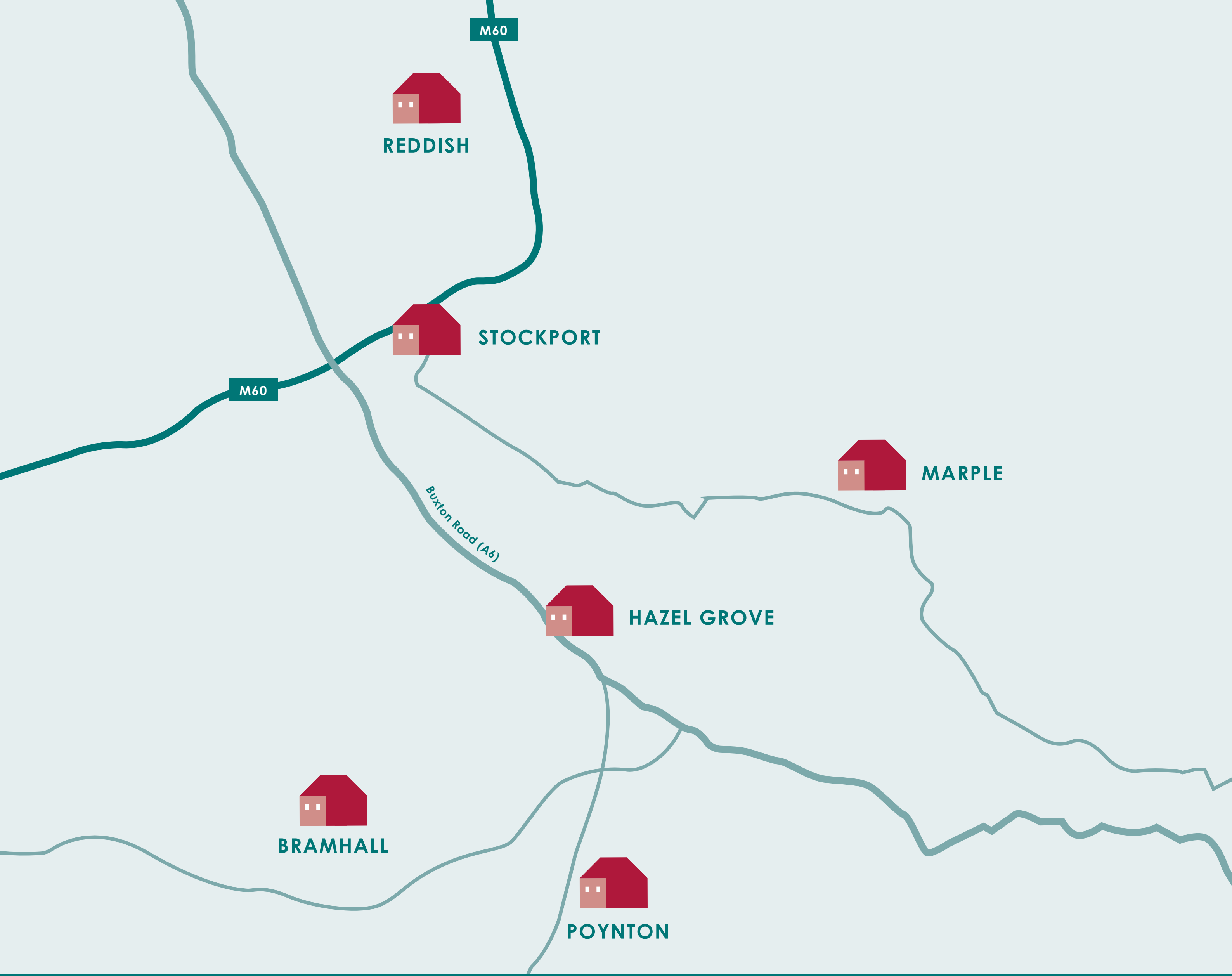
DIRECTORS	DATE OF BIRTH	DATE OF APPOINTMENT	OCCUPATION	OTHER DIRECTORSHIPS
S. Fletcher	25.04.63	05.02.18	Building Society Chief Executive.	_
J. Aspin	13.05.70	24.11.16	Building Society Finance Director	Vernon Estates Ltd* Vernon Financial Services Ltd* Vernon Property Services Ltd* The Mortgage Gateway Ltd*
J. Quirke	08.06.66	04.01.18	Chartered Management Accountant	The British Show Jumping Association Q Accounting Services Ltd
W. Gray	25.11.65	02.04.18	Company Director/Consultant	Wesleyan Bank Mortgage Market Ltd Owed Ltd
A.S. Murdoch	27.03.49	29.11.07	Chartered Surveyor	Berkeley Towers Residents Company Limited Brookhouse Properties Limited
J. Hughes	24.02.62	01.04.14	Company Director/Consultant	Vernon Estates Ltd* Vernon Financial Services Ltd* Vernon Property Services Ltd* The Mortgage Gateway Ltd*
S. Jee	29.05.55	01.12.14	Company Director Chartered Accountant	Babcock Pension Trust Ltd Cavendish Fluor Partnership Ltd Magnox Ltd Magnox Electric Gp Pension Trustee Co. Ltd The Sutton Academy The Riverside Group Ltd Riverside Foundation (Trustee) Riverside Consultancy Services Ltd Riverside Urban Services Ltd Riverside Finance PLC The Hulme Hall Trust Foundation (Trustee) The St Michael's Housing Trust (Trustee) Donald Bates Charity (Trustee) Eleanor Godfrey Crittall Charity (Trustee)

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

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

* Dormant subsidiary of Society

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



Reddish
4 Gorton Road
Reddish, Stockport
SK5 6AE

0161 429 4315
reddish@thevernon.co.uk

Stockport
19 St Petersgate
Stockport
SK1 1HF

0161 429 4305
info@thevernon.co.uk

Marple
1 The Ridgedale Centre
Hollins Lane, Stockport
SK6 6AW

0161 429 4316
marple@thevernon.co.uk

Hazel Grove
190 London Road
Hazel Grove, Stockport
SK7 4DQ

0161 429 4313
hazelgrove@thevernon.co.uk

Bramhall
12b Woodford Road,
Bramhall, Stockport
SK7 1JJ

0161 429 4312
bramhall@thevernon.co.uk

Poynton
87 Park Lane
Poynton, Stockport
SK12 1RD

01625 855830
poynton@thevernon.co.uk

Head Office
19 St Petersgate
Stockport
SK1 1HF

Email
info@thevernon.co.uk

Website
www.thevernon.co.uk

Telephone
0161 429 6262

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