PENRITH BUILDING SOCIETY

Annual Report and Accounts

31 December 2019

CONTENTS

CHIEF EXECUTIVE'S BUSINESS REVIEW
FOR THE YEAR ENDED 31 DECEMBER 2019

Having completed my second year as Chief Executive of your Building Society, it is my privilege to report that 2019 was a year that broke many records, supported by loyalty from our membership and a team of colleagues that really did go that extra mile for you as well as the business itself.

A year of significant growth and progress

Penrith Building Society remains a great business and continues to stay true to its heritage. I hope you will remember that a year ago, I advised you that where 2018 was the year in which we changed our objectives, distribution model and strategy, 2019 was going to be the year that the Society delivered. The team and I are pleased to report that this is exactly what we did, exceeding our expectations in many areas in market conditions that continued to prove very challenging. Our great value products in conjunction with our high level of service led to significant growth in both savings balances and mortgage lending. Our excellent team of staff in every area of the business really did step up to the mark to deliver an extremely robust set of financial results. These results saw profit increase year on year by 5.27% to £169,674 and total assets growing by 5.38% to £113.4 million, predominantly driven by an exceptional performance in mortgage lending.

As a result of our significant lending performance, we reduced liquidity ratios to a more optimal operating level. In addition, where the competitive nature of the market has seen margins on both sides of the balance sheet come under increasing pressure, the Society saw its net interest margin for 2019 increase by four basis points to 1.81%, which is again testament to the strategy we have adopted and achieved.

Economic and Political Outlook

Regarding the market conditions that we operate in, economic and political uncertainty coupled with the emergence of a steady stream of new entrants to the marketplace meant that conditions remained challenging. This is fast becoming the norm and I am proud of the efforts of my colleagues in ensuring that we have successfully navigated these challenges and continue to thrive. In addition, the Board and I remain absolutely confident and committed to our strategy, however, it would be remiss of us not to constantly monitor and review our position in areas of the market that we both want to, and can, compete in without moving outside of risk appetite.

With the UK having withdrawn from the European Union on 31 January 2020, we do now gain a sense of clarity in the direction our Country will take, but, we must also consider that this is only the first stage and that the Government has now given itself firm red lines regarding the date of exit. We expect this to continue to provide uncertainty throughout 2020 until the specifics of negotiated trade deals become clearer, but again remain confident in our chosen strategy. Regarding interest rates, at this point we don't expect a movement in the Bank of England base rate during 2020, but this will be balanced against the economic outlook and our focus remains on maintaining a balanced business that offers best value to our loyal membership whilst ensuring we remain sustainable.

Record breaking mortgage performance

Mortgage lending remains critical to our success and long-term sustainability, so it is particularly pleasing to report that this year we have achieved extraordinary levels of lending helping more members with their borrowing needs than we have before which has resulted in the Society's mortgage assets growing by 12.98% to £90.74 million. This represented our best gross lending performance with the Society completing £26.53 million of new mortgage lending.

Savings growth

Where our lending proposition gained excellent traction in 2019, so did the need for a balanced level of funding. It is pleasing to report that savings balances increased by £5.6 million to £101.4 million. Our mutual ethos and commitment to be fair to both our saving and borrowing members also meant that our weighted average rate across our savings range over the year increased by three basis points to 1.18%.

When considering the savings market, the Society predicts further competition for funding during 2020 as financial institutions continue to pay down their drawings from the Term Funding Scheme and the Funding for Lending Scheme. The Society remains confident however, that we will be able to gain our required share of the market through competitive pricing.

Member engagement

I am also able to report a stable year in our membership base which continues to show a real vote of confidence in the Society. With the Help to Buy ISA Scheme coming to an end in November 2019, we were very pleased with the number of new members that we attracted due to our offering and the strength of the rate we made available. This was an excellent Scheme and we hope to be able to help these saving members gain a foot on the property ladder as they progress through their life. We remain completely committed to the community that we serve in Penrith and the Eden Valley as well as our many members that live in all corners of the United Kingdom.

Meeting the unique needs of borrowers in our heartland and beyond as well as supporting those members that are underserved by the mainstream lenders continues to stand us in good stead. Our individual approach to underwriting continues to allow us to also support the borrowing needs of our members both existing and new as well as specific demographics such as later life borrowers and UK citizens who are making their living in different areas of the globe.

Supporting our Community

Our social purpose as a mutually owned organisation is something that continues to drive our culture and is at the heart of everything we do. In 2019 we supported many local charities and causes in Penrith and around the Eden Valley. We continued to support the financial education of the younger generation of Penrith in conjunction with Queen Elizabeth Grammar School and Ullswater Community College and remain committed to this going forward.

Our affinity accounts supported Pride in Penrith Lottery, Eden Valley Hospice & Jigsaw, Penrith RUFC Juniors and the Penrith & District Red Squirrel Group. In 2019, we also proudly introduced another affinity partner which gives our members the opportunity to support another charity close to our hearts, Annie Mawson's Sunbeams Music Trust.

Future Outlook

Our progress in 2019, both commercially and strategically, means we remain optimistic as we look to the future. As stated previously, the Board and I are strongly committed to the Society having a successful and sustainable future as an independent, vibrant Building Society mutually owned by you, our loyal members. The Society has an extremely experienced, capable and talented Board and Executive Team that will continue to monitor any adverse indicators relating to this and many other factors in ensuring the Society remains resilient and strong against potential economic shocks.

As we approach 2020, we have stronger financial foundations in the Society and we remain committed to our strategic objectives and direction and are confident in achieving them.

Our Society exists because of the commitment and dedication of our staff and the ongoing loyalty and support of our members. I would like to thank you all for helping make 2019 such a rewarding year and I look excitedly to continued success in 2020.

Timothy J Bowen (Chief Executive)
6 March 2020

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

The Directors have pleasure in presenting their Annual Report, together with the Group and Society Accounts and Annual Business Statement, for the year ended 31 December 2019.

This is the first year that the Society's fully owned subsidiary has been operational and therefore Group accounts have been prepared for the first time. The principal activity of the subsidiary is detailed in Note 15 of the Accounts. As the activity of the subsidiary is aligned with that of the Society, references and results reported throughout the Directors' Report to Society include the consolidated performance and position of the subsidiary, unless specifically noted otherwise.

Strategic Business Review

The vision is to be a thriving, sustainable and relevant building society, that is committed to what it does, has straighforward great value products and delivers long-term value for members and the community.

Our values, which support the vision, are summarised as follows:

Straightforward – We will be easy to transact with and will always look for ways to make things more straightforward for our members.

Mutual – Our members are at the heart of everything we do. We will continue to enhance the benefits of mutuality and will never lose sight of our purpose.

Aspiring – We will be there to support our members and our staff to achieve what they aspire to, for themselves and their families throughout their lifetime.

Relevant – We will always look for ways to ensure we stay relevant whilst remaining true to our roots.

Trustworthy – We are transparent, honest and fair in our dealings with our members, so they can have the utmost trust and confidence in us as an organisation.

In working towards the achievement of our vision, our long-term strategy is to grow in a controlled manner. The Board and Executive:

- Remain confident that we have and will continue to successfully identify areas of the mortgage market that we can both be competitive in and wish to compete in and continue to leverage our intermediary relationships.
- Are committed to continuing as an independent, profitable and operationally resilient mutual, whilst continuing to fulfil the social aspect of our purpose.
- Will maximise the value of the Group's brands, by engaging with and supporting the financial education of our membership and the community we serve.
- Continue to invest in improving our people, processes, systems and controls.
- Are in agreement about the requirement to identify and invest in the right option regarding the working environment for the Group, to promote growth, efficiency, member experience and staff wellbeing.
- Continue to identify the right strategic partners, to maximise value in all areas of the business.

Achieving the above will allow the Group, over a longer-term horizon, to be able to generate stronger returns, withstand financial stress and operate credibly and competitively in the financial services environment.

The Group's principal business objectives are the provision of mortgage finance for residential property, savings products for private individuals and local businesses and related services.

Key Performance Indicators

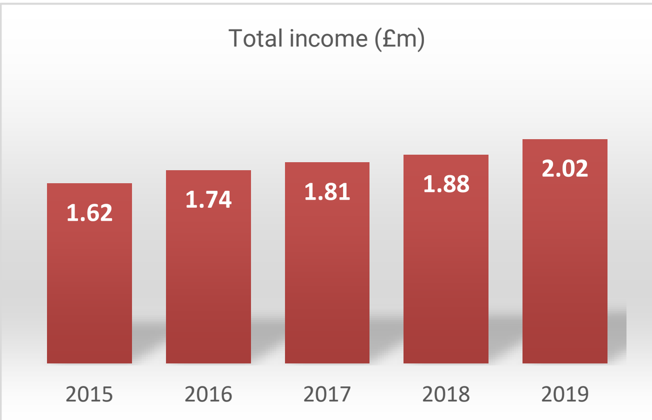
The Board uses a number of key performance indicators to measure and monitor the performance and position of the Society on an ongoing basis. A summary of these measures over the last five years has been explained further below.

Income and Expenditure

The Society made a profit for the year after taxation of £169,674 (2018: 161,183).

Total income is £2.02 million, compared to £1.88 million in 2018. The net interest margin widened following a repricing of mortgage products mid year to better reflect the market and the risks associated with a bespoke underwriting approach. This helped income targets to be met against a challenging mortgage environment.

The Society continues to monitor fees for mortgage products, keeping these as low as possible and pays fees on certain products on behalf of borrowers. Introducer fees are paid to intermediaries, through which the Society continues to source a significant amount of new lending.



DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2019

Key Performance Indicators, continued

Income and expenditure

Management expenses including depreciation are £1.80 million (2018: £1.69 million), an increase of 6.62%. The cost income ratio is now 89.34% (2018: 89.75%). Management expenses expressed as a ratio of mean total assets are 1.63% (2018: 1.57%).

The most significant investment continued to be made in our people and technology to support the future sustainability of the Society and, to improve the experience of members as they interact with the Society.

Investment was also made in the distribution channels for the Society, following the appointment of a Business Development Manager at the start of the year. This led to further enhancement of the intermediary relationships. The decision was taken to create a subsidiary company through which the Society could run its direct mortgage business, with the risks associated with the advice process being managed by a third party and the reward being seen through a share of the procurement fee income from these cases.

The performance of the mortgage book continues to be strong in the low interest rate environment, with arrears being managed through arrangements being put in place with the affected borrowers and the number of cases above three months in arrears being kept to a minimal.

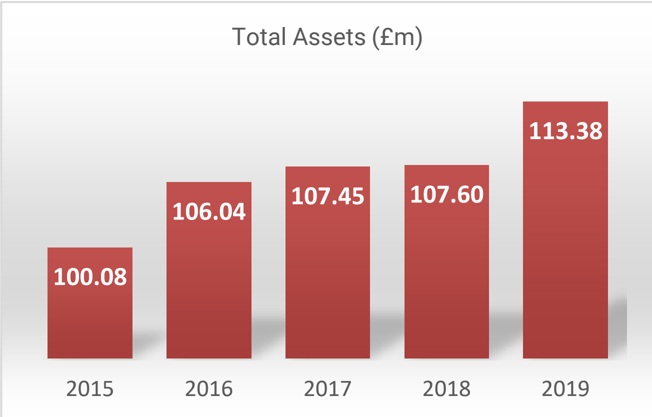
The level of individual loan loss provisions is reduced following the sale all remaining properties in possession and a general low level of more serious arrears and is now only £22,050 (2018: £76,112).

The collective loan loss provision continues to be calculated using a risk weighted approach and has increased to £106,828 (2018: £96,873) as a result of the growth in the size of the mortgage book. The Society continues to apply a 5% reduction to the House Price Index used to estimate current value of properties in this calculation, reflecting the concerns around property prices with the current political uncertainties.

Costs associated with the Financial Services Compensation Scheme Levy decreased this year resulting in a credit being recognised at year end.

Total assets

The growth in mortgage assets was supported by the need for additional savings funds and an overall growth in total assets to £113.38 million (2018: £107.60 million).

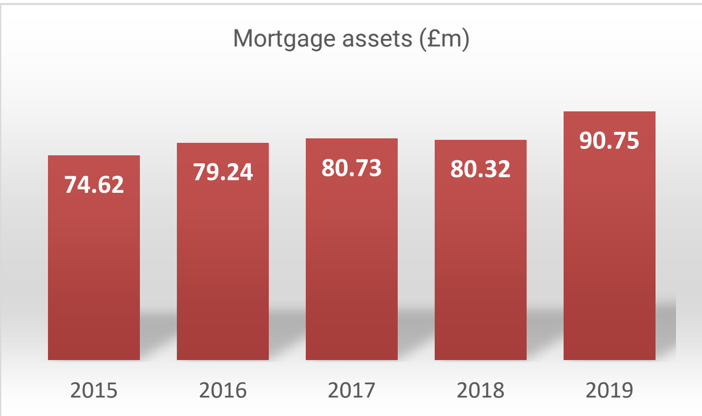


Loans and advances

Changes were made to the mortgage distribution model this year, consolidating the intermediary partners the Society works with and utilising the subsidiary to broker direct cases.

The Society is restricted as to the levels of fixed rate mortgage business it can write annually, which has been challenging in the continued low interest rate environment. However, we maintain a good range of variable rate mortgage products and are able to support those who are unable to go to mainstream lenders for their mortgage needs due to more complex financial positions which we can individually underwrite.

Our gross lending increased to £26.53 million (2018: £15.42 million), which was a record lending achievement for the Society and a significant step up from the previous year. The appointment of the Business Development Manager and a range of products that suit the market we are looking to operate in have been key to this. We completed 202 advances, including 17 further advances.



Our strategy to retain existing borrowers has continued to prove effective, with a retention rate above 68% for those borrowers at the end of mortgage schemes.

Net mortgage assets now stand at £90.75 million (2018: £80.32 million) as a result of both the advances and retentions work.

At 31 December 2019 there was one mortgage case (2018: none) where the repayment of principal and interest was twelve or more months in arrears and five cases (2018: one) with forbearance measures in place.

In spite of an increase in forbearance measures, we continue to maintain a very small number of arrears cases in the current low interest rate environment and as noted above, the mortgage loan loss provisions required are minimal. The Society had no properties in possession at the end of 2019 (2018: one).

The Society takes all reasonable steps to minimise loss and to ensure that the provisions of the Responsible Lending Policy are monitored through individual underwriting so that due account may be taken of prevailing economic conditions.

In particular, the Society is vigilant to the financial stresses which may arise for borrowers if interest rates start to increase.

We offer constructive assistance and forbearance to borrowers in financial difficulty and maintain a personal approach, which our borrowers prefer, allowing us to develop a better understanding of their needs and individual circumstances.

DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2019

Key Performance Indicators, continued

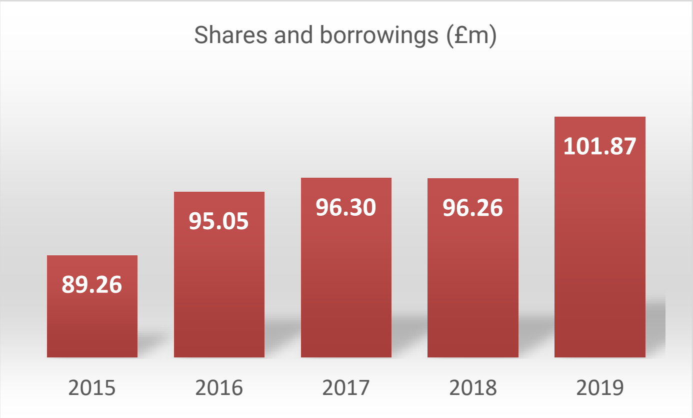
Shares and borrowings

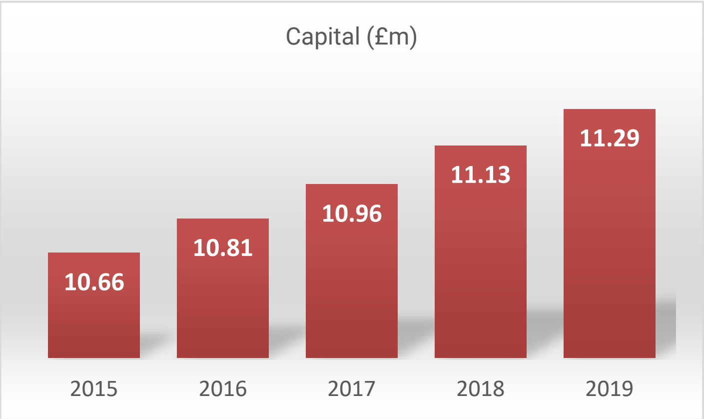
Shares and borrowings have increased to a total of £101.87 million at the year end (2018: £96.26 million).

The inflows were seen on the Help to Buy ISA, fixed rate bonds and a fixed term bond, the latter being in the final quarter of 2019.

The Society monitors our savings rates compared to the market on a regular basis and has seen the weighted average rate on the savings products increase from 1.15% to 1.18% in 2019. We have not adjusted any savings rates down in 2019.

The focus in 2019 was to attract good quality residential mortgage assets to replace surplus liquid assets (being cash and treasury investments) to improve the margin. Liquid assets fell to £21.54 million at the end of 2019 (2018: £26.16 million), being 21.14% (2018: 27.17%) of total shares and borrowings.





Capital

At 31 December 2019, the Society's capital is £11.29 million (2018: £11.13 million).

A satisfactory level of capital is maintained to ensure the Society is protected against any adverse changes in economic conditions in general or in circumstances particular to the Society.

The free capital ratio (the aggregate of general reserve and collective impairment for losses on loans and advances less tangible and intangible assets) has been consistent year on year at 11.43% of total shares and borrowings (2018: 11.42%).

Gross capital amounted to 11.09% of total shares and borrowings (2018: 11.56%), but still remained strong for the building society sector.

To meet regulatory requirements, a risk assessment of the Society's capital policies and procedures (the Internal Capital Adequacy Assessment Process) is carried out by the Executive and approved by the Board at least annually.

The table opposite summarises the Core Tier 1 Ratio, being Core Tier 1 Capital (reserves excluding mortgage impairments) as a percentage of risk weighted assets and the Leverage Ratio, being Tier 1 Capital as a percentage of total assets plus mortgage impairments plus a proportion of mortgage pipeline commitments.

These aspects are expanded on further in the Society's Basel IV disclosures for Pillar 3, available on the Society's website, www.penrithbs.co.uk

	2019 £m	**2018 £m**
Tier 1 capital	11.3	11.1
Total capital	11.3	11.1
Risk weighted assets:		
Liquid assets	3.7	5.2
Loans and advances	35.1	29.7
Other assets	1.0	1.2
Operational risk	1.9	1.7
Total risk weighted assets	41.7	37.8
Capital ratios:		
Core tier 1	27.01%	29.42%
Leverage	9.96%	10.33%

Country by Country Reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 place certain reporting obligations on financial institutions that are within the scope of the Capital Reporting Directive IV (CRD IV). The purpose of the regulations is to provide clarity on the source of the Society's income and the location of its operations. The annual reporting requirements as at 31 December 2019 are included in Note 30 on page 38.

Principal Risks and Uncertainties

The main risks to which the Society is exposed are detailed below.

In addition to these risks, the Society is at risk from the uncertainties surrounding Brexit, which could impact the markets in which we operate. In particular changes to interest rates, a fall in house prices and a weakening of the UK economy could influence borrowers' abilities to repay mortgages and levels of new business for both mortgages and savings.

The Society has a policy of low exposure to risk so as to maintain member confidence and to allow the achievement of its corporate objectives. There is a formal structure for risk management which includes full control procedures as well as the establishment of risk limits, mandates and reporting lines.

Principal Risks and Uncertainties, continued

As a regulated financial institution, we have undertaken stress testing on our Corporate Plan forecasts. The most recent stress tests included a 40%+, reduction in the House Price Index, an increase in unemployment and both increases and decreases to interest rates, all factors which have been highlighted around Brexit. This showed the Society is resilient to the impact this would have on our results and that the business is sustainable.

Credit Risk
This is the risk of a borrower or counterparty not meeting obligations when they fall due. All applications for mortgages are assessed individually under the Board approved Responsible Lending Policy and existing mortgages are monitored regularly for potential default. With regard to counterparty investments, the Board has set appropriate credit limits covering exposure to individual counterparties, sectors and countries and processes are in place to ensure that such limits are not breached and are monitored on a regular basis. Exposures to this risk are set out in Note 29 on page 35.

Interest Rate Risk
This is the risk of exposure to movements in interest rates. The Society has a small tranche of fixed rate mortgage and savings products and this risk arises from the exposure to fixed rate investments including Certificates of Deposit, Gilts and Treasury Bills. This risk is managed by appropriate policies approved by the Board. The interest rate sensitivity of the Society at 31 December 2019 is detailed in the market risk section of Note 29 on page 37.

Liquidity Risk
This is the risk of the Society being unable to meet its financial obligations as they fall due. The Board approved Liquidity Policy requires that sufficient liquid resources be held to ensure that all fluctuations in funding are covered, member confidence is maintained and the Society is able to meet calls on funds when they fall due, in line with recovery plan options.

Funding Risk
The Society is a retailer of financial instruments in the form of mortgage and savings products and also uses wholesale financial instruments to invest in liquid assets and, to raise funds from wholesale money markets in support of its retail savings operations. These instruments also allow the management of risks arising from these business markets. This is further discussed in the Liquidity Risk section of Note 29 on page 38.

Reputational Risk
This is the risk of events arising which damage our reputation or lead to loss of public confidence. The Society has controls in place which are monitored by the Board with an aim to safeguard members' funds at all times and periodically reviews risks and contingency funding strategies through disaster recovery tests.

Operational Risk
This is the risk of loss through inadequate or failed systems, human error or other external factors. All areas of the Society's business have appropriate Board approved systems of control and policies and adherence to these is monitored by senior management and the Audit, Risk and Compliance Committee.

Conduct Risk
This is the risk of the Society not being fair to its members in all dealings with them. The Board monitors the Society's response to this risk through the Conduct & Operational Risk Committee, which considers within its role new product development, the existing product base, member feedback and complaints and overall trends in member management information.

Concentration Risk
This is the risk of loss due to a large individual or connected exposure that could be affected by common factors and the risk to the Society of its geographical concentration in Cumbria. The Board sets maximum limits for exposures to individual borrowers and treasury counterparties. It also monitors lending both within the county and externally and has set targets to increase the national coverage to mitigate the local concentration risk.

Fraud and Financial Crime Risk
This is the risk of a loss due to a fraudulent transaction or money laundering related activities. The Society has formal processes in place to identify all members from their initial contact with the business and at other points in their relationship cycle, which involve face to face contact, or the use of external information. Ongoing transactions are monitored for unusual activity based on our knowledge of the members and other third party relationships.

Climate Risk
This is an emerging risk to the Society due to the changes in the environment. In recent years the Society has seen increased risks due to floods and other factors for properties in the mortgage book and has been assessing the risk of modern methods of construction when considering how a loan can be underwritten. Monitoring of this risk will be developed further in 2020 to ensure our Responsible Lending Policy adequately reflects the risks in this area.

Cyber Risk
This is the risk of loss due to a cyber related event. The Society continues to invest in its technology infrastructure and controls to limit the exposure to a potential loss due to a cyber attack. Penetration tests are carried out periodically on the core systems and access to the key areas are restricted by both physical and non-physical measures.

Personnel Risk
As a small business, the Society is reliant on key personnel to manage the business day to day. The Society maintains Blind Handover documents, in line with the Senior Managers and Certification Regime and has a formal succession plan in place for key roles, which is managed through the Nominations Committee.

DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2019

Land and Buildings

The Directors consider that the overall market value of the Society's Principal Office is in excess of the book value.

Donations

During the year charitable donations totalling £6,642 (2018: £8,338) were made. No contributions were made for political purposes.

Directors

The following persons were Directors of the Society during the year:

Non-Executive Directors

Rob Cairns	Chairman
Alan Waterfield	Vice Chairman
Will Lindsay	Senior Independent Director
Janice Lincoln	
Richard Drinkwater	
Richard Vecqueray	

Executive Directors

Tim Bowen	Chief Executive
Elspeth James	Finance Director

All Directors retire on an annual basis and offer themselves for re-election, with the exception of Alan Waterfield, who is retiring from the Board after over 9 years of continued service and Richard Vecqueray, who is stepping down due to other commitments after three years of continued service.

During the 12 months ended 31 December 2019, Tim Bowen has been a Non-Executive Director of Mutual Vision Technologies Limited, which provides IT services to the Society. There were no other associated bodies in which the Society or its Directors had an interest.

Staff

The Directors are pleased to record their appreciation to management and staff for their hard work and loyal service rendered during the year.

The Board encourages the personal development and training of both management and staff in order to ensure that employees have sufficient expertise, qualifications and relevant skills to provide the standard of service required. Wherever appropriate, staff and management attend suitable training courses and seminars to support their personal development.

Creditor Payment Policy

Our policy is to agree the terms of payment at the commencement of trading with each supplier, to ensure that they are aware of those terms and to abide by them. Where terms of payment have not been agreed we settle the supplier's invoice on being satisfied that the supplier has fully conformed with the terms and conditions of purchase. Creditor days were 12 at 31 December 2019 (2018: 12 days)

Change of External Auditor

Following the unanimous recommendation of the Audit, Risk and Compliance Committee, the Board intends to propose to members an ordinary resolution that Mazars LLP be reappointed as auditor of the Society until the conclusion of the 2021 Annual General Meeting.

Going Concern

Forecasts of the Society's financial position for the period ending at least twelve months from the date of the signing of these accounts have been prepared. The effects of various stressed scenarios on the Society's financial position have also been calculated. These forecasts have satisfied the Directors that the Society has adequate resources to continue in business for the foreseeable future. For this reason, the accounts continue to be prepared on the going concern basis.

Post Balance Sheet Events

The post balance sheet events have been recorded in Note 28, on page 34.

Approved and signed on behalf of the Board

Tim Bowen	**Alan Waterfield**
(Chief Executive)	**(Vice Chairman)**
6 March 2020	

Penrith building society
Listening and Supporting, Since 1877

CORPORATE GOVERNANCE REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

The Society's Board views good corporate governance as an essential part of the Board's responsibility to the Society's members. The Society has regard to the UK Corporate Governance Code (2018 version) issued by the Financial Reporting Council in developing its policies and procedures as set out below:

Leadership

The Board

The Board provides leadership and direction in achieving the Society's objectives and activities and is responsible for the continued success of the Society for its members. It is responsible for setting strategy, formulating policies and providing guidance on the management of the Society. It regularly reviews financial performance and ensures that there are effective risk management controls and procedures in place. It reviews and updates the Corporate Plan for the Society on an annual basis ensuring the strategic objectives are fit for purpose and are aligned to the Society's vision and values.

Board Composition

The Board comprises two Executive Directors (the Chief Executive and Finance Director) and six Non-Executive Directors. The Executive Directors are responsible for the day to day management of the Society within the guidelines set by the Board. Non-Executive Directors are essential for the governance of the Society providing, amongst other things, challenge to the Executive Directors and senior management, setting objectives, monitoring performance and determining remuneration of the Executive Directors.

The Chairman, a Non-Executive Director, is elected annually by the Board. The main role of the Chairman is to lead the Board and ensure its effective operation in all aspects of its role.

Effectiveness

Board Independence

The Board considers that all of its Non-Executive Directors are independent. Will Lindsay is Senior Independent Director and is available to members having any concerns which they consider would be inappropriate to discuss with the Executive Directors or other management. The Senior Independent Director also facilitates a meeting of the Non-Executive Directors without the Chairman being present.

The Society's Rules require all Directors to submit themselves for election by members within sixteen months of their appointment to the Board and for re-election at least every three years thereafter. However, the Board has adopted the revised code of annual re-election.

Board Appointments

Where the need for a new director is identified, for any reason, the Chief Executive prepares a description of the person required based on the skills, qualifications and experience needed to ensure an adequate balance of skills at Board level. The Nominations Committee, which includes the Chairman, oversees the recruitment of all Directors.

A formal recruitment process will be employed and may include the advertising of the position in appropriate media, canvassing the Society's membership or use of an external search agency.

The Chairman of the Board, where possible, is appointed from among the existing Non-Executive Directors. Where there is no suitable candidate identified, an external search agency would be used.

The Board has regard to the Walker Report on Diversity.

It is necessary for Board appointments to be notified to the Society's Regulators. Where an Executive Director or an Approved Non-Executive Director is to be appointed this must be formally approved by the Society's Regulators under the Senior Managers and Certification Regime and this may include a personal interview with the Prudential Regulation Authority or Financial Conduct Authority or both.

Performance Evaluation

A formal process exists to evaluate, on an annual basis, the performance and effectiveness of individual Directors and of the Board as a whole. In 2019, the appraisal of the Chairman was carried out by the Chief Executive and Senior Independent Director. The other Non-Executive Directors' appraisals were carried out by the Chief Executive and Chairman, except for that of the Senior Independent Director, which was completed by the Chief Executive and Vice Chairman. These appraisals are based on a number of factors including attendance at meetings and external events, contribution and performance at meetings and challenge to the Executive.

Appraisal of the Chief Executive was carried out by the Chairman and Vice Chairman and the appraisal of the Finance Director was carried out by the Chairman and Chief Executive. Both these individuals are appraised on an annual basis.

The appraisal of the Chairman includes specific requirements to review how they lead the Board, promoting a culture of openness and debate, ensuring all Directors contribute to discussions and that they receive accurate, timely and clear information to allow them to discharge their Board responsibilities.

The effectiveness of the Board as a whole and its committees is reviewed annually by the Board. This includes a review of terms of reference for the Board and committees and confirmation that information, training, time and resources have been made available to all members of the Board or committees to allow them to participate in the relevant meetings.

Accountability

The Executive Directors and management team have created a Risk Management Framework to identify, quantify (if possible) and manage risks faced by the Society. The sub-risks within this are linked to underlying day to day controls within the Society, to ensure risk is being appropriately managed. The Board is responsible for the oversight and challenge of this process and reviews the risk strategy and policies on a continual basis as both internal and external factors impact on the day to day activities of the Society.

The Board has delegated the responsibility for managing internal control to the Executive Directors and Senior Management Team. The Internal Audit function has been outsourced and provides independent assurance to the Board through the Audit, Risk and Compliance Committee that these controls are adequate and effective.

Fitness and Propriety

All Directors must meet the fitness and propriety requirements under the Senior Managers and Certification Regime and must complete a questionnaire annually confirming their continued compliance with this requirement.

All Directors are provided with clear, timely and accurate information to enable them to fulfil their duties and responsibilities. They have access to the advice of the Secretary. In addition, any Director may take independent professional advice at the Society's expense should this be considered necessary.

There are ever increasing burdens on Non-Executive Directors. They must devote considerable time to the Society. As well as attendance at Board Meetings, there must be a commitment to develop skills and knowledge from both internal and external sources to enable them to fulfil their duties and responsibilities. All new Directors are provided with induction training and all Directors are encouraged to attend training courses, seminars and other events to maintain up to date knowledge of the matters affecting the Society and the building society sector as a whole.

Strategic Direction

The Executive Directors and management team input to the Corporate Plan on an annual basis, which is agreed and approved by the Board. From the Corporate Plan an operational plan for the business is created to allow each strategic objective to be managed and monitored by both management and the Board, the latter reviewing progress on at least a quarterly basis.

Culture

The Society reviews the cultural behaviour of the Board and staff on a monthly basis through its Conduct and Operational Risk Committee (CORC), a management sub-committee of the Executive Risk Committee. A formal culture dashboard setting out the Society's response to the alignment of business performance and behaviours is to be created in 2020 and outcomes from this will be reported to the CORC and escalated to the Board as appropriate. Additionally in 2019, the Board undertook two independent staff surveys on culture, one through the Banking Standards Board and the other, via Internal Audit. The output from both surveys has been reviewed and actions to address points raised forms part of the strategic objectives for 2020 within the Corporate Plan.

Additionally, the Board have appointed Will Lindsay as a workforce NED champion to allow staff to express their views on the Society outwith the Executive team. All NEDs are encouraged to attend staff training sessions monthly where strategy updates are provided, to allow additional staff engagement and to outline their role on the Board.

Separately to the workforce NED champion, the Society has a whistleblowing NED champion in Janice Lincoln. This allows the staff to raise concerns in confidence and anonymously if they wish. There is a formal agenda item each Board meeting to review any whistleblowing reports arising and to ensure arrangements are in place to undertake an independent investigation and follow up on matters that are raised.

Board and Committee Meetings

Main Board Meetings are held at least twice in every quarter. Additional meetings may be called as required.

Following the principles of good corporate governance, the Board has established certain committees to advise on various issues. The terms of reference for these committees may be obtained from the Secretary. The committees in question are outlined below and a table detailing meeting attendance is provided at the end of the section.

Audit, Risk and Compliance Committee (ARCC)

The Audit, Risk and Compliance Committee is comprised of Janice Lincoln, Will Lindsay, Alan Waterfield and Richard Drinkwater. Janice Lincoln is Chair of the Committee and is a retired building society Finance Director. Both Janice Lincoln and Alan Waterfield are qualified accountants and bring recent, relevant financial experience. In addition, representatives of Internal and External Audit and Internal Compliance and the Executive Directors attend most of these meetings by invitation.

The Audit, Risk and Compliance Committee Report for 2019 is on page 12.

The principal purposes of the Committee includes ensuring that the Society complies with all regulatory and prudential requirements and reviewing the Society's internal controls and management systems against the Society's risk management environment. The Committee is also responsible for the review of the effectiveness of the compliance monitoring and internal audit functions, approval of their respective annual review plans and the monitoring of the External Auditor's independence, objectivity and effectiveness.

Remuneration Committee (RemCo)

The Remuneration Committee is comprised of the Society's Non-Executive Directors. The Chairman of the Committee is Alan Waterfield. The Committee is responsible for setting the Society's remuneration policy for Executive Directors and Non-Executive Directors Fees. The Committee also sets all other benefits and matters relevant to the Executive Directors including contracts of employment with the Society.

The Directors' Remuneration Report for 2019 is on page 14.

Penrith building society
Listening and Supporting, Since 1877

CORPORATE GOVERNANCE REPORT, continued
FOR THE YEAR ENDED 31 DECEMBER 2019

Nominations Committee (NomCo)

The Nominations Committee is comprised of Rob Cairns, Alan Waterfield, Richard Vecqueray, Janice Lincoln and Tim Bowen. Alan Waterfield is Chair of the Committee. The Committee is responsible for making recommendations on appointments to the Board, ensuring that the Board has sufficient directors with appropriate skill sets, who are fit and proper and independent.

The Committee has an annual responsibility to review the Society's Succession Plan and to ensure this remains appropriate to the on-going needs of the Society for both Executive and Non-Executive Directors.

Executive Risk Committee

The Executive Risk Committee is comprised of Elspeth James and Tim Bowen. Elspeth James is Chair of the Committee. Two members of the Society's Executive also attend the meetings and a Non-Executive Director, Will Lindsay attends on a quarterly basis.

The Committee has oversight of the Society's policies and procedures in all areas having an impact on the Society's members and makes recommendations thereon to the Board and management.

Assets and Liabilities Committee (ALCO)

The Assets and Liabilities Committee is a management committee chaired by Tim Bowen which reports monthly to the Board. The Committee monitors liquidity and treasury risk and reviews product pricing for both savings and mortgages against the market. It also reviews forward looking economic data and how the Society's cash flow forecasts and budget projections respond and adapt to market conditions. Non-Executive Directors are encouraged to attend ALCO at least twice a year, or more, if available.

The table overleaf below details attendance of the Directors at the Board and Committee meetings held during 2019.

Relationship with Members

The Society's on-going relationship with its members is an important area of focus. In 2019 opportunities to engage directly with members, included the Annual General Meeting, Penrith Show and the Christmas gathering. These will continue in 2020, with the first being the Annual General Meeting of the Society on 22 April 2020.

The following table details attendance of the Directors at the Board and Committee meetings held during 2019:

	Board	ARCC	RemCo	NomCo	ERC	ALCO
Number of meetings	**9**	**4**	**2**	**6**	**12**	**12**
Rob Cairns	9	1*	2	6	-	3*
Richard Drinkwater	8	3	2	-	-	2*
Janice Lincoln	9	4	2	5	-	2*
Will Lindsay	9	4	2	-	4	2*
Richard Vecqueray	7	2*	2	6	-	1*
Alan Waterfield	9	4	2	5	-	2*
Tim Bowen	9	4*	2*	6	9	11
Elspeth James	9	4*	1*	-	11	12

(* denotes where an individual attended a meeting by invitation only)

Approved and signed on behalf of the Board

Alan Waterfield (Vice Chairman)
6 March 2020

AUDIT, RISK AND COMPLIANCE COMMITTEE REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

The Audit, Risk and Compliance Committee (ARCC) is an essential part of the Society's governance framework, to which the Board has delegated oversight of financial reporting, internal controls, risk management, internal audit and external audit. This report provide an overview of the ARCC's work and details how it has discharged its responsibilities during the year.

The responsibilities of the ARCC are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees. The main function of the ARCC is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- The integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained therein;
- The effectiveness of the system of internal control processes;
- The internal audit and external audit processes;
- The appointment, re-appointment and removal of the external auditors and the periodic review of their performance and independence; and
- The policy on the use of external auditors for non-audit work.

Following each ARCC meeting, the minutes of the meeting are distributed to the Board, and the ARCC Chair provides an update to the Board on key matters discussed.

The composition of the ARCC is detailed on page 10. The Chief Executive, Finance Director, Retail Operations & Distribution Executive and the Head of Risk & Compliance attend the meeting by invitation. Representatives of PwC (internal auditor), and Mazars (external auditor), are also invited to each meeting. At least twice a year, after a meeting, the ARCC have a discussion with the external and internal auditor without management being present.

Key areas reviewed during 2019

The ARCC met four times during the year and focused on the following matters:

Financial Reporting

The primary role of the ARCC in relation to financial reporting is to review and assess with management and the external auditor the integrity and appropriateness of the annual financial statements concentrating on amongst other matters:

- The quality and acceptability of accounting policies and practices;
- The clarity of the disclosures and compliance with financial reporting standards and relevant financial and governance reporting requirements including advising the Board on whether the Annual Report and Accounts, when taken as a whole are fair, balanced and understandable and provide information sufficient for Members to assess the Society's performance, business model and strategy; and
- The material areas in which significant judgements have been applied.

The primary areas of judgement considered by the Committee in relation to the 2019 accounts were:

- Loan loss provisions: Review of judgements used to determine timing of recognition and valuation of loan loss provisions in line with FRS102, specifically HPI forecasts, forced sale discounts and selling costs; and
- Interest income recognition: Review of the design, implementation and effectiveness of controls around the calculation of interest income and charges, including the timing of applicable fees and commission recognition, and behavioural life under effective interest rate methodologies;

The ARCC considered whether the 2019 Annual Report and Accounts were fair, balanced and understandable by satisfying itself that there was a robust process of review and challenge to ensure balance and consistency.

The ARCC fully discharged its responsibilities in relation to financial reporting of the Annual Report and Accounts 2019.

Internal Audit

The ARCC is responsible for monitoring internal audit activities and effectiveness and ensuring that sufficient resources are in place.

In order to provide the scalability and flexibility of specialist resources required within internal audit, the Society continues to outsource this role to PwC.

Key reviews were completed through their agreed work programme during the year including areas of internal control significance (e.g. Anti-Money Laundering, Counter Terrorist Financing and Sanctions, Crisis Management, Mortgage Lending, Employee Engagement and Performance Management and Recovery Planning)

Internal audit findings and thematic issues identified were considered by the ARCC, as well as management's response and the tracking and completion of outstanding actions.

The ARCC considers the guidance from the Chartered Institute of Internal Auditors entitled 'Effective Internal Audit in the Financial Services Sector' when ensuring that the internal auditors and the ARCC were fulfilling their obligations in a robust manner.

The ARCC also approved the fee for the internal audit work for the year having reviewed the scope of the work programme in detail.

PwC operate in accordance with an Internal Audit Charter. The ARCC is satisfied PwC satisfy the required skills and resource to fulfill the role.

AUDIT, RISK AND COMPLIANCE COMMITTEE REPORT, continued
FOR THE YEAR ENDED 31 DECEMBER 2019

Systems of Internal Controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of Members' and Society assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Society operates in an evolving business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the Society's ability to react accordingly. It is the role of management to implement the Board's policies on risk and control. It is also recognised that all employees have responsibility for internal control as part of their accountability for achieving objectives. Staff training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

The internal audit function provided independent assurance to the Board on the effectiveness of the internal control framework through the ARCC. The ARCC reviewed this aspect through regular reporting from management, the Society's internal auditor and the external auditor. The main internal control matters which were reviewed by the ARCC in 2019 were:

- Conduct related issues;
- Prudential related issues;
- Internal audit plans;
- Control reports from the external auditor in relation to the financial reporting process arising from the external audit. During the year Mazars did not highlight any material control weaknesses; and
- The status of issues raised in control reports which were tracked closely. During the year, the volume and age profile of issues raised remained within appropriate parameters.

The information received and considered by the ARCC provided reasonable assurance that during 2019 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code.

External Audit

In June 2019 KPMG LLP advised the Society that they were not willing to continue as auditor of the Society after the 2019 year end. As a result the Society conducted a competitive tender process in which three firms, all of which had financial services experience, were invited to tender for the position. A shortlist of two firms made face to face presentations to a panel comprising the Society's Chair of ARCC, Finance Director and Finance Manager. Following this it was concluded that Mazars LLP was the most appropriate firm for the Society. Mazars LLP also confirmed that it was able to undertake the audit for the year ended 2019.

The members of the ARCC unanimously recommended to the Board, to appoint Mazars LLP as external auditor to transition the external audit for the year ended 2019. This recommendation was both free from influence by a third party and no contractual term had been imposed on the Society limiting its choice of auditor. KPMG LLP formally resigned as auditor of the Society on 15 October 2019 and Mazars LLP were appointed as such with effect from 1 November 2019.

The effectiveness of the external audit process is dependent on appropriate audit risk identification and at the start of the audit cycle the ARCC receives from Mazars a detailed audit plan, identifying their assessment of the key risks.

The ARCC or the ARCC Chair, on behalf of the ARCC holds regular private meetings with the external auditor. This provides the opportunity for open dialogue and feedback from the ARCC and the auditor without management being present. Matters typically discussed include the auditor's assessment of business risks and management's activity in relation to these risks, the transparency and openness of interactions with management, confirmation that there has been no restriction in scope placed on them by management and the independence of their audit.

The ARCC considers the reappointment of the external auditor, including rotation of the audit partner, each year and also assesses their independence on an ongoing basis. The external auditor is required to rotate the auditor partner responsible for the Society's audit at least every five years. The audit in relation to the 2019 results was the first for the current audit partner and indeed the firm after they were appointed in September 2019, following a robust selection process.

The ARCC approved the fees for audit services for 2019 after a review of the level and nature of the work to be performed and being satisfied that the fees were appropriate for the scope of the work required.

ARCC Effectiveness

The ARCC conducted a self-assessment review to monitor its effectiveness which concluded that the ARCC had operated effectively and in accordance with its Terms of Reference. The Terms of Reference were reviewed during the year and found to be fit for purpose.

Approved and signed on behalf of the ARCC

Janice Lincoln (Director)
6 March 2020

DIRECTORS' REMUNERATION REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

The Society's Remuneration Policy is to reward Directors through salary and fees according to their skills, expertise, experience and overall contribution, taking into account salary and fee levels in comparable organisations. The Remuneration Policy follows the 'Remuneration Code' guidelines put in place by the Financial Conduct Authority (FCA), which sets out the standards and policies the Society is required to meet when setting pay for Directors. The Society does not have bonus or share option schemes and therefore no element of variable remuneration. In addition, due to its size, the Society does not have any material risk takers who meet the proportionality thresholds set by the FCA on the implementation of the Remuneration Code and therefore no separate additional disclosures are required.

The Board will include an advisory resolution on the Directors' Remuneration Report at the forthcoming Annual General Meeting.

Non-Executive Directors

The remuneration of all Non-Executive Directors is fee based and is reviewed annually by the Board. They do not participate in any performance pay scheme, pension arrangements or other benefits and do not have service contracts.

The Chairman of the Board, Chairman of the Audit, Risk and Compliance Committee, Chairman of the Nominations Committee and Senior Independent Director receive higher fees than other Non-Executive Directors in recognition of the additional workload and responsibilities incumbent on those positions.

Executive Directors

The Society's policy is to set remuneration at levels sufficient to attract and retain Executives of sufficient calibre and expertise.

Executive Directors' remuneration comprises basic salary and pension benefits, the latter is based on a fixed percentage of salary.

Their remuneration level and structure is considered by the Remuneration Committee which meets at least twice a year, with reference to job content and responsibilities, the performance of the individual and salaries in similar organisations. Additionally the Remuneration Committee consider the achievement of the strategic objectives within the Corporate Plan and the ongoing delivery of the longer term strategy for the Society when considering any inflationary increases to Executive Directors salaries.

The Society does not have a defined benefit final salary pension scheme. The Society makes contributions to the private pension arrangements of the Executive Directors. The contributions are currently at a level above that available to staff. This will be aligned from 1 April 2020, as part of the annual pay review for the Society.

There are no incentive schemes in place for the Executive Directors. The Remuneration Committee has the discretion to add a bonus payment to the remuneration of the Executive Directors annually if they feel there are aspects of their performance that would support an additional reward. This is aligned with the approach taken for all staff and is as a result of the appraisal process completed each year when achievement of objectives, aligned to the strategic goals of the Society, are reviewed.

The Chief Executive's and Finance Director's contracts of employment require a 12 month and 6 month notice period respectively.

Remuneration detail is set out in Note 7 on page 28.

Approved and signed on behalf of the Remuneration Committee

Alan Waterfield (Director)
6 March 2020

DIRECTORS' RESPONSIBILITIES
IN RESPECT OF THE ANNUAL REPORT, THE ANNUAL BUSINESS STATEMENT, THE DIRECTORS' REPORT AND THE ANNUAL ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2019

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

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

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

In preparing these annual accounts, the Directors are required to:

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

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

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Society:

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

The Directors are responsible for such internal controls as they determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Society and to prevent and detect fraud and other irregularities.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PENRITH BUILDING SOCIETY

Opinion

We have audited the annual accounts of Penrith Building Society (the 'Society') and its subsidiary (the 'Group') for the year ended 31 December 2019 which comprise the Income Statement (including Statement of Comprehensive Income), Statement of Financial Position, Cash Flow Statement, Statement of Change in Members' Interest and notes to the accounts, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the annual accounts:

- give a true and fair view of the state of the Group's and Society's affairs as at 31 December 2019 and of the Group's and Society's income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, as applied to and public interest entities and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The impact of uncertainties due to the United Kingdom exiting the European Union on our audit

The Directors' view on the impact of Brexit is disclosed on page 6.

The United Kingdom withdrew from the European Union on 31 January 2020 and entered into an Implementation Period which is scheduled to end on 31 December 2020. However the terms of the future trade and other relationships with the European Union are not yet clear, and it is therefore not currently possible to evaluate all the potential implications to the Society's activities, customers, suppliers and the wider economy.

We considered the impact of Brexit on the Society as part of our audit procedures, applying a standard firm wide approach in response to the uncertainty associated with the Society's future prospects and performance.

However, no audit should be expected to predict the unknowable factors or all possible implications for the Society and this is particularly the case in relation to Brexit.

Conclusions relating to going concern

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

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

Key audit matters

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

We summarise below the key audit matters in forming our audit opinion above, together with an overview of the principal audit procedures performed to address each matter and, where relevant, key observations arising from those procedures. These matters, together with our findings, were communicated to those charged with governance through our Audit Completion Report.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PENRITH BUILDING SOCIETY, continued

<table>
<tr><th>Key audit matter (Group and Society)</th><th>How our audit addressed this key audit matter</th></tr>
<tr><td>Credit risk – impairment of loans and advances to customers (refer to page 24, accounting policy and page 31 annual accounts disclosures)

Credit risk is an inherently judgemental area due to the use of subjective assumptions and a high degree of estimation in arriving at both the specific and collective provisions.

Specific impairment

Loans are assessed for individual impairment by the directors where the loan is in arrears by at least three months, or collateral has been repossessed by the Society.

Collective impairment

The collective impairment is derived from a model that uses a combination of the Society's historical experience and, due to the Society's limited loss experience, external data, adjusted for current conditions. In particular, judgement is required on the key assumptions of probability of defaults existing, time taken for defaults to be identified and forced sale discounts against collateral (including selling costs). The impairment model is most sensitive to movements in the forced sales discount, probability of default and house price index assumptions.</td><td>We performed the following procedures:

• Tested the design and the operating effectiveness of the key controls operating at the Society in relation to credit processes for the monitoring of loans, collections and provisioning.
• Tested the processes by which management identify non-performing loans. We focussed on the identification of impairment triggers, calculation of impairment and consideration of collateral arrangements where relevant.
• Critically assessed specific provisions to gain assurance that they are appropriate by reviewing a selection of non-performing loans, loans in arrears and a selection of loans across the performing portfolio. We challenged management's level of provision by performing an assessment of the valuation of collateral or other sources of repayment.
• Assessed the collective provision methodology and the model used in its calculation. We tested the accuracy of the data input in the model, challenged the key assumptions and considered whether they are consistent with our understanding of the Society loan portfolio. We recalculated the collective provision and verified the inputs to source information.
• Assessed the collective impairment model for its sensitivity to changes in the key assumptions by performing stress testing to help us assess the reasonableness of the assumptions applied by management.

Based on the audit procedures performed, we concur that management has appropriately applied the stated accounting policy and the requirements of FRS 102, in relation to the assessment of impairment of loans and advances to customers and the related disclosures in the annual accounts.</td></tr>
<tr><td>Risk of fraud in revenue recognition – interest income recognition

Net fees earned or incurred on loans forms part of the effective interest rate and is included in interest receivable and similar income. The Society uses a model that spreads the net fees over the expected lives of the loans.

Judgement is required in deciding and assessing the expected repayment profile of the loans and hence the mortgage life used in the effective interest rate ('EIR') calculation. This is informed by product mix and past customer behaviour when loans are repaid.</td><td>We performed the following procedures:

• Assessed the design of the controls that management has adopted in respect of approval of the assumptions used in the recognition of interest and fee income.
• Assessed the basis of management's judgments in respect of the cash flows and timing of the cash flows included in the calculations.
• Validated the inputs to management's calculations to supporting documents, by testing a selection of the cash flows to supporting documents.
• Performed substantive audit procedures to validate the mathematical accuracy of management's calculation.
• Assessed the reasonableness of the expected repayment profile assumptions against historical experience of loan lives based on customer behaviour and product mix.

Based on the audit procedures performed, we concur that management has appropriately applied the stated accounting policy and the requirements of FRS 102, in relation to income recognition and related disclosures.</td></tr>
</table>

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PENRITH BUILDING SOCIETY, continued

Our application of 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 annual accounts line items and disclosures and in evaluating the effect of misstatements, both individually and on the annual accounts as a whole. Based on our professional judgement, we determined materiality for the annual accounts as a whole as follows:

Overall materiality (Group and Society)	£112,000
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 to provide mortgages, savings products and other financial services for the mutual benefit of members and customers and not one of profit maximisation. 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.
Performance materiality	Performance materiality is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. Performance materiality of £78,500 was applied in the audit based on 70% of overall materiality.
Reporting threshold	We agreed with the directors that we would report to them misstatements identified during our audit above £3,300 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

An overview of the scope of our audit

As part of designing our audit, we determined materiality and assessed the risk of material misstatement in the annual accounts, whether due to fraud or error, and then designed and performed audit procedures responsive to those risks. In particular, we looked at where the directors made subjective judgements such as making assumptions on significant accounting estimates.

We tailored the scope of our audit to ensure that we performed sufficient work to be able to give an opinion on the annual accounts as a whole. We used the outputs of a risk assessment, our understanding of the Group and the Society, their environment, controls and critical business processes, to consider qualitative factors in order to ensure that we obtained sufficient coverage across all annual accounts line items.

Our audit procedures were designed to respond to those identified risks, including non-compliance with laws and regulations (irregularities) and fraud that are material to the annual accounts.

In identifying and assessing risks of material misstatement in respect to irregularities including non-compliance with laws and regulations, our procedures included but were not limited to:

- at planning stage, we gained an understanding of the legal and regulatory framework applicable to the Group and the Society, the structure of the Group, the industry in which they operate and considered the risk of acts by the Group and the Society which were contrary to the applicable laws and regulations;
- during the audit, we focused on areas of laws and regulations that could reasonably be expected to have a material effect on the annual accounts from our general commercial and sector experience and through discussions with the directors (as required by auditing standards), from inspection of the Group's and Society's regulatory and legal correspondence and review of minutes of directors' meetings in the year. We identified that the principal risks of non-compliance with laws and regulations related to breaches of regulatory requirements of the PRA and the FCA. We also considered those other laws and regulations that have a direct impact on the preparation of the annual accounts ,such as the Building Societies Act 1986 and UK tax legislation; and
- we discussed with the directors the policies and procedures in place regarding compliance with laws and regulations. We discussed amongst the engagement team the identified laws and regulations, and remained alert to any indications of non-compliance.

Our procedures in relation to fraud included but were not limited to:

- inquiries of management whether they have knowledge of any actual, suspected or alleged fraud;
- gaining an understanding of the internal controls established to mitigate risk related to fraud;
- discussion amongst the engagement team regarding risk of fraud such as opportunities for fraudulent manipulation of annual accounts, and determined that the principal risks were related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates, in particular in relation to loan impairments and the effective interest rate method of income recognition, and significant one-off or unusual transactions; and
- addressing the risk of fraud through management override of controls by performing journal entry testing.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PENRITH BUILDING SOCIETY, continued

The primary responsibility for the prevention and detection of irregularities including fraud rests with both those charged with governance and management. As with any audit, there remained a risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal controls.

As a result of our procedures, we did not identify any "Key audit matters" relating to irregularities. The risks of material misstatement that had the greatest effect on our audit, including fraud, are discussed under "Key audit matters" within this report.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the annual accounts and our auditor's report thereon. Our opinion on the annual accounts does not cover the other information and, except to the extent otherwise explicitly stated below in our report, we do not express any form of assurance conclusion 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 such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in 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 in this regard.

Opinions on the Annual Business Statement and the Directors' Report

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

- the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it;
- the information given in the Directors' Report for the financial year is consistent with the accounting records and the annual accounts; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception

The Building Societies Act 1986 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society's individual annual accounts are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations which we consider necessary for the purpose of our audit.

We have nothing to report in these respects.

Responsibilities of Directors

As explained more fully in the directors' responsibilities statement set out on page 15, the directors are responsible for the preparation of the annual accounts and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

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

Auditor's 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 auditor's 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 auditor's report.

Other matters which we are required to address

Following the recommendation of the audit committee, we were appointed by the directors on 1 February 2020 to audit the annual accounts for the year ending 31 December 2019 and subsequent financial periods. The period of total uninterrupted engagement is 1 year, covering the year ending 31 December 2019.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PENRITH BUILDING SOCIETY, continued

Use of the audit report

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Tim Hudson (Senior Statutory Auditor)
for and on behalf of Mazars LLP
Chartered Accountants and Statutory Auditor

Mazars LLP
One St Peter's Square
Manchester
M2 3DE

6 March 2020

INCOME STATEMENT (INCLUDING STATEMENT OF COMPREHENSIVE INCOME)
FOR THE YEAR ENDED 31 DECEMBER 2019

	Notes	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Interest receivable and similar income	3	3,087,264	2,892,773	3,087,264	2,892,773
Interest payable and similar charges	4	(1,112,611)	(1,020,702)	(1,112,611)	(1,020,702)
Net interest receivable		**1,974,653**	**1,872,071**	**1,974,653**	**1,872,071**
Fees and commissions receivable		34,641	18,315	23,958	18,315
Fees and commissions payable		(4,121)	(3,196)	(4,121)	(3,196)
Other operating income		11,820	(4,047)	11,820	(4,047)
Total income		**2,016,993**	**1,883,143**	**2,006,310**	**1,883,143**
Administration expenses	6	(1,712,638)	(1,613,558)	(1,708,619)	(1,613,558)
Depreciation and amortisation	17/18	(89,356)	(76,499)	(89,356)	(76,499)
Operating profit before provisions		**214,999**	**193,086**	**208,335**	**193,086**
Impairment losses on loans and advances	14	(7,412)	11,816	(7,412)	11,816
Release of FSCS scheme levy	26	2,281	2,216	2,281	2,216
Profit on ordinary activities before tax		**209,868**	**207,118**	**203,204**	**207,118**
Tax on profit on ordinary activities	9	(40,194)	(45,935)	(38,928)	(45,935)
Profit for the financial year		**169,674**	**161,183**	**164,276**	**161,183**

Profit for the financial year arises from continuing operations and is attributable to members.

The notes on pages 24 to 38 form part of these accounts.

Penrith building society
Listening and Supporting, Since 1877

STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 2019

	Notes	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Assets					
Liquid assets:					
Cash in hand	10	50,114	56,610	50,114	56,610
Treasury bills	12	9,978,819	9,978,964	9,978,819	9,978,964
Loans and advances to credit institutions	11	6,979,467	10,094,021	6,971,217	10,094,019
Debt securities	12	4,529,452	6,029,731	4,529,452	6,029,731
		21,537,852	26,159,326	21,529,602	26,159,324
Loans and advances to customers					
Loans fully secured on residential properties		89,701,653	79,460,969	89,701,653	79,460,969
Loans fully secured on land		1,044,464	862,371	1,044,464	862,371
	13	90,746,117	80,323,340	90,746,117	80,323,340
Investment in subsidiary	15	-	-	102	2
Other investments	16	144,933	144,933	144,933	144,933
Tangible fixed assets	17	126,603	121,235	126,603	121,235
Intangible fixed assets	18	111,825	107,941	111,825	107,941
Investment properties	19	425,000	425,000	425,000	425,000
Other debtors	20	292,470	317,610	289,968	317,610
Total assets		**113,384,800**	**107,599,385**	**113,374,150**	**107,599,385**
Liabilities					
Shares	21	99,374,466	93,886,050	99,374,466	93,886,050
Amounts owed to credit institutions	22	502,301	500,247	502,301	500,247
Amounts owed to other customers	23	1,996,792	1,877,698	1,996,792	1,877,698
		101,873,559	96,263,995	101,873,559	96,263,995
Other liabilities	24	41,165	49,157	39,899	49,157
Accruals and deferred income		138,054	120,059	134,068	120,059
Deferred tax liability	25	39,756	39,310	39,756	39,310
Provisions for liabilities	26	(2,521)	1,751	(2,521)	1,751
Total liabilities		**102,090,013**	**96,474,272**	**102,084,761**	**96,474,272**
Reserves					
Total reserves attributed to members of the Society		11,294,787	11,125,113	11,289,389	11,125,113
Total reserves and liabilities		**113,384,800**	**107,599,385**	**113,374,150**	**107,599,385**

Approved by the Board of Directors on 4 March 2020 and signed on its behalf by:

Alan Waterfield (Vice Chairman) **Janice Lincoln (Director)** **Tim Bowen (Chief Executive)**

The notes on page 24 to 38 form part of these accounts.

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2019

	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Cash flows from operating activities				
Profit on ordinary activities before tax	209,868	207,118	203,204	207,118
Depreciation and amortisation	89,356	76,499	89,356	76,499
Decrease in impairment of loans and advances	(44,107)	(177,255)	(44,107)	(177,255)
Decrease in provisions for liabilities	(7,412)	(6,070)	(7,412)	(6,070)
	247,705	**100,292**	**241,041**	**100,292**
Changes in operating assets and liabilities				
Decrease/ (increase) in prepayments, accrued income and other assets	26,004	(17,209)	28,406	(17,209)
Increase in accruals, deferred income and other liabilities	20,825	16,317	16,837	16,317
(Increase)/decrease in loans and advances to customers	(10,378,670)	585,127	(10,378,670)	585,127
Increase/ (decrease) in shares	5,488,416	(664,567)	5,488,416	(664,567)
Increase in amounts owed to credit institutions and other customers	121,148	628,826	121,148	628,826
Decrease/ (increase) in loans and advances to credit institutions	4,010,920	(3,039)	4,010,920	(3,039)
Taxation paid	(49,157)	(33,278)	(49,157)	(33,278)
Net cash (outflow)/ inflow from operating activities	**(760,514)**	**512,177**	**(762,100)**	**512,177**
Cash flows from investing activities				
Purchase of debt securities	(24,429,400)	(25,942,507)	(24,429,400)	(25,942,507)
Disposal of debt securities	25,930,688	25,961,865	25,930,688	25,961,865
Purchase of tangible and intangible fixed assets	(98,607)	(67,407)	(98,607)	(67,407)
Investment in subsidiary undertakings	-	(2)	-	(2)
Net cash used in investing activities	**1,402,681**	**(48,051)**	**1,402,681**	**(48,051)**
Net increase in cash and cash equivalents	**889,872**	**564,418**	**881,622**	**564,418**
Cash and cash equivalents at the start of the year	**5,138,905**	**4,574,487**	**5,138,905**	**4,574,487**
Cash and cash equivalents at the end of the year (see Note 10)	**6,028,777**	**5,138,905**	**6,020,527**	**5,138,905**

STATEMENT OF CHANGE IN MEMBERS' INTERESTS
FOR THE YEAR ENDED 31 DECEMBER 2019

General reserves

	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Balance as at 1 January	11,125,113	10,963,930	11,125,113	10,963,930
Total comprehensive income for the year	169,674	161,183	164,276	161,183
Balance as at 31 December	11,294,787	11,125,113	11,289,389	11,125,113

The notes on page 24 to 38 form part of these accounts.

NOTES TO THE ACCOUNTS

1. Principal accounting policies

1.1. Basis of preparation

The Society has prepared the annual accounts in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 ('the accounts regulations') and Financial Reporting Standard 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) as issued in September 2015.

In preparing the annual accounts under FRS 102, the use of certain critical account estimates and judgments has been required. The areas involving a higher degree of judgement or areas where assumptions and estimates are significant to the annual accounts are set out in Note 2.

1.2. Basis of accounting

The annual accounts have been prepared under the historical cost convention. This is except for Investment Properties, which are measured at fair value.

The annual accounts have been prepared on a going concern basis. This is discussed in the Directors' Report on page 8, under the heading 'Going Concern'.

The presentation currency of the annual accounts is sterling and all amounts have been rounded to the nearest pound.

1.3. Basis of consolidation

The Group accounts consolidate the accounts of the Society and its subsidiary undertaking, and exclude any profits or losses on intra group transactions. These accounts are made up to 31 December 2019. Unless otherwise stated, the acquisition method of accounting has been adopted. In the Society's accounts, investments in subsidiary undertakings are stated at the lower of cost and recoverable amount. Uniform accounting policies are applied throughout the Group.

1.4. Interest income and expense

Interest income and interest expense for all interest bearing financial instruments are recognised in 'interest receivable and similar income' or 'interest payable and similar charges' using the effective interest rates of the financial assets or financial liabilities to which they relate. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability.

Fees receivable and payable on mortgage assets are generally recognised when all contractual obligations have been fulfilled and are spread over the expected life of the mortgage, as part of the effective interest rate model outlined in 1.6 below.

Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the carrying amount as reduced by an allowance for impairment.

1.5. Commissions

Commission receivable from the sale of third-party products is recognised on fulfilment of contractual obligations, that is when policies go on risk or on completion of a mortgage.

1.6. Financial assets

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

a) Loan Commitments

The Group's loans and advances to customers are classified as loan commitments. Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

The Group measures its loans and advances at amortised cost less impairment provisions. The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition, minus principal repayments, plus the cumulative amortisation using the effective interest rate method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

The initial value may, if applicable, include certain fees such as application, product, legal, valuation or higher lending charges, which are recognised over the expected scheme life of mortgage assets, as noted in 1.4 above.

Discounted rates on mortgages are recognised over the expected scheme life of mortgage assets and for certain schemes, will form part of the effective interest rate model.

Throughout the year and at each year end, the mortgage life assumptions for each scheme are reviewed for appropriateness.

Any changes to the expected life assumptions of the mortgage assets are recognised through interest receivable and similar income and reflected in the carrying value of the mortgage assets in loans and advances to customers.

b) Debt instruments

Debt instruments are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity, and which are not designated as at fair value through the income statement.

Debt instruments are carried at amortised cost using the effective interest rate method (see above), less any impairment losses.

The Group derecognises a financial asset when its contractual rights to a cash flow are discharged or cancelled, or expire or substantially all the risk and rewards of ownership have been transferred.

NOTES TO THE ACCOUNTS, continued

1. Principal accounting policies, continued

1.7. Financial liabilities measured at amortised costs

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

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

1.8. Impairment of financial assets

a) Assets carried at amortised cost

A financial asset or group of financial assets are 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.

Throughout the year and at each year end individual assessments are made of all loans and advances against properties which are in possession or in arrears by three months or more and/or are subject to forbearance activities. Individual impairment provisions are made against those loans and advances where there is objective evidence of impairment.

Objective evidence of impairment may include:

- Significant financial difficulty of the borrower/issuer;
- Deterioration in payment status;
- Renegotiation of the terms of an asset due to financial difficulty of the borrower or issuer, including granting a concession/forbearance to the borrower or issuer;
- Becoming probable that the borrower or issuer will enter bankruptcy or other financial reorganisation; and
- Any other information discovered during regular review suggesting that a loss is likely in the short to medium term.

The Group considers evidence of impairment for assets carried at amortised cost at both an individual asset and a collective level. Those found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified by grouping together loans and advances and held to maturity investments with similar risk characteristics.

In assessing collective impairment, the Group uses external market data to build a risk weighted model of historical trends of the probability of default, the timing of recoveries and the amount of loss that may be incurred. 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 as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

In considering expected future cash flows, account is taken of any discount which may be needed against the value of the property at the statement of financial position date thought necessary to achieve a sale and anticipated realisation costs.

Where certain emerging impairment characteristics are considered significant but not assessed as part of the impairment calculation, the Board may elect to apply an overlay to the impairment provision.

The amount of impairment loss is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of provisions.

b) Forbearance strategies and renegotiated loans

A range of forbearance options are available to support borrowers who are experiencing financial difficulty. The purpose of forbearance is to support borrowers who have temporary financial difficulties and help them get back to normal payments.

The main options offered by the Group include:

- Reduced or suspended monthly payments (concessions);
- An arrangement to clear outstanding arrears; and
- Extension of mortgage term.

Borrowers requesting a forbearance option will need to provide information to support the request which is likely to include an income and expenditure form, 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 Borrowers Experiencing Repayment Difficulties Policy and associated procedures. At the appropriate time, the forbearance option that has been implemented is cancelled and the borrower's normal contractual payment is restored.

1.9. Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity at the date of the statement of financial position, including cash and loans and advances to credit institutions.

1.10. Investment properties

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

Subsequent to initial recognition, investment properties are held at fair value. An annual independent desktop valuation is completed by a RICS qualified surveyor to obtain a current market (fair) value of the investment properties, which considers their rental yield and ownership structure . Any gains or losses arising from changes in the fair value are recognised in the income statement in the period that they arise and no depreciation is provided in respect of investment properties applying the fair value model.

Rental income from investment properties is accounted for on an accruals basis.

NOTES TO THE ACCOUNTS, continued

1. Principal accounting policies, continued

1.11. Tangible assets – property, plant and equipment

Additions and improvements to office premises and equipment, including costs directly attributable to the acquisition of the asset, are capitalised at cost. In the statement of financial position, the value of property, plant and equipment represents the original cost, less cumulative depreciation.

The costs, less estimated residual values of assets, are depreciated on a straight-line basis over their estimated useful economic lives as follows:

- Freehold buildings - over 100 years
- Office and IT, fixtures and fittings - over 5 years
- No depreciation is provided on freehold land.

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

1.12. Intangible assets – computer software

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

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

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is 5 years. The amortisation period used is reviewed annually.

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

1.13. Investments in other assets

The carrying value of investments in non-financial assets other than investment properties are reviewed each year end 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 in the income statement, if the carrying amount of an asset exceeds its estimated recoverable amount. An impairment loss is reversed if, and only if, the reasons for the impairment have ceased to apply. Impairment losses recognised in prior years are assessed at each year end for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, if no impairment loss had been recognised.

1.14. Employee benefits

The Group operates a defined contribution pension scheme. The assets of which are held separately from those of the Group. For this scheme, the cost is charged to the income statement as contributions become due.

1.15. Other provisions

The Group has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated and when the Group has an obligation in accordance with International Financial Reporting Interpretation Committee, Interpretation 21: Levies. The amount provided is based on information received from the FSCS, forecast future interest rates and the Group's historic share of industry protected deposits.

1.16. Contingent liabilities

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised in the statement of financial position.

1.17. Leases

Leases in which the Group assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. All other leases, being those held by the Group, are classified as operating leases. Rental payments (including costs for services and insurance) made under operating leases are recognised in the income statement 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. Lease incentives are recognised in the income statement over the term of the lease as an integral part of the total lease expense.

NOTES TO THE ACCOUNTS, continued

1. Principal accounting policies, continued

1.18. Taxation

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

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantially enacted at the date of the statement of financial position, and any adjustments 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 balances are not discounted.

Both current and deferred taxes are determined using the rates enacted or substantively enacted at the statement of financial position date.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities and other future taxable profits.

2. Accounting estimates and judgements

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 historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are described below:

2.1. Impairment losses on loans and advances to customers

The Group reviews its mortgage book at least on a quarterly 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 expected cash flows.

Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), borrower behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions. The impairment provisions are sensitive to changes in the underlying assumptions, with the House Price Indexation being the most critical. If the reduction in the HPI was to increase from 5% to 10% then the closing impairment provisions would increase by £56,047 (2018: £37,333).

2.2. Expected mortgage life

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement.

At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

3. Interest receivable and similar income

	Group and Society	
	2019	2018
	£	£
On loans fully secured on residential property	2,880,453	2,718,762
On other loans	50,529	41,915
On debt securities	51,703	44,947
On treasury bills	71,796	48,684
On liquid assets	32,783	38,465
	3,087,264	2,892,773

Interest on debt securities includes £51,703 (2018: £44,947) arising from fixed income investment securities.

4. Interest payable and similar charges

	Group and Society	
	2019	2018
	£	£
On shares held by individuals	1,092,876	1,004,464
On other shares	1,001	1,196
On deposits and other borrowings	18,734	15,042
	1,112,611	1,020,702

NOTES TO THE ACCOUNTS, continued

5. Employees

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

	Group and Society 2019 No.	2018 No.
Full time	18	17
Part time	6	7
Total	24	24

6. Administrative expenses

	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Staff costs				
Wages and salaries	689,997	588,473	689,997	588,473
Social security costs	117,757	101,899	117,757	101,899
Other pension costs	54,578	56,248	54,578	56,248
	862,332	746,620	862,332	746,620
Other admin expenses	850,306	866,938	846,287	866,938
	1,712,638	1,613,558	1,708,619	1,613,558
Other admin expenses includes:				
Audit of these annual accounts* (excluding VAT)	65,000	46,125		

*The audit fee for the subsidiary company of £2,000 is included above (2018: £nil). No non-audit services were provided.

7. Directors' emoluments

	Group and Society 2019 £	2018 £
Fees for services as Non-Executive Directors:		
Robert Cairns	19,199	18,822
Alan Waterfield	15,466	15,162
Will Lindsay	15,466	15,162
Janice Lincoln	15,983	15,670
Richard Drinkwater	13,333	13,071
Richard Vecqueray	13,333	13,071
Total for Non-Executive Directors	92,780	90,958
For services as Executive Directors:		
Timothy Bowen		
Salary	101,500	100,000
Pension contributions	10,150	10,000
	111,650	110,000
Elspeth James**		
Salary	65,975	64,427
Pension contributions	6,598	6,271
	72,573	70,698
Total for Executive Directors	184,223	180,698
Total for Directors Emoluments	277,003	271,656

**Elspeth James works on a four day contract.

8. Directors' loans and related party transactions

The aggregate amount of loans outstanding at 31 December 2019 to two (2018: two) Directors and connected persons was £217,713 (2018: £235,032). These loans were made on normal commercial terms.

A register of loans to Directors and connected persons is maintained under Section 68 of the Building Societies Act 1986 at the Head Office of the Society. This is available for inspection during normal office hours over the period of 15 days prior to the Society's Annual General Meeting and at the Annual General Meeting.

Tim Bowen and Elspeth James are directors of Horse and Farrier Management Company Limited, which has no connection to the Group at this time. At 31 December 2019 the company had share capital and net assets of £2 and has been dormant since its incorporation on 5 August 2009.

NOTES TO THE ACCOUNTS, continued

8. Directors' loans and related party transactions, continued

The Society holds unlisted shares and an interest bearing loan in Mutual Vision Technologies Limited which provides IT services to the Society, as detailed in Note 16. Tim Bowen is a director of this company and receives personal fees of £3,135 (2018: £nil). In 2019 a dividend of £2,415 (2018: £5,453) was paid to the Society and amounts paid for IT services were £220,428 (2018: £232,724) of which £57,892 (2018: £55,666) were capitalised, see Note 18.

9. Taxation

	Group 2019 £	Group 2018 £	Society 2019	Society 2018
Current tax				
Current tax on income for the period	39,748	49,157	38,482	49,157
Adjustments in respect of previous periods	-	3,822	-	3,822
Total current tax	39,748	52,979	38,482	52,979
Deferred tax (see Note 25)				
Origination and reversal of timing differences	499	(9,532)	499	(9,532)
Adjustment in respect of previous periods	-	1,485	-	1,485
Effect of changes in tax rates	(53)	1,003	(53)	1,003
Total deferred tax	446	(7,044)	446	(7,044)
Total tax expense	40,194	45,935	38,928	45,935
Reconciliation of effective tax rate:				
Profit for the year	209,868	207,118	203,204	207,118
Total effective tax at 19.00% (2018: 19.00%)	39,875	39,352	38,609	39,352
Effects of:				
Non-deductible expenses	372	273	372	273
Change of rate on deferred tax balances	(53)	1,003	(53)	1,003
Adjustments from previous periods	-	5,307	-	5,307
Total tax expense included in income statement	40,194	45,935	38,928	45,935

The main rate of UK corporation tax is 19%. This will be reduced to 17% from 1st April 2020. These rate reductions were substantively enacted at 7 September 2016 and their effects are therefore recognised in the annual accounts.

10. Cash and cash equivalents

	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Cash in hand	50,114	56,610	50,114	56,610
Loans and advances to credit institutions (Note 11)	5,978,663	5,082,295	5,970,413	5,082,295
	6,028,777	5,138,905	6,020,527	5,138,905

11. Loans and advances to credit institutions

	Group 2019 £	Group 2018 £	Society 2019	Society 2018
Accrued interest	804	11,724	804	11,724
Repayable on demand	5,978,663	5,082,295	5,970,413	5,082,295
Other loans and advances by residual maturity payable:				
In not more than 3 months	-	3,000,000	-	3,000,000
In not more than 1 year	1,000,000	2,000,000	1,000,000	2,000,000
	6,979,467	10,094,019	6,971,217	10,094,019

NOTES TO THE ACCOUNTS, continued

12. Debt securities

	Group and Society 2019 £	Group and Society 2018 £
Treasury bills	9,978,819	9,978,964
Certificates of deposit	4,529,452	6,029,731
	14,508,271	16,008,695
Debt securities have remaining maturities as follows:		
Accrued interest	42,494	41,631
In not more than one year	14,465,777	15,967,064
	14,508,271	16,008,695
Transferrable debt securities (excluding accrued interest) comprise:		
Unlisted	4,501,341	6,001,340

Movement in debt securities (excluding accrued interest) during the year can be summarised as follows:

	Group and Society 2019	Group and Society 2018
At 1 January	15,967,064	15,986,422
Disposals and maturities	(25,930,688)	(25,961,865)
Acquisitions	24,429,400	25,942,507
At 31 December	14,465,776	15,967,064

13. Loans and advances to customers

	Group and Society 2019 £	Group and Society 2018 £
Loans fully secured on residential property	89,701,653	79,460,969
Loans fully secured on land	1,044,464	862,371
	90,746,117	80,323,340

The remaining maturity of loans and advances to customers from the date of the statement of financial position is as follows:

	Group and Society 2019 £	Group and Society 2018 £
In not more than three months	813,320	754,689
In more than three months but not more than one year	3,045,395	2,536,687
In more than one year but not more than five years	15,981,279	16,254,389
In more than five years	71,035,001	60,950,560
	90,874,995	80,496,325
Impairment (see Note 14)	(128,878)	(172,985)
	90,746,117	80,323,340

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

NOTES TO THE ACCOUNTS, continued

14. Allowance for impairment

	Group and Society		
	Loans fully secured on land	Loans fully secured on residential property	Total
At 1 January	£	£	£
Individual provision	-	76,112	76,112
Collective provision	11,921	84,952	96,873
	11,921	161,064	172,985
Utilisation of provision			
Individual provision	-	(51,519)	(51,519)
Collective provision	-	-	-
	-	(51,519)	(51,519)
Income statement			
Individual provision	-	(2,543)	(2,543)
Collective provision	4,907	5,048	9,955
	4,907	2,505	7,412
At 31 December			
Individual provision	-	22,050	22,050
Collective provision	16,828	90,000	106,828
	16,828	112,050	128,878

The Society has five mortgage cases where forbearance has been exercised (2018: two), including one (2018: one) where an individual provision has been created.

15. Investment in subsidiary

	Shares	Loans	Total
Cost	**£**	**£**	**£**
At 1 January 2019	2	-	2
Advanced in year	-	100	100
At 31 December 2019	2	100	102

The Society directly holds 100% of the issued ordinary share capital of the following company which is registered in England and Wales:

	Principal Activity
Cumbria Mortgage Centre Limited	Tied Mortgage Broker

The subsidiary operates within the United Kingdom and is included in the Group's accounts. No Director had a beneficial interest in any shares or debentures of the subsidiary undertaking.

16. Other investments

The Society holds unlisted shares and an interest bearing loan in Mutual Vision Technologies Limited which provides IT services to the Society, as follows:

Unlisted investments

	Shares	Loans	Total
Cost	**£**	**£**	**£**
At 1 January 2019 and 31 December 2019	6,914	138,019	144,933

The above investment is held with the intention of use on a continuing basis in the Society's activities and hence is classified as a financial fixed asset. The shares in Mutual Vision Technologies Limited are held at cost less accumulated impairment losses.

NOTES TO THE ACCOUNTS, continued

17. Tangible fixed asset

	Group and Society		
	Freehold land and buildings	Office and IT, fixtures and fittings	Total
Cost	**£**	**£**	**£**
At beginning of year	40,000	600,186	640,186
Additions	-	40,715	40,715
At end of year	40,000	640,901	680,901
Depreciation			
At beginning of year	16,400	502,551	518,951
Charge for the year	400	34,947	35,347
At end of year	16,800	537,498	554,298
Net book value			
31 December 2019	23,200	103,403	126,603
31 December 2018	23,600	97,635	121,235

The net book value of the freehold premises occupied by the Society for its own activities is £23,200 (2018: £23,600).

18. Intangible fixed assets

	Group and Society IT software and development costs
Cost	**£**
At beginning of year	425,728
Additions	57,892
At end of year	483,620
Depreciation	
At beginning of year	317,787
Charge for the year	54,008
At end of year	371,795
Net book value	
31 December 2019	111,825
31 December 2018	107,941

19. Investment properties

	Group and Society
Cost	**£**
Balance at 1 January 2019 and 31 December 2019	425,000

The investment properties have been fair valued at 31 December 2019. This valuation was completed by an external, independent valuer, having an appropriate recognised professional qualification and recent experience in the location and class of property being valued.

Rental income from investment property is accounted for on an accruals basis, as set out in Note 1.10.

20. Other debtors

	Group 2019	Group 2018	Society 2019	Society 2018
	£	£	£	£
Prepayments and accrued income	292,470	317,610	289,968	317,610

NOTES TO THE ACCOUNTS, continued

21. Shares

	Group and Society 2019 £	Group and Society 2018 £
Held by individuals	99,228,767	93,725,019
Other shares	145,699	161,031
	99,374,466	93,886,050

Shares are repayable with remaining maturities from the date of the statement of financial position as follows:

	Group and Society 2019 £	Group and Society 2018 £
Accrued interest	374,446	305,279
Repayable on demand	97,678,294	91,787,461
In not more than 3 months	1,321,726	1,793,310
	99,374,466	93,886,050

22. Amounts owed to credit institutions

	Group and Society 2019 £	Group and Society 2018 £
Accrued interest	2,301	247
Repayable with agreed maturity dates of periods of notice:		
In not more than 3 months	500,000	500,000
	502,301	500,247

23. Amounts owed to other customers

Amounts owed to other customers are repayable with the remaining maturity from the date of the statement of financial position as follows:

	Group and Society 2019 £	Group and Society 2018 £
Repayable on demand	1,996,792	1,877,698

24. Other liabilities

	Group 2019 £	Group 2018 £	Society 2019 £	Society 2018 £
Other liabilities due within one year comprise:				
Corporation tax	39,748	49,157	38,482	49,157
Other creditors	1,417	-	1,417	-
	41,165	49,157	39,899	49,157

25. Deferred taxation

	Group and Society 2019 £	Group and Society 2018 £
At beginning of year	39,310	46,354
Charge /(credit) to statement of income for year	446	(7,044)
At end of year	39,756	39,310
The elements of deferred taxation are as follows:		
Differences between accumulated depreciation and amortisation and capital allowances	34,323	32,185
Other timing differences	5,433	7,125
	39,756	39,310

The net reversal of deferred tax assets and liabilities expected to occur in the next reporting period is an increased charge of £2,489 (2018: £756), being the ongoing unwinding of the tax charges associated with the transition to FRS 102.

NOTES TO THE ACCOUNTS, continued

26. Provisions for liabilities

FSCS Levy	Group and Society	
	2019	2018
	£	£
At beginning of year	1,751	7,821
Levy paid in year	(1,991)	(3,854)
Release for the year	(2,281)	(2,216)
At end of year	(2,521)	1,751

In common with all regulated UK deposit takers, the Society pays levies to the FSCS to enable the FSCS to meet claims against it and to cover the costs of running the scheme, as required.

The provision of £1,751 held on 1 January 2019 was to cover a payment due to the failure of Dial-A-Cab. The final payment made was £1,991. At the end of 2019 the Society was advised that it would receive a rebate due to the higher than expected recoveries, including the settlement of the FSCS's claim in Kaupthing Singer & Friedlander. The amount due has been calculated as £2,521.

27. Contingent liabilities and commitments

There were no contracted capital commitments at the financial year end. Detail on future mortgage commitments is in Note 29 on page 35. At 31 December 2019 the Society has future minimum lease payments under non-cancellable operating leases as follows:

	Group and Society	
	2019	2018
Office equipment leases which expire:	£	£
Within 1 year	29,815	25,120
Within 2-5 years inclusive	77,511	34,888
Over 5 years	1,473	-

28. Post balance sheet event

The Society's loan investment in Mutual Vision Technologies Limited, as set out in Note 16, was converted to 5,575 equity ordinary shares in the company on 1 January 2020. This took the total equity ordinary shares held by the Society in the company to 18,875. The 18,875 ordinary equity shares were subsequently converted into A ordinary shares.

29. Financial instruments

The Society is a retailer of financial instruments in the form of mortgage and savings products, and also uses wholesale financial instruments to invest in liquid assets and may raise funds from wholesale money markets in support of its retail savings operations.

These instruments also allow it to manage the risks arising from these business markets. The Society has a formal structure for managing risk, including formal risk policies, risk limits, reporting structures, mandates and other control procedures. This structure is reviewed regularly by the Board.

Instruments commonly used for risk management purposes include derivative financial instruments, which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates.

The Society does not use any derivative financial instruments, as the Society does not currently offer any capped rate mortgage or savings products that would give rise to a balance sheet exposure and all fixed rate mortgage products are internally matched by fixed rate deposits.

The Society does not enter into any financial instruments for trading or speculative purposes.

Categories of financial assets and liabilities

Financial assets and liabilities are measured on an on-going basis at amortised cost. Notes 1.6 and 1.7 describe how classes of financial instrument are measured and how income and expenses are recognised.

The tables on the following page analyse the Society's assets and liabilities by financial classification:

NOTES TO THE ACCOUNTS, continued

29. Financial instruments, continued

Categories of financial assets and liabilities, continued

31 December 2019

	Group and Society		
	Loan Commitments	Debt Instruments	Total
Financial assets	£	£	£
Cash in hand	-	50,114	50,114
Loans and advances to credit institutions	-	6,979,467	6,979,467
Debt securities	-	14,508,271	14,508,271
Loans and advances to customers	90,746,117	-	90,746,117
Total financial assets	90,746,117	21,537,852	112,283,969
Non-financial assets			1,100,831
Total assets			113,384,800
Financial liabilities			
Shares	-	99,374,466	99,374,466
Amounts owed to other customers	-	1,996,792	1,996,792
Amounts owed to credit institutions		502,301	502,301
Total financial liabilities	-	101,873,559	101,873,559
Non-financial liabilities			216,454
General reserves			11,294,787
Total liabilities			113,384,800

31 December 2018

	Group		
	Loan Commitments	Debt Instruments	Total
Financial assets	£	£	£
Cash in hand	-	56,610	56,610
Loans and advances to credit institutions	-	10,094,019	10,094,019
Debt securities	-	16,008,695	16,008,695
Loans and advances to customers	80,323,340	-	80,323,340
Total financial assets	80,323,340	26,159,324	106,482,664
Non-financial assets			1,116,721
Total assets			107,599,385
Financial liabilities			
Shares	-	93,886,050	93,886,050
Amounts owed to other customers	-	1,877,698	1,877,698
Amounts owed to credit institutions	-	500,247	500,247
Total financial liabilities	-	96,263,995	96,263,995
Non-financial liabilities			210,277
General reserves			11,125,113
Total liabilities			107,599,385

Credit risk

Credit risk, as noted in the Directors' Report on page 7, is the risk that a borrower or counterparty of the Society will cause a financial loss for the Society by failing to discharge an obligation. The Society has policies in place to manage credit risk arising from a borrower or counterparty, with clearly defined risk appetite statements and appropriate credit limits. The risk appetite statements are supported by a number of qualitative and quantitative measures that are monitored by the Board on a monthly basis. Further challenge and oversight is provided by the ARCC as part of its quarterly meetings.

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

	Group 2019	Group 2018 £	Society 2019	Society 2018 £
Cash in hand	50,114	56,610	50,114	56,610
Loans and advances to credit institutions	6,979,467	10,094,019	6,971,217	10,094,019
Debt securities	14,508,271	16,008,695	14,508,271	16,008,695
Loans and advances to customers	90,746,117	80,323,340	90,746,117	80,323,340
Total statement of financial position exposure	112,283,969	106,482,664	112,275,719	106,482,664
Off balance sheet exposure – mortgage commitments	6,306,246	5,130,963	6,306,246	5,130,963
	118,590,215	111,613,627	118,581,965	111,613,627

NOTES TO THE ACCOUNTS, continued

29. Financial instruments, continued

Credit risk, continued

Credit quality analysis of counterparties

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

The following table provides details on the exposure the Society has to counterparties, being all liquid assets with financial institutions, excluding cash in hand, by their Fitch rating, where appropriate:

	Group and Society	
	2019	**2018**
	£	**£**
UK Government securities	9,978,819	9,978,964
Financial institutions		
AAA to AA-	-	500,466
A+ to A-	9,995,925	10,101,234
BB- to BBB-	-	1,506,859
Unrated	1,504,743	4,015,191
Total exposure to counterparties	21,479,487	26,102,714

At 31 December 2019 all exposures to financial institutions were within the UK (2018: all exposures were within the UK).

Credit quality analysis of loans and advances to customers

The Board is responsible for approving the Responsible Lending Policy which includes the Society's credit risk appetite. The lending portfolio is monitored daily by the Mortgage team and reviewed monthly by the Retail Credit Risk Committee (RCRC) to ensure it remains in line with the stated risk appetite, including adherence to lending principles, policies and limits.

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

Loans and advances to customers are predominantly made up of retail loans fully secured against UK residential property, as set out in the table below. These are primarily residential or buy to let loans, only 1% of the book is secured on commercial property.

Over half the Society's borrowers are based in Cumbria, being 56.57% (2018: 68.55%) of the mortgage book totals. Borrowers in Scotland represent 2.10% (2018: 0.70%) of the mortgage book and the remaining 41.33% (2018: 30.75%) is spread across the rest of England and Wales.

The table below sets out information about the credit quality of loans and advances to customers by payment due status net of provisions:

	Group and Society			
	2019		**2018**	
Arrears analysis	**£**	**%**	**£**	**%**
Not impaired:				
Neither past due or impaired	88,351,476	97.36	78,766,457	98.05
Past due up to 3 months but not impaired	1,696,299	1.87	1,346,095	1.68
Past due over 3 months but not impaired	610,351	0.67		
Possession	-	-	-	-
Impaired:				
Not past due	-	-	-	-
Past due up to 3 months	-	-	-	-
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	85,718	0.11
Past due over 12 months	87,991	0.10	-	-
Possession	-	-	125,070	0.16
	Indexed	**Unindexed**	**Indexed**	**Unindexed**
	£	**£**	**£**	**£**
Value of collateral held:				
Neither past due or impaired	236,347,252	217,560,786	206,199,082	188,995,059
Past due but not impaired	7,526,988	7,086,450	8,242,010	7,614,950
Impaired	142,494	137,000	420,461	394,000
	244,016,734	224,784,236	214,861,553	197,004,009

NOTES TO THE ACCOUNTS, continued

29. Financial instruments, continued

Credit risk, continued

Credit quality analysis of loans and advances to customers, continued

Note 1.8 (a) sets out the Society's approach to the impairment of financial assets. The Society uses HPI indexing to update the property values of its residential and buy to let portfolios on a quarterly basis. Collateral values are adjusted by the Nationwide House Price Index to derive the indexed valuation at 31 December. This is a UK house price index and takes into account regional data from the 12 standard planning regions of the UK. The collateral consists of UK property and land.

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

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

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

Note 1.8 (b) sets out the Society's approach to forbearance strategies. Product reviews for mortgages are undertaken if a change of product is appropriate, this could be due to a borrower not switching products on the maturity of their fixed or discounted term. All borrowers are contacted by the Society on maturity of their discount or fixed rate product.

Capitalisation occurs when arrears are incorporated into the capital balance outstanding for the purpose of restructuring the loan.

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

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

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

	2019 No.	2018 No.
Type of Forbearance:		
Interest only concession at year end	2	1
Reduced payment concessions at year end	3	-
Total	5	1

These are included as part of the collective impairment provision of £106,828 (2018: £96,873). Total loans in forbearance represent £440,487 (2018: £96,145).

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.

The Society is only affected by interest rate risk. It 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 by matching the maturity dates of assets and liabilities.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivities of the Society's financial assets and financial liabilities to various standard and non-standard interest rate scenarios.

Standard scenarios that are considered on a quarterly basis include a 2% parallel fall or rise in the bank base rate. If there was a 2% parallel upwards shift in interest rates the favourable impact on reserves would be £76,000 (2018: £168,000).

NOTES TO THE ACCOUNTS, continued

29. Financial instruments, continued

Liquidity risk

Liquidity risk, as noted in the Directors' Report on page 7, is the risk that the Society will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The Society monitors liquidity requirements on a daily basis in line with specific policies in this area, approved by the Board.

The liquidity risk appetite is supported by qualitative and quantitative measures that are monitored by the Board on a monthly basis.

The Society's policy is to maintain sufficient funds in a liquid form at all times to ensure that the Society can cover all fluctuations in funding, retain public confidence in the solvency of the Society and to enable the Society to meet its financial obligations

The tables below analyse the remaining contractual maturity of the Society's financial liabilities, at undiscounted amounts.

The analysis of the contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued, for the average period until maturity on the amounts outstanding at the statement of financial position date.

31 December 2019	**On demand**	**Not more than 3 months**	**More than 3 months, but no more than 1 year**	**More than 1 year but not more than 5 years**	**More than five years**	**Total**
Financial liabilities	**£**	**£**	**£**	**£**	**£**	**£**
Shares	91,279,769	25,701	3,974,544	4,094,452	-	99,374,466
Amounts owed to other customers	1,996,792	-	-	-	-	1,996,792
Amounts owed to credit institutions	-	502,301	-	-	-	502,301
Total financial liabilities	93,276,561	528,002	3,974,544	4,094,452	-	101,873,559

31 December 2018	**On demand**	**Not more than 3 months**	**More than 3 months, but no more than 1 year**	**More than 1 year but not more than 5 years**	**More than five years**	**Total**
Financial liabilities	**£**	**£**	**£**	**£**	**£**	**£**
Shares	86,546,737	-	3,761,034	3,578,279	-	93,886,050
Amounts owed to other customers	1,877,698	-	-	-	-	1,877,698
Amounts owed to credit institutions	-	500,247	-	-	-	500,247
Total financial liabilities	88,424,435	500,247	3,761,034	3,578,279	-	96,263,995

30. Country by country reporting

The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by the Capital Requirements (Country-by-Country Reporting) Regulation 2013. The purpose of these regulations is to provide clarity on the Group's income and the location of its operations.

The Society's principal activities are mortgage lender and provider of savings accounts. The subsidiary's principal activity, as detailed in Note 15, is that of a tied mortgage broker. All of the consolidated entities were incorporated in the UK.

The consolidated financial statements of the Group include the audited results of the Society and its subsidiary company.

For the year ended 31 December 2019:

- The Group's turnover (being net interest receivable) was £1.97 million (2018: £1.87m). Profit before tax £0.21 million (2018: £0.21 million) all of which arose from UK based activity.
- Number of employees for the Group and Society was 24 (2018: 24).
- Group corporation tax of £49,167 (2018: £33,278) was paid in the year and is within the UK tax jurisdiction.
- No public subsidies were received in the year (2018: none).

ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2019

1. Statutory percentages

	2019	Statutory Limit
Lending Limit	2.10%	25.00%
Funding Limit	2.45%	50.00%

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

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 difference between the total assets of the Group plus provisions for bad and doubtful debts and the aggregate of liquid assets and tangible and intangible 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, plus provisions for bad and doubtful debts and interest in suspense.

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

X = shares and amounts owed to other customers, being the aggregate of: the principal value of, and interest accrued on, shares in the Group; and 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.

Other percentages

	2019 %	2018 %
As percentage of shares and borrowings:		
Gross capital	11.09	11.56
Free capital	11.43	11.42
Liquid assets	21.14	27.17
As a percentage of mean assets:		
Profit after tax	0.15	0.15
Management expenses	1.63	1.57

The above percentages have been prepared from the Group's accounts and in particular:

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

"Gross capital" represents the general reserves.

"Free capital" represents the aggregate of gross capital and collective impairment for losses on loans and advances less tangible and intangible fixed assets.

"Liquid assets" represent the total cash in hand, treasury bills, loans and advances to credit institutions and debt securities.

"Management expenses" represent the aggregate of administrative expenses and depreciation.

"Mean total assets" is the average of the total assets at 31 December 2018 and 31 December 2019.

ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2019, continued

2. Information relating to the directors

Name (Date of Birth)	Date of Appointment	Business Occupation	Other Directorships
Rob Cairns, Chairman (01/06/1951)	01/05/2013	Retired Chief Executive	Corrie & Co Ltd
Richard Drinkwater (01/08/1952)	01/07/2017	Business Entrepreneur	
Janice Lincoln (08/02/1957)	01/10/2014	Retired Finance Director	Manchester Building Society Darlington Mind Ltd
Will Lindsay (06/10/1953)	01/06/2015	Retired Banker	
Richard Vecqueray (18/09/1971)	27/04/2017	Veterinary Director	
Alan Waterfield (29/12/1970)	01/07/2010	Director	Alan Waterfield Consulting Ltd
Tim Bowen, Chief Executive (04/11/1979)	27/04/2017	Chief Executive	Horse and Farrier Courtyard Management Ltd Mutual Vision Technologies Ltd
Elspeth James (06/05/1974)	01/01/2013	Finance Director	Horse and Farrier Courtyard Management Ltd Cumbria Mortgage Centre Ltd

Documents may be served on the above named Directors c/o Mazars LLP at the following address:
One St Peter's Square, Manchester, M2 3DE

Service Contracts

None of the Non-Executive Directors has a service contract.

The Chief Executive and Finance Director have contracts which can be terminated by either party giving not less than 12 and 6 months prior written notice respectively. These specific contracts were entered into on 1 January 2018 and 1 September 2012 respectively.