PENRITH BUILDING SOCIETY

Annual Report and Accounts

31 December 2018

CONTENTS

CHIEF EXECUTIVE'S REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018

Penrith Building Society truly is a great business and it is hard to believe that a year has already passed since I wrote to our members with my reflections on 2017 and plans for the coming year. 2018 was the Society's year of change and investment where we focused on ensuring that our Corporate Plan objectives were achieved. This required the need for change and increased investment to ensure that we continued to lay further foundations that will lead to a successful and sustainable future.

I am pleased to be able to report that 2018 exceeded expectations in terms of the change that we implemented within the Society and the investments we made. These investments included; bringing new talent into the Society, updating our brand and infrastructure and continuing to invest and develop in becoming increasingly more operationally resilient.

As stated at the beginning of 2018, in order for this to happen, the Society's financial performance would be flat on previous years in relation to our Balance Sheet, mortgage assets and profitability.

It is pleasing to report a Balance Sheet that achieved parity with how we began the year and we have seen a year on year growth in our profit.

The Society's mortgage assets did see a small contraction in 2018. This can be attributed to the following factors.

Firstly, enhancing the way we view the business to ensure we do not exclusively focus on adding loans to the balance sheet, but also look at how we can build even stronger relationships and retain our current members. As a result of this, the redesign and implementation of our products, pricing and distribution strategy has given further clarity and confidence on the level of potential and opportunity that exists for the Society.

Secondly, increasing competition in the mortgage market and consumer bias towards fixed rate products due to political and economic uncertainty. However, whilst we are limited with regards to the level of fixed rate mortgage business we can distribute, by positioning the Society into areas of the market that we can both be competitive in and want to compete in, we remain assured that we can achieve our growth objectives.

Additionally, the appointment of a full time Business Development Manager in early 2019 will further ensure the achievement of said objectives.

Added to this, 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. Profitability has improved even with the additional investment in the business from a people and technology perspective.

With regard to market conditions, the Board are aware that UK house prices have reduced in recent months as the market takes stock and considers the various impacts associated with the political developments around Brexit. Confidence appears to be dwindling and as a result the Society will continue to focus on the quality of its mortgage lending, ensuring that the excellent quality and performance of its mortgage book continues.

When reflecting on the savings market, the Society predicted a higher level of competition in 2018 that never really came to be. The Society does, however, expect the savings market to become increasingly competitive in 2019 as other financial institutions begin to plan for substantial increases in retail funding. This arises from the requirement to repay funds drawn from both the Bank of England's Term Funding Scheme and the Funding for Lending Scheme, neither of which the Society participated in.

Competition in both the mortgage and savings market is a good thing for all consumers and should be encouraged, however, economically, this can impact the net interest margin (NIM) of all institutions within the Financial Services Industry and this was seen across the sector in 2018. The Society, however, by predicting this and positioning ourselves well in the market in 2018, has seen our NIM follow an upward trend rather than the compression seen across the sector as a whole.

It is important to state that the Society does have adequate plans in place to operate in a tougher market, and, where required, to review our strategic objectives within the Corporate Plan.

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.

Additionally, regardless of the political and economic uncertainty that currently exists, the Board 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.

Moving away from the financial and economic areas of the Society, our social purpose as a mutually owned organisation is something that continues to drive the culture within the Society and is at the heart of everything that we do.

Last year we supported many local charities and causes in Penrith and the Eden Valley. We once again continued to support the financial education of the younger generation of Penrith in conjunction with Queen Elizabeth Grammar School and Ullswater Community College. Financial education is an area the Society will focus on even more over the next three years.

CHIEF EXECUTIVE'S REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018, continued

Our affinity accounts supported Pride in Penrith Lottery, Eden Valley Hospice & Jigsaw, Penrith RUFC Juniors and the Penrith & District Red Squirrel Group. We also hope to launch another affinity account with Annie Mawson's Sunbeams Music Trust and in addition, the Society is proud to announce that in 2019, we will be Sunbeams Music Trust's partner in the Local Business Charity Awards.

It would be remiss of me not to thank our wonderful members of staff. I want to thank each of you for your hard work and commitment over this past year and I am looking forward to continuing to achieve great things as a team over the coming years.

Timothy J Bowen (Chief Executive)
28 February 2019

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2018.

Business Review

The Society's 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. We will continue to identify areas of the mortgage market that we can both be competitive in and wish to compete in, continuing to leverage our larger intermediary relationships.

The Board and Executive Team are committed to continuing as an independent, profitable and operationally resilient mutual whilst fulfilling the social aspect of our purpose.

Maximising the value of the Society's rebrand by engaging with and supporting the financial education of our membership and the community we serve will be a future priority. Considered investment will be made in improving our people, processes, systems and making us a reliable Society for all.

Identifying the right partners to collaborate with will also be key to the Society's success.

Looking forward this will allow the Society to be able to generate stronger returns, withstand financial stress and operate credibly and competitively in the financial services environment.

DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2018

Key Performance Indicators

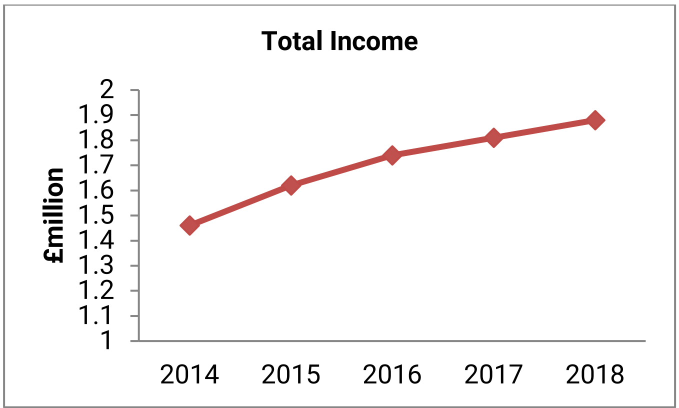
The Society uses a number of key performance indicators to measure and monitor performance. A summary of these measures over the last five years has been explained further below.

Income and Expenditure

The Society made a profit for the year after taxation of £161,183 (2017: £135,956).

Total income is £1.88 million compared to £1.81 million in 2017. The net interest margin widened following a change in rates across the Society's products on 1 September 2018. This helped income targets to be met against a challenging mortgage environment.

The Society continues to keep fees for mortgage products low 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.



Management expenses including depreciation is £1.69 million (2017: £1.57 million), an increase of 7.33%. The cost income ratio is now 89.75% (2017: 87.19%). Management expenses expressed as a ratio of mean total assets are 1.57% (2017: 1.48%).

The most significant investment was made in 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, where new intermediary relationships are being developed and a full time Business Development Manager has been appointed. This investment in the business model will continue in 2019.

The performance of the mortgage book continues to be good in the low interest rate environment, with arrears being managed through arrangements being put in place with the affected borrowers.

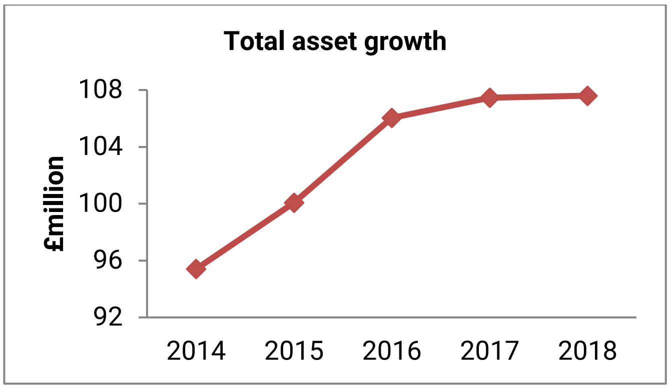
The level of individual loan loss provisions is reduced following the sale of two properties in possession and a general low level of more serious arrears and is now only £76,112 (2017: £278,407).

The collective loan loss provision level has increased to £96,873 (2017: £71,833) following a decision to apply a 5% reduction to the House Price Index used to estimate current value of properties. The reduction is in light of a general downturn in property prices due to 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 Society made a conscious decision to maintain its total assets at a level consistent with the prior year in light of the changes in the Society and uncertainty in the market overall. This has been achieved with total assets now at £107.60 million (2017: £107.45 million).



Loans and advances

Changes were made to the mortgage distribution model this year, consolidating the intermediary partners the Society works with.

The Society is restricted as to the levels of fixed rate mortgage business it can write annually. As a result, it faced difficulties in competing with the market on the back of a rising interest rate environment and a move by borrowers to fixed rate deals where possible.

We maintain a strong level of variable rate mortgages 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.

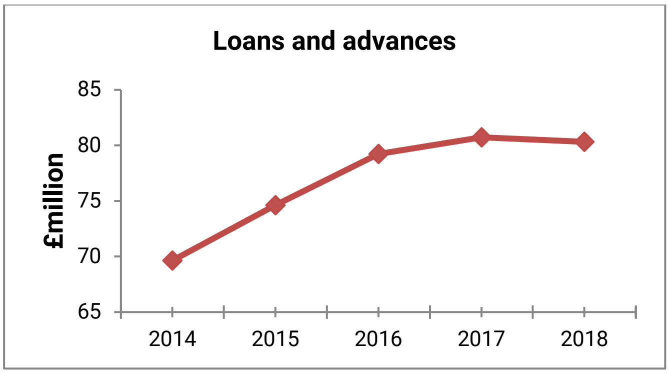
Our gross lending total fell to £15.42 million (2017: £17.34 million), but strategies put in place, including the appointment of the Business Development Manager, will see this improving again in 2019. We completed 158 advances, including 21 further advances.

Our strategy to retain existing borrowers has continued to prove effective, with a retention rate of 69% for those at the end of mortgage schemes.

However, the net mortgage assets have contracted due to lower levels of advances and the book now stands at £80.32 million (2017: £80.73 million).

Key Performance Indicators, continued

Loans and advances



At 31 December 2018 there are no mortgage cases (2017: none) where the repayment of principal and interest is twelve or more months in arrears and one case (2017: three) with forbearance measures in place.

This confirms a continuing trend in low numbers of arrears cases over the last five years in the current low interest rate environment. The Society has one property in possession at the end of 2018 (2017: three) and holds an individual provision to cover the potential shortfall.

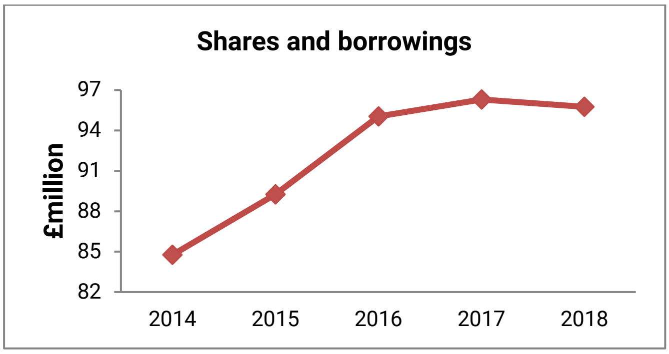
The Society takes all reasonable steps to minimise loss and to ensure that the provisions of the Responsible Lending Policy are monitored through individual underwriting so that due account may be taken of prevailing economic conditions.

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.

Shares and borrowings

Shares and borrowings have reduced to a total of £96.26 million at the year end (2017: £96.30 million).



The outflow was driven by the maturity of a Regular Savings product, with customers taking the funds elsewhere as we had no notice or higher rate product available.

The Society monitors our savings rates compared to the market on a regular basis.

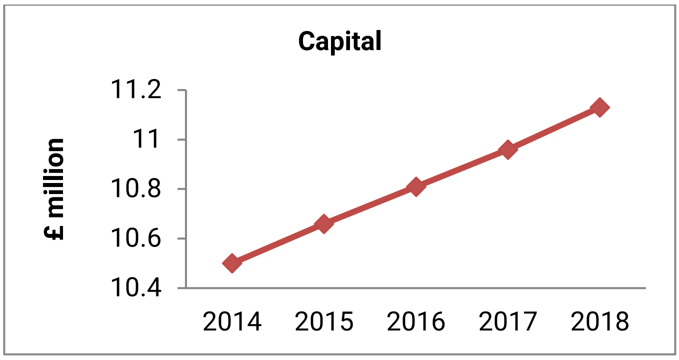
Following the base rate rise in August 2018, we maintained or increased rates on our savings accounts across the range. As a result, we remain on par with, or above, the average rates for the building society sector.

The focus continues to be on attracting good quality residential mortgage assets to replace liquid assets (being cash and treasury investments) to improve the margin. Liquid assets were £26.16 million in 2018 (2017: £25.59 million), being 27.17% (2017: 26.58%) of total shares and Borrowings.

Capital

At 31 December 2018, the Society's capital is £11.13 million (2017: £10.96 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) is 11.42% of total shares and borrowings (2017: 11.21%).

Gross capital amounted to 11.56% of total shares and borrowings (2017: 11.39%).

Risk assessment is carried out on an ongoing basis. To meet regulatory requirements, an 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 annually.

The table overleaf 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

DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2018

Key Performance Indicators, continued

Capital, continued

	2018 £	2017 £
Tier 1 capital	11,125,113	10,963,930
Total capital	11,125,113	10,963,930
Risk weighted assets:		
Liquid assets	5,181,275	5,214,460
Loans and advances	29,729,561	30,214,778
Other assets	1,173,330	1,627,305
Operational risk	1,724,690	1,609,817
Total risk weighted assets	37,808,856	38,666,360
Capital ratios:		
Core tier 1	29.42%	28.36%
Leverage	10.33%	10.20%

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 2018 are included in note 3 on page 24.

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.

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.

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.

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 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.

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 2018 is detailed in the market risk section of note 29 on page 30.

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.

Financial 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 note 29 on page 28.

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.

DIRECTORS' REPORT continued
FOR THE YEAR ENDED 31 DECEMBER 2018

Principal Risks and Uncertainties, continued

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.

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 £8,338 (2017: £8,552) were made. No contributions were made for political purposes.

Directors

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

Non-Executive Directors

Robert J Cairns	Chairman
Alan G Waterfield	Vice Chairman
William RC Lindsay	Senior Independent Director
Janice Lincoln	
Richard L Drinkwater	
Richard J Vecqueray	

Executive Directors

Timothy J Bowen	Chief Executive
Elspeth L James	Finance Director

The Directors retiring by rotation in accordance with the Rules and offering themselves for re-election are Will Lindsay having served on the Board for a 3-year period and Elspeth James, having served on the Board for a 7-year period.

During the 12 months ended 31 December 2018, Tim Bowen had 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.

Going Concern

Forecasts of the Society's financial position for the period ending 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

There are no post balance sheet events to report.

Approved and signed on behalf of the Board

Timothy J Bowen	**Robert J Cairns**
(Chief Executive)	**(Chairman)**
28 February 2019	

CORPORATE GOVERNANCE REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018

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 (2016 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.

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 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.

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 Financial Conduct Authority or Prudential Regulation 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 2018, 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. 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 effectiveness of the Board as a whole and its committees is reviewed annually by the Board.

Accountability

The Executive Directors and senior management have created a Risk Management Framework to identify, quantify (if possible) and manage risks faced by the Society. 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 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.

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 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 2018 is overleaf on page 9.

Nominations Committee (NomCo)

The Nominations Committee is comprised of Rob Cairns, Alan Waterfield, Richard Vecqueray 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 staff 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.

The table overleaf (on page 9) details attendance of the Directors at the Board and Committee meetings held during 2018.

Relationship with Members

The Society's on-going relationship with its members is an important area of focus. In 2018 opportunities to engage directly with members, included the Annual General Meeting and the Christmas gathering. These will continue in 2019, with the first being the Annual General Meeting of the Society on 28 March 2019.

CORPORATE GOVERNANCE REPORT, continued
FOR THE YEAR ENDED 31 DECEMBER 2018

The following table details attendance of the Directors at the Board and Committee meetings held during 2018

	Board	ARCC	RemCo	NomCo	ERC	ALCO
Number of meetings	**10**	**4**	**1**	**2**	**9**	**10**
Rob Cairns	10(10)	1*	1(1)	2(2)	-	3*
Richard Drinkwater	10(10)	4(4)	1(1)	-	-	1*
Janice Lincoln	10(10)	4(4)	1(1)	-	-	1*
Will Lindsay	9(10)	4(4)	1(1)	-	3*	1*
Richard Vecqueray	10(10)	3*	1(1)	2(2)	-	1*
Alan Waterfield	9(10)	4(4)	1(1)	2(2)	-	2*
Tim Bowen	10(10)	3*	1*	2(2)	8(9)	8(10)
Elspeth James	9(10)	4*	1*	-	9(9)	10(10)

(Brackets denote the number of meetings an individual was eligible to attend and * denotes where an individual attended a meeting by invitation only)

Approved and signed on behalf of the Board

Robert J Cairns (Chairman)
28 February 2019

DIRECTORS' REMUNERATION REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018

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. Their salaries are considered by the Remuneration Committee which meets at least twice a year.

Salary levels are set having regard to job content and responsibilities, the performance of the individual and salaries in similar organisations.

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 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 8 on page 24.

Approved and signed on behalf of the Remuneration Committee

Alan G Waterfield (Director)
28 February 2019

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 2018

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

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

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

1. Our opinion is unmodified

We have audited the annual accounts of Penrith Building Society for the year ended 31 December 2018 which comprise the Income Statement (including Statement of Comprehensive Income), Statement of Financial Position, Cash Flow Statement, Statement of Change in Members' Interests, and the related notes, including the accounting policies in note 1.

In our opinion the annual accounts:

- give a true and fair view of the state of affairs of the Society as at 31 December 2018 and of the income and expenditure of the Society for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- have been prepared in accordance with the requirements of the Building 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 are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the Directors on 26 November 2010. The period of total uninterrupted engagement is for the nine financial years ended 31 December 2018.

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

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

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the annual accounts and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

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

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

Key audit matter	The risk (continued)	Our response (continued)
The impact of uncertainties due to Britain exiting the European Union on our audit *Refer to page 6 (principal risks), page 2 and* *(Chief Executive Report)*	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in the impairment of loans and advances to customers and the effective interest rate income recognition sections below, and related disclosures and the appropriateness of the going concern basis of preparation of the annual accounts (see below). All of these depend on assessments of the future economic environment and the business' future prospects and performance. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: • Our Brexit knowledge – We considered the Directors' assessment of Brexit-related sources of risk for the Society's business and financial resources compared with our own understanding of the risks. We considered the Directors' plans to take action to mitigate the risks. • Sensitivity analysis – When addressing the impairment of loans and advances to customers, the effective interest rate income recognition and other areas that depend on forecasts, we compared the Directors' analysis with our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty. • Assessing transparency – As well as assessing individual disclosures as part of our procedures on impairment of loans and advances to customers, and the effective interest rate income recognition revenue recognition, we considered all of the Brexit related disclosures together, including those in the Directors' Report, comparing the overall picture against our understanding of the risks. **Our results** As reported under impairment of loans and advances to customers and the effective interest rate income recognition, we found the resulting estimates and related disclosures on impairment, effective interest rate income recognition and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Key audit matter	The risk	Our response
Impairment of loans and advances to customers (£172,985; 2017: £350,240)	**Subjective estimate** Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.	Our procedures included: • *Control design:* We tested the design and implementation of controls over the approval of the loan impairment assumptions and estimates. • *Benchmarking assumptions:* We compared the key assumptions used in the model of forced sale discounts (including selling costs) with externally available data, including KPMG's building society database.

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

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

Key audit matter	The risk (continued)	Our response (continued)
Impairment of loans and advances to customers, continued Refer to page 23 (accounting policy) and page 26 (financial disclosures).	The Directors judge individual impairments by reference to loans that have reached three or more months in arrears, or been repossessed by the Society. 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.	• *Our sector experience:* We challenged the key impairment assumptions used in the model, including probability of default and forced sale discounts using our knowledge of recent impairment experience in this industry. • *Sensitivity analysis:* We assessed the collective models and individual impairments for their sensitivity to changes in the key assumptions by performing stress testing to help us assess the reasonableness of the assumptions. • *Historical comparison:* We assessed the key assumptions used in the collective and individual models, being probability of default and forced sale discounts, against the Society's historical experience. • *Assessing transparency:* We assessed the adequacy of the Society's disclosures about the degree of estimation involved in arriving at the provision. **Our results** We found the resulting estimate of the loan portfolio impairment provision impairment of loans and advances to customers to be acceptable (2017: result acceptable).

Key audit matter	The risk	Our response
Effective interest rate income recognition (£21,740; 2017: £40,438) Refer to page 20 (accounting policy) and page 26 (financial disclosures).	Subjective estimate: Using a model, interest and fees earned and incurred on loans are recognised using the effective interest rate ('EIR') method that spreads directly attributable expected cash flows over the expected lives of the loans. The Directors apply judgement in deciding and assessing the expected repayment profiles used to determine the EIR period. The most critical element of judgement in this area is the estimation of the future redemption profiles of the loans. This is informed by product mix and past customer behaviour of when loans are repaid.	Our procedures included: • *Control design:* We tested the design and implementation of controls over the approval of the EIR assumptions. • *Our sector experience:* We assessed the key assumptions behind the expected customer lives and profiles of significant loan products against our own knowledge of industry experience and trends, including benchmarking with comparable lenders. • *Historical comparison:* We assessed the reasonableness of the model's expected repayment profiles assumptions against historical experience of loan lives based on customer behaviour, product mix and recent performance. • *Assessing transparency:* We assessed the adequacy of the Society's disclosures about the degree of estimation involved in arriving at the interest income recognised. **Our results** We found the resulting estimate of effective interest rate income recognition to be acceptable. (2017: acceptable)

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

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

Materiality for the annual accounts as a whole was set at £27,000 (2017: £26,000), determined with reference to a benchmark interest receivable and similar income of £2,892,773 (2017: £2,667,354), of which it represents 0.93% (2017: 0.97%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £1,300 (2017: £1,300), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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

4. We have nothing to report on going concern

The Directors have prepared the annual accounts on the going concern basis as they do not intend to liquidate the Society or to cease its operations, and as they have concluded that the Society's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the annual accounts ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Society will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Society's business model, including the impact of Brexit, and analysed how those risks might affect the Society's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the Directors' Statement in Note 1, to the annual accounts on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Society's use of that basis for a period of at least twelve months from the date of approval of the annual accounts.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the annual accounts. Our opinion on the annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our annual accounts audit work, the information therein is materially misstated or inconsistent with the annual accounts or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Annual Business Statement and Directors' Report

In our opinion:

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

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

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

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

We have nothing to report in these respects.

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

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 11, the Directors are responsible for: the preparation of annual accounts which give a true and fair view; such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error; assessing the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the annual accounts from our general commercial and sector experience, through discussion with the Directors (as required by auditing standards), and from inspection of the Society's regulatory and legal correspondence and discussed with the Directors the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Society is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related building society legislation) and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Society is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Society's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the Society's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the Directors and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

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

David Allen (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 Sovereign Street
Sovereign Square
Leeds
LS1 4DA
28 February 2019

INCOME STATEMENT (INCLUDING STATEMENT OF COMPREHENSIVE INCOME)
FOR THE YEAR ENDED 31 DECEMBER 2018

	Notes	2018 £	2017 £
Interest receivable and similar income	4	2,892,773	2,667,354
Interest payable and similar charges	5	(1,020,702)	(882,126)
Net interest receivable		1,872,071	1,785,228
Fees and commissions receivable		18,315	3,442
Other operating income		(7,243)	17,375
Total income		1,883,143	1,806,045
Administration expenses	7	(1,613,558)	(1,499,415)
Depreciation and amortisation	18/19	(76,499)	(75,279)
Operating profit before provisions		193,086	231,351
Impairment losses on loans and advances	15	11,816	(73,174)
Provisions for FSCS scheme levy	27	2,216	2,706
Profit on ordinary activities before tax		207,118	160,883
Tax on profit on ordinary activities	10	(45,935)	(24,927)
Profit for the financial year		161,183	135,956

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

The notes on pages 20 to 31 form part of these accounts.

STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 2018

	Notes	2018 £	2017 £
Assets			
Liquid assets:			
Cash in hand	11	56,610	55,718
Treasury bills	13	9,978,964	9,989,114
Loans and advances to credit institutions	12	10,094,019	9,527,454
Debt securities	13	6,029,731	6,019,688
		26,159,324	25,591,974
Loans and advances to customers			
Loans fully secured on residential properties		79,460,969	79,773,352
Loans fully secured on land		862,371	957,860
	14	80,323,340	80,731,212
Investment in subsidiary	16	2	-
Other investments	17	144,933	173,015
Tangible fixed assets	18	121,235	134,001
Intangible fixed assets	19	107,941	104,266
Investment properties	21	425,000	445,000
Other debtors	20	317,610	271,571
Total assets		107,599,385	107,451,039
Liabilities			
Shares	22	93,886,050	94,550,617
Amounts owed to credit institutions	23	500,247	-
Amounts owed to other customers	24	1,877,698	1,749,119
		96,263,995	96,299,736
Other liabilities	25	49,157	30,893
Accruals and deferred income		120,059	102,305
Deferred tax liability	26	39,310	46,354
Provisions for liabilities	27	1,751	7,821
Total liabilities		96,474,272	96,487,109
Reserves			
Total reserves attributed to members of the Society		11,125,113	10,963,930
Total reserves and liabilities		107,599,385	107,451,039

Approved by the Board of Directors on 28 February 2019 and signed on its behalf by:

Robert J Cairns (Chairman) **Janice Lincoln (Director)** **Timothy J Bowen (Chief Executive)**

The notes on page 20 to 31 form part of these accounts.

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2018

	2018 £	2017 £
Cash flows from operating activities		
Profit on ordinary activities before tax	207,118	160,883
Depreciation and amortisation	76,499	75,279
(Decrease)/ increase in impairment of loans and advances	(177,255)	54,299
Decrease in provisions for liabilities	(6,070)	(19,651)
	100,292	**270,810**
Changes in operating assets and liabilities		
Increase in prepayments, accrued income and other assets	(17,209)	(10,005)
Increase in accruals, deferred income and other liabilities	16,317	30,406
Decrease/(increase) in loans and advances to customers	585,127	(1,519,321)
(Decrease)/increase in shares	(664,567)	1,220,144
Increase in amounts owed to credit institutions and other customers	628,826	29,009
Increase in loans and advances to credit institutions	(3,039)	(3,816)
Taxation paid	(33,278)	(33,327)
Net cash inflow/(outflow) from operating activities	**512,177**	**(286,910)**
Cash flows from investing activities		
Purchase of debt securities	(25,942,507)	(25,981,629)
Disposal of debt securities	25,961,865	24,292,302
Purchase of tangible and intangible fixed assets	(67,407)	(60,825)
Investment in subsidiary undertakings	(2)	-
Net cash used in investing activities	**(48,051)**	**(1,750,152)**
Net increase/(decrease) in cash and cash equivalents	**564,418**	**(1,766,252)**
Cash and cash equivalents at the start of the year	**4,574,487**	**6,340,739**
Cash and cash equivalents at the end of the year (see note 11)	**5,138,905**	**4,574,487**

STATEMENT OF CHANGE IN MEMBERS' INTERESTS
FOR THE YEAR ENDED 31 DECEMBER 2018

General reserves

	2018 £	2017 £
Balance as at 1 January	10,963,930	10,827,974
Total comprehensive income for the year	161,183	135,956
Balance as at 31 December	11,125,113	10,963,930

The notes on page 20 to 31 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.

The Society holds a £2 investment in a dormant subsidiary undertaking. The Society applies the exemption from the requirement to consolidate subsidiaries that are not material for the purpose of giving a true and fair view of the Society and its subsidiary as a whole, as set out in the accounts regulations.

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

The annual accounts have been prepared under the historical cost convention.

The annual accounts have been prepared on a going concern basis. This is discussed in the Directors' Report on page 6, under the heading 'Going Concern'.

1.2. 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 1.5 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.

1.3. 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.

1.4. Financial assets

The Society 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 Society becomes a party to the contractual provision of the instrument.

a) Loan Commitments

The Society'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 Society 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 1.2 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.

b) Debt instruments

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

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

The Society 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

1.5. Financial liabilities measured at amortised costs

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

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

1.6. 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 Society 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 Society 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 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, amounts recoverable under mortgage indemnity policies 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 Society 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.

1.7. 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.

NOTES TO THE ACCOUNTS, continued

1. Principal accounting policies, continued

1.8. 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.

1.9. Intangible assets – computer software

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

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

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is 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 that its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

1.10. 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. 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.

1.11. 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.

1.12. Employee benefits

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

NOTES TO THE ACCOUNTS, continued

1. Principal accounting policies, continued

1.13. Other provisions

The Society has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated and when the Society has an obligation in accordance with 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 Society's historic share of industry protected deposits.

1.14. 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.

1.15. Leases

Leases in which the Society 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 Society, 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.

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

2.1. Impairment losses on loans and advances to customers

The Society reviews its mortgage book at least on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Society is required to exercise a degree of judgement. 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 £37,333 (2017: £21,016).

2.2. Expected mortgage life

In determining the expected life of mortgage assets, the Society 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.

NOTES TO THE ACCOUNTS, continued

3. Country by country reporting

The Society is UK registered, with the head office and branch in one location in Penrith, Cumbria.

The chief operating decision maker has been identified as the Board. The Board reviews the Society's internal reporting in order to assess performance and allocate resources.

The table below sets out the country by country disclosures required by the Capital Requirements Directive IV:

Type of entity:	Credit institution
Nature of activity:	Financial services
Location:	United Kingdom

	2018	2017
Turnover	£1,883,143	£1,806,045
No. of employees	24	23
Profit before tax	£207,118	£160,883
Tax paid in year	£33,278	£33,327

4. Interest receivable and similar income

	2018 £	2017 £
On loans fully secured on residential property	2,718,762	2,538,127
On other loans	41,915	45,981
On debt securities	44,947	39,518
On treasury bills	48,684	13,728
On liquid assets	38,465	30,000
	2,892,773	2,667,354

Interest on debt securities includes £44,947 (2017: £39,518) arising from fixed income investment securities.

5. Interest payable and similar charges

	2018 £	2017 £
On shares held by individuals	1,004,464	868,078
On other shares	1,196	1,571
On deposits and other borrowings	15,042	12,477
	1,020,702	882,126

6. Employees

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

	2018 No.	2017 No.
Full time	18	17
Part time	6	6
Total	24	23

7. Administrative expenses

	2018 £	2017 £
Staff costs		
Wages and salaries	588,473	485,730
Social security costs	101,899	82,300
Other pension costs	56,248	153,949
	746,620	721,979
Other admin expenses	866,938	777,436
	1,613,558	1,499,415
Other admin expenses includes:		
Audit of these annual accounts (excluding VAT)	46,125	45,000

8. Directors' emoluments

	2018 £	2017 £
Fees for services as Non-Executive Directors:		
Robert J Cairns	18,822	18,270
Alan Waterfield	15,162	14,938
Will Lindsay	15,162	14,938
Janice Lincoln	15,670	15,438
Richard Drinkwater (Appointed 1/7/2017)	13,071	6,439
Richard Vecqueray (Appointed 1/4/2017)	13,071	9,658
Total for Non-Executive Directors	90,958	79,681
For services as Executive Directors:		
Timothy Bowen (Appointed 27/4/2017)		
Salary	100,000	53,333
Pension contributions	10,000	5,333
	110,000	58,666
Amyn S Fazal* (Retired 31/12/2017)		
Salary	-	111,432
Pension contributions	-	11,143
	-	122,575
Elspeth L James**		
Salary	64,427	56,773
Pension contributions	6,271	5,979
	70,698	62,752
Total for Executive Directors	180,698	243,993
Total for Directors Emoluments	271,656	323,674

*Amyn Fazal sacrificed salary of £96,953 in lieu of additional pension contributions throughout 2017.

**Elspeth James was on maternity leave for part of 2017 and returned to work on a four-day week contract.

NOTES TO THE ACCOUNTS, continued

9. Directors' loans and related party transactions

The aggregate amount of loans outstanding at 31 December 2018 to two (2017: three) Directors and connected persons was £235,032 (2017: £562,971). 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, a management company associated with the properties in possession to the Society. At 31 December 2018 the company had share capital and net assets of £2 and has been dormant since its incorporation on 5 August 2009.

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 17. Tim Bowen is a director of this company but receives no fees or other income for this role personally. In 2018 a dividend and fees of £5,453 (2017: £8,579) were paid to the Society and amounts paid for IT services were £177,058 (2017: £229,531).

10. Taxation

	2018 £	2017 £
Current tax		
Current tax on income for the period	49,157	29,456
Adjustments in respect of previous periods	3,822	-
Total current tax	52,979	29,456
Deferred tax (see note 26)		
Origination and reversal of timing differences	(9,532)	(4,529)
Adjustment in respect of previous periods	1,485	-
Impact of change of rate on deferred tax balances	1,003	-
Total deferred tax	(7,044)	(4,529)
Total tax expense	45,935	24,927

10. Taxation, continued

Reconciliation of effective tax rate:		
Profit for the year	207,118	160,883
Total effective tax at 19.00% (2017: 19.25%)	39,352	30,964
Effects of:		
Non-deductible expenses	273	268
Change of rate on deferred tax balances	1,003	-
Adjustments from previous periods	5,307	-
Movement in deferred tax	-	(6,305)
Total tax expense included in income statement	45,935	24,927

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.

11. Cash and cash equivalents

	2018 £	2017 £
Cash in hand	56,610	55,718
Loans and advances to credit institutions (see note 12)	5,082,295	4,518,769
	5,138,905	4,574,487

12. Loans and advances to credit institutions

	2018 £	2017 £
Accrued interest	11,724	8,685
Repayable on demand	5,082,295	4,518,769
Other loans and advances by residual maturity payable:		
In not more than 3 months	3,000,000	2,500,000
In not more than 1 year	2,000,000	2,500,000
	10,094,019	9,527,454

Penrith building society
Listening and Supporting, Since 1877

NOTES TO THE ACCOUNTS, continued

13. Debt securities

	2018	2017
	£	£
Treasury bills	9,978,964	9,989,114
Certificates of deposit	6,029,731	6,019,688
	16,008,695	16,008,802
Debt securities have remaining maturities as follows:		
Accrued interest	41,631	22,380
In not more than one year	15,967,064	15,986,422
	16,008,695	16,008,802
Transferrable debt securities (excluding accrued interest) comprise:		
Unlisted	6,001,340	6,002,901

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

	2018	2017
	£	£
At 1 January	15,986,422	14,297,095
Disposals and maturities	(25,961,865)	(24,292,302)
Acquisitions	25,942,507	25,981,629
At 31 December	15,967,064	15,986,422

14. Loans and advances to customers

	2018	2017
	£	£
Loans fully secured on residential property	79,460,969	79,773,352
Loans fully secured on land	862,371	957,860
	80,323,340	80,731,212

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

	2018	2017
	£	£
In not more than three months	754,689	826,625
In more than three months but not more than one year	2,536,687	2,750,161
In more than one year but not more than five years	16,254,389	16,554,498
In more than five years	60,950,560	60,950,168
	80,496,325	81,081,452
Impairment (see note 15)	(172,985)	(350,240)
	80,323,340	80,731,212

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

15. Allowance for impairment

	Loans fully secured on land	Loans fully secured on residential property	Total
At 1 January	£	£	£
Individual provision	130,564	147,843	278,407
Collective provision	5,000	66,833	71,833
	135,564	214,676	350,240
Utilisation of provision			
Individual provision	(138,557)	(26,882)	(165,439)
Collective provision	-	-	-
	(138,557)	(26,882)	(165,439)
Income statement			
Individual provision	7,993	(44,849)	(36,856)
Collective provision	6,921	18,119	25,040
	14,914	(26,730)	(11,816)
At 31 December			
Individual provision	-	76,112	76,112
Collective provision	11,921	84,952	96,873
	11,921	161,064	172,985

The Society has one mortgage case where forbearance has been exercised (2017: three), including one (2017: one) where an individual provision has been created.

16. Investment in subsidiary

The Society set up a 100% owned subsidiary, Cumbria Mortgage Centre Limited on 1 November 2018.

The subsidiary was dormant to 31 December 2018. The ordinary share capital is £2. The Society has elected not to consolidate the financial results on the basis of materiality.

17. 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 2018	6,914	166,101	173,015
Repaid in year	-	(28,082)	(28,082)
At 31 December 2018	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.

NOTES TO THE ACCOUNTS, continued

18. Tangible fixed asset

	Freehold land and buildings	Office and IT, fixtures and fittings	Total
Cost	**£**	**£**	**£**
At beginning of year	40,000	588,443	628,443
Additions	-	11,743	11,743
At end of year	40,000	600,186	640,186
Depreciation			
At beginning of year	16,000	478,442	494,442
Charge for the year	400	24,109	24,509
At end of year	16,400	502,551	518,951
Net book value			
31 December 2018	23,600	97,635	121,235
31 December 2017	24,000	110,001	134,001

The net book value of the freehold premises occupied by the Society for its own activities is £23,600 (2017: £24,000).

19. Intangible fixed assets

	IT software and development costs
Cost	**£**
At beginning of year	370,063
Additions	55,665
At end of year	425,728
Depreciation	
At beginning of year	265,797
Charge for the year	51,990
At end of year	317,787
Net book value	
31 December 2018	107,941
31 December 2017	104,266

20. Other debtors

	2018	2017
	£	£
Prepayments and accrued income	317,610	271,571

21. Investment properties

	Total
Cost	**£**
Balance at 1 January 2018	445,000
Net gains from fair value adjustments	(20,000)
Balance at 31 December 2018	425,000

The investment properties have been fair valued at 31 December 2018. 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.

Any loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for on an accruals basis, as set out in the accounting policies in note 1.

22. Shares

	2018	2017
	£	£
Held by individuals	93,725,019	94,317,151
Other shares	161,031	233,466
	93,886,050	94,550,617

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

	2018	2017
	£	£
Accrued interest	305,279	202,386
Repayable on demand	91,787,461	92,489,806
In not more than 3 months	1,793,310	1,858,425
	93,886,050	94,550,617

23. Amounts owed to credit institutions

	2018	2017
	£	£
Accrued interest	247	-
Repayable with agreed maturity dates of periods of notice:		
In not more than 3 months	500,000	-
	500,247	-

24. 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:

	2018	2017
	£	£
Repayable on demand	1,877,698	1,749,119
	1,877,698	1,749,119

NOTES TO THE ACCOUNTS, continued

25. Other liabilities

	2018 £	2017 £
Other liabilities due within one year comprise:		
Corporation tax	49,157	29,852
Other shares	-	1,041
	49,157	30,893

26. Deferred taxation

	2018 £	2017 £
At beginning of year	46,354	50,883
Credit to statement of income for year	(7,044)	(4,529)
At end of year	39,310	46,354

The elements of deferred taxation are as follows:		
Differences between accumulated depreciation and amortisation and capital allowances	32,185	39,788
Other timing differences	7,125	6,566
	39,310	46,354

The net reversal of deferred tax assets and liabilities expected to occur in the next reporting period is an increased charge of £756 (2017: £2,620), being the ongoing unwinding of the tax charges associated with the transition to FRS 102.

27. Provisions for liabilities

FSCS Levy

	2018 £	2017 £
At beginning of year	7,821	27,472
Levy paid in year	(3,854)	(16,945)
Charge for the year	(2,216)	(2,706)
At end of year	1,751	7,821

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.

During the first half of 2018, the FSCS repaid the final amounts due to HM Treasury following the failures of Bradford & Bingley and Dunfermline Building Society. The invoice paid by the Society in July 2018 for £3,854 (2017: £16,945) was the last invoice that included interest or capital costs for these failures.

At the end of 2018 the Society has been advised of a payment to cover the failure of Dial-A-Cab, which has resulted in a provision of £1,751 at the year end.

28. Contingent liabilities and commitments

There were no contracted capital commitments at the financial year end. At 31 December 2018 the Society has future minimum lease payments under non-cancellable operating leases as follows:

	2018 £	2017 £
Office equipment leases which expire:		
Within 1 year	25,120	20,846
Within 2-5 years inclusive	34,888	40,875
Over 5 years	-	-

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 2018

Financial assets	Loan Commitments £	Debt Instruments £	Total £
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			11,335,390
Total liabilities			107,599,385

31 December 2017

Financial assets	Loan Commitments £	Debt Instruments £	Total £
Cash in hand	-	55,718	55,718
Loans and advances to credit institutions	-	9,527,454	9,527,454
Debt securities	-	16,008,802	16,008,802
Loans and advances to customers	80,731,212	-	80,731,212
Total financial assets	-	25,591,974	106,323,186
Non-financial assets			1,127,853
Total assets			107,451,039
Financial liabilities			
Shares	-	94,550,617	94,550,617
Amounts owed to other customers	-	1,749,119	1,749,119
Total financial liabilities	-	96,299,736	96,299,736
Non-financial liabilities			11,151,303
Total liabilities			107,451,039

Credit risk

Credit risk, as noted in the Directors' Report on page 6, 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:

	2018 £	2017 £
Cash in hand	56,610	55,718
Loans and advances to credit institutions	10,094,019	9,527,454
Debt securities	16,008,695	16,008,802
Loans and advances to customers	80,323,340	80,731,212
Total statement of financial position exposure	106,482,664	106,323,186
Off balance sheet exposure – mortgage commitments	5,130,963	2,497,259
	111,613,627	108,820,445

Credit quality analysis of counterparties

The following table provides details on the exposure the Society has to counterparties. Included in the table is an analysis of the financial institutions by their Fitch rating, where appropriate:

	2018 £	2017 £
UK Government securities	9,978,964	9,989,114
Financial institutions		
AAA to AA-	500,466	-
A+ to A-	10,101,234	5,016,455
BB- to BBB-	1,506,859	5,520,869
Unrated	4,015,191	5,009,818
Total exposure to counterparties	26,102,714	25,536,256

At 31 December 2018 all exposures to financial institutions were within the UK (2017: all exposures were within the UK).

29. Financial instruments, continued

Credit risk, continued

Credit quality analysis of loans and advances to customers

The Society's borrowers are primarily in Cumbria, being 68.55% (2017: 56.95%) of the mortgage book totals. Borrowers in Scotland represent 0.70% (2017: 0.72%) of the mortgage book and the remaining 30.75% (2016: 42.33%) is spread across the rest of England and Wales.

The table below sets out information about the credit quality of financial assets and the allowance for impairment/loss held by the Society against those assets:

In respect of loans and advances to customers:	**2018 £**	**%**
Fully secured on residential property:		
Current	77,712,587	96.54
Past due up to 3 months	1,346,095	1.67
Past due 3 to 6 months	96,854	0.12
Past due 6 to 12 months	275,742	0.34
Possessions	190,755	0.24
Total fully secured on residential property:	79,622,033	98.91
Fully secured on land:		
Current	874,292	1.09
Total fully secured on land:	874,292	1.09
Gross loans and advances to customers	80,496,325	100.00
Provision for impairment losses	(172,985)	
Total loans and advances to customers	80,323,340	

In respect of loans and advances to customers:	**2017 £**	**%**
Fully secured on residential property:		
Current	78,522,474	96.84
Past due up to 3 months	759,491	0.94
Past due 3 to 6 months	440,266	0.54
Past due 6 to 12 months	42,554	0.05
Past due over 12 months	32,488	0.04
Possessions	190,755	0.24
Total fully secured on residential property:	79,988,028	98.65
Fully secured on land:		
Current	905,940	1.12
Possessions	187,484	0.23
Total fully secured on land:	1,093,424	1.35
Gross loans and advances to customers	81,081,452	100.00
Provision for impairment losses	(350,240)	
Total loans and advances to customers	80,731,212	

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 £168,000 (2016: £100,000).

Liquidity risk

Liquidity risk, as noted in the Directors' Report on page 6, 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 on the next page 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.

NOTES TO THE ACCOUNTS, continued

29. Financial instruments, continued

Liquidity risk, continued

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

31 December 2017	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	88,277,114	-	2,804,637	3,468,866	-	94,550,617
Amounts owed to other customers	1,749,119	-	-	-	-	1,749,119
Total financial liabilities	90,026,233	-	2,804,637	3,468,866	-	96,299,736

ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2018

1. Statutory percentages

	2018	Statutory Limit
Lending Limit	2.16%	25.00%
Funding Limit	2.47%	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 Society plus provisions for bad and doubtful debts and the aggregate of liquid assets and tangible and intangible fixed assets as shown in the Society's accounts.

Y = the principal of, and interest accrued on, loans owed to the Society 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 Society; and
the principal of, and interest accrued on, sums deposited with the Society.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

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

2. Other percentages

	2018 %	2017 %
As percentage of shares and borrowings:		
Gross capital		
Free capital	11.56	11.39
Liquid assets	11.42	11.21
	27.17	26.58
Profit for the financial year after taxation as a percentage of mean total assets	0.15	0.13
Management expenses as a percentage of mean total assets	1.57	1.48

The above percentages have been prepared from the Society'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 2017 and 31 December 2018.

ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2018, continued

3. 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 JDWL Consulting Ltd
Will Lindsay (06/10/1953)	01/06/2015	Retired Banker	Lindsay Consultants Ltd
Richard Vecqueray (18/09/1971)	27/04/2017	Veterinary Director	Evidence Group Ltd Sunstone Technology Ltd Barbican Animal Health Ltd
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 Community Sustainability Services
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 KPMG LLP at the following address:
1 Sovereign Street, Sovereign Square, Leeds, LS1 4DA.

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.